LOVEFiLM.COM

LOVEFILM INTERNATIONAL LIMITED

Annual report
for the year ended 31 December 2008

Registered Company Number: 04392195

Lovefilm International Limited

Annual report
for the year ended 31 December 2008

Directors and advisers

Directors

Nicholas Buckle
Simon Calver
Simon Cook
Greg Greeley
Charles Gurassa
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 2008

The directors present their annual report and the audited financial statements of the Group and Company for the year ended 31 December 2008.

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

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

On 1 November 2008, the Group undertook a reorganisation which has resulted in all UK operations now being held in one company, Lovefilm UK Limited (LF UK). The reorganisation had three steps. First, LF UK acquired the UK business and assets of the Company in return for the issue by LF UK of 8,501 ordinary shares to the Company. Secondly, the Company transferred the entire issued share capital of LF UK to Video Island Entertainment Limited (VIEL) in return for the issue by VIEL of 9,303 ordinary shares to the Company. Thirdly, VIEL transferred its UK business and assets to LF UK in return for the issue by LF UK of 3,743 ordinary shares to VIEL.

The management of the business and the execution of the Group's strategy are subject to a number of risks. The main operational risks, and mitigating factors, are set out in the Business Review and the main financial risks are disclosed in note 27.

Results and dividends
The Group's loss for the year was £1.2 million (2007: £8.8 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 2008
(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

Simon Calver
Chief Executive Officer
10 June 2009

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 group and parent company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. The financial statements are required by law to give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group 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 that the financial statements comply with IFRSs as adopted by the European Union; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business, in which case there should be supporting assumptions or qualifications as necessary

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 Group and the Company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Group and 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 2008

LOVEFiLM International Limited is an online, home entertainment business, focused on DVD rental, DVD retail, movie downloads and movie information. The Group operates under the LOVEFiLM brand in the United Kingdom, Germany, Sweden, Denmark and Norway and serves over 1 million customers.

Revenue for the year was £73.1 million (2007: £49.3 million). The operating profit before amortisation of intangibles, exceptional items and share based payments was £2.8 million (2007: £3.7 million loss) and the statutory operating loss was £4.2 million (2007: £7.4 million). The Group had a pre-tax loss for the year of £7.4 million (2007: £9.4 million).

The Group does not hedge its foreign exchange exposure. Therefore the financial performance of the Group reflects foreign exchange gains and losses arising on the translation of the financial performance of overseas subsidiaries into sterling.

The year ended 31 December 2008 was one of significant transformation for the Group. On 25 April 2008 the Group acquired the online DVD rental businesses of Amazon EU Sarl for a consideration of £62.6 million, significantly increasing its customer base in Germany and further strengthening its leading position in the UK. Allied to the acquisition, the Group continued to invest in marketing activities, brand awareness, customer service and operating efficiencies in order to maintain customer growth across all the countries in which it operates. These investments enabled the Group to move into profit at the operating level before amortisation of intangibles, exceptional items and share based payments.

Cash inflow from operating activities was £13.4 million (2007: £5.3 million).

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 (£3.91 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-based DVD rental, and retail, as principlal 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 3% 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. Our strategy is to position LOVEFiLM as a leading provider of movie content and information in whatever format consumers demand. 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 Group has prepared a detailed risk assessment which is reviewed *no less than once a year* by the Audit Committee and *no less than once a year* by the directors.

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 geographic 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), broadcast multi-channel TV and nascent digital offerings.

Technological and market changes

Whist 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 digital delivery as it currently holds in DVD. To date, however, LOVEFiLM has not experienced any slowdown in demand for the DVD format.

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 28.

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 2008 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 2008 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 2008 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

11 June 2009

Consolidated income statement for the year ended 31 December 2008

	Note	2008 £'000	2007 £'000
Revenue	1,5	73,073	49,252
Cost of sales		(33,910)	(21,103)
Gross profit		39,163	28,149
Operating expenses		(43,326)	(35,583)
Operating loss	5,6	(4,163)	(7,434)
Operating profit/(loss) before amortisation of intangibles, exceptional items and share based payments		2,839	(3,706)
Amortisation of intangibles	13	(4,399)	(2,957)
Exceptional items	9	(1,559)	-
Share based payments	23	(1,044)	(771)
		(4,163)	(7,434)
Finance costs	10	(3,390)	(2,150)
Finance income	11	132	186
Loss before taxation		(7,421)	(9,398)
Taxation	12	6,189	596
Loss for the financial period attributable to equity shareholders	24	(1,232)	(8,802)

Consolidated statement of recognised income and expense for the year ended 31 December 2008

	Note	2008 £'000	2007 £'000
Loss for the financial period	24	(1,232)	(8,802)
Exchange differences	24	3,286	617
Total recognised gains/(losses) for the period		2,054	(8,185)

Balance sheets as at 31 December 2008

	Note	Group 2008 £'000	Group 2007 £'000	Company 2008 £'000	Company 2007 £'000
Assets					
Non-current assets					
Intangible assets	13	**91,707**	38,000	**-**	-
Property, plant and equipment	14	**21,399**	12,440	**-**	8,695
Investments in subsidiaries	15	**77**	77	**153,566**	43,338
Deferred tax assets	21	**5,244**	-	**-**	-
Trade and other receivables	17	**-**	-	**39,209**	-
		118,427	50,517	**192,775**	52,033
Current assets					
Stock	16	**338**	-	**-**	-
Trade and other receivables	17	**4,378**	3,725	**1,793**	6,647
Cash at bank and in hand	26	**2,900**	3,060	**132**	1,507
		7,616	6,785	**1,925**	8,154
Liabilities					
Current liabilities					
Trade and other payables	18	**(19,255)**	(13,962)	**(3,676)**	(8,014)
Borrowings and overdrafts	19	**-**	(5,817)	**-**	(4,371)
Provisions	20	**(57)**	(147)	**-**	(147)
		(19,312)	(19,926)	**(3,676)**	(12,532)
Net current (liabilities)/assets		**(11,696)**	(13,141)	**(1,751)**	(4,378)
Non-current liabilities					
Borrowings	19	**(10,542)**	(6,962)	**(10,542)**	(6,898)
Trade and other payables	18	**(42)**	(144)	**(42)**	(144)
Provisions	20	**(333)**	(333)	**-**	(333)
Deferred tax liabilities	21	**(1,367)**	(60)	**-**	-
		(12,284)	(7,499)	**(10,584)**	(7,375)
Net assets		**94,447**	29,877	**180,440**	40,280
Equity					
Share capital	22	**5**	4	**5**	4
Share premium	24	**76,694**	17,617	**76,694**	17,617
Merger reserve	24	**35,684**	35,684	**35,684**	35,684
Other reserves	24	**3,638**	1,244	**4,031**	1,423
Translation reserve	24	**3,947**	661	**-**	-
Retained earnings	24	**(25,521)**	(25,333)	**64,026**	(14,448)
Total equity	24	**94,447**	29,877	**180,440**	40,280

The financial statements were approved by the board of directors and authorised for issue on 10 June 2009 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 2008

	Note	Group 2008 £'000	Group 2007 £'000	Company 2008 £'000	Company 2007 £'000
Cash flows from operating activities					
Cash generated from operations	25	16,634	6,880	8,687	4,891
Finance income		132	186	75	61
Finance costs		(3,390)	(1,791)	(3,332)	(1,416)
Net cash from operating activities		13,376	5,275	5,430	3,536
Cash flows from investing activities					
Acquisition expenses		(1,341)	-	(1,341)	-
Acquired cash at bank and in hand		6,500	-	6,500	-
Purchase of property, plant and equipment		(16,214)	(12,452)	(9,174)	(10,307)
Purchase of intangible assets		(250)	-	-	-
Net cash used in investing activities		(11,305)	(12,452)	(4,015)	(10,307)
Cash flows from financing activities					
Proceeds from issue of ordinary share capital		155	280	155	280
Loans from/(to) group undertakings		-	-	(2,218)	(1,938)
Proceeds from borrowings		10,542	9,000	10,542	9,000
Repayment of obligation under borrowings		(7,757)	(873)	(7,757)	(873)
Proceeds from new finance leases		1,825	2,212	1,825	2,212
Repayment of obligation under finance leases		(5,594)	(2,942)	(5,337)	(1,008)
Net cash from financing activities		(829)	7,677	(2,790)	7,673
Net increase in cash and cash equivalents		1,242	500	(1,375)	902
Cash and cash equivalents at beginning of period	26	1,806	1,357	1,507	605
Effect of foreign exchange rate changes		(148)	(51)	-	-
Cash and cash equivalents at end of period	26	2,900	1,806	132	1,507

Notes to the financial statements for the year ended 31 December 2008

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, DVD retail, movie downloads and movie information to the general public.

2. Adoption of new and revised standards

In the current year, two Interpretations issued by the International Financial Reporting Interpretations Committee are effective for the current period. These are: IFRIC 11 *IFRS 2 – Group and Treasury share Transactions* and IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction.* The adoption of these Interpretations has not led to any changes in the Group's accounting policies

In addition, at the date of authorisation of the financial statements, the following Standards and Interpretations which have not been applied in these financial statements were in issue but not yet effective:

IFRS 1 (amended)/IAS 27 (amended)	*Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*
IFRS 2 (amended)	*Share-based Payment – Vesting Conditions and Cancellations*
IFRS 3 (revised 2008)	*Business Combinations*
IAS 1 (revised 2007)	*Presentation of Financial Statements*
IFRS 8	*Operating Segments*
IAS 23 (revised 2007)	*Borrowing Costs*
IAS 27 (revised 2008)	*Consolidated and Separate Financial Statements*
IAS 32 (amended)/IAS 1 (amended)	*Puttable Financial Instruments and Obligations Arising on Liquidation*
IFRIC 12	*Service Concession Arrangements*
IFRIC 15	*Agreements for the Construction of Real Estate*
IFRIC 16	*Hedges of a Net Investment in a Foreign Operation*

The directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the Group.

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. 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. 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 2008. 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.

Notes to the financial statements for the year ended 31 December 2008

Significant accounting policies (continued)

(c) 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.

(d) 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.

(e) 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.

(f) 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 2008

Significant accounting policies (continued)

(g) Stock

Stock is stated at the lower of cost and net realisable value. Cost comprises the purchase price of DVDs and those overheads that have been incurred in bringing the stock to their present location and condition. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in selling. The estimated selling price is based on an average of recent historic disposals.

(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 and deducted from the value of the borrowings initially. The discount is 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.

(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.

Notes to the financial statements for the year ended 31 December 2008

Significant accounting policies (continued)

(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.

(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.

- 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, except for warrants, which are discussed in (i) Borrowing 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.

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 month to ascertain an average age and, therefore, an average cost of disposed, lost and damaged discs. Historic net book value calculations are revised once updated data has been analysed.

Determining the fair value of DVDs acquired as part of the acquisition of Amazon EU Sarl's online DVD rental businesses required the Group to estimate the net book value of the discs acquired. The Group applied it own average age to the DVDs bought from the UK business and applied Amazon's estimation of average age for DVDs acquired from the German business.

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, the value of a multi- year marketing agreement with Amazon 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 £83.9 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 23.

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.

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 2008 for continuing operations

	United Kingdom £'000	Continental Europe £'000	Total £'000
Revenue	**60,056**	**13,017**	**73,073**
Operating profit/(loss) before amortisation of intangibles, exceptional items and share based payments	6,187	(3,348)	2,839
Amortisation of intangibles	(3,513)	(886)	(4,399)
Exceptional items	(1,040)	(519)	(1,559)
Share based payments	(1,044)	-	(1,044)
Operating loss	**590**	**(4,753)**	**(4,163)**
Net finance costs	(3,116)	(142)	(3,258)
Loss before taxation	(2,526)	(4,895)	(7,421)
Taxation	6,108	81	6,189
Profit/(loss) for the financial period attributable to equity shareholders	**3,582**	**(4,814)**	**(1,232)**
Goodwill	72,526	11,364	83,890
Other non-current assets	26,877	7,660	34,537
Current assets	5,969	1,647	7,616
Current liabilities	(15,406)	(3,906)	(19,312)
Non-current liabilities	(12,284)	-	(12,284)
Net assets	**77,682**	**16,765**	**94,447**
Other segment items:			
Capital expenditure:			
- Property, plant and equipment	13,454	2,760	16,214
- Intangible assets	256	71	327
Depreciation	(5,049)	(1,911)	(6,960)
Amortisation	(3,513)	(886)	(4,399)

Notes to the financial statements for the year ended 31 December 2008

5. Segmental information (continued)

Period ended 31 December 2007 for continuing operations

	United Kingdom £'000	Continental Europe £'000	Total £'000
Revenue	**41,465**	**7,787**	**49,252**
Operating loss before amortisation of intangibles, exceptional items and share based payments	(740)	(2,966)	(3,706)
Amortisation of intangibles	(2,687)	(270)	(2,957)
Share based payments	(771)	-	(771)
Operating loss	**(4,198)**	**(3,236)**	**(7,434)**
Net finance costs	(1,832)	(132)	(1,964)
Loss before taxation	(6,030)	(3,368)	(9,398)
Taxation	547	49	596
Loss for the financial period attributable to equity shareholders	**(5,483)**	**(3,319)**	**(8,802)**
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)
Net assets	**18,708**	**11,169**	**29,877**
Other segment items:			
Capital expenditure:			
- Property, plant and equipment	10,307	2,145	12,452
Depreciation	(4,299)	(1,262)	(5,561)
Amortisation	(2,687)	(270)	(2,957)

Notes to the financial statements for the year ended 31 December 2008

6. Operating loss

Operating loss is stated after charging:	2008	2007
	£'000	£'000
Depreciation of property, plant and equipment	6,690	5,561
Loss on disposal of property, plant and equipment	4,269	3,537
Amortisation of intangible assets	4,399	2,957
Operating leases - land and buildings	396	263

The analysis of auditors' remuneration is as follows:

The audit of the Company and consolidated financial statements	106	89
The audit of the Company's subsidiaries pursuant to legislation	34	24
Tax fees	304	26
Other services	3	17
	447	156

7. Directors and key management remuneration

	2008	2007
Directors	£'000	£'000
Aggregate emoluments	632	754
	632	754

No directors (2007: nil) exercised share options during the year.

The aggregate remuneration of the highest paid director was £276,000 (2007: £290,000).

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

	2008	2007
	£'000	£'000
Key management remuneration		
Aggregate emoluments	1,296	1,274
Termination benefits	106	-
	1,402	1,274

Notes to the financial statements for the year ended 31 December 2008

8. Employees

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

	Group	Group	**Company**	Company
	2008	2007	**2008**	2007
Warehouse	**193**	123	**135**	119
Professional	**111**	72	**62**	47
Customer service	**29**	38	**14**	21
Executive	**13**	14	**9**	12
	346	247	**221**	199

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

	Group	Group	**Company**	Company
	2008	2007	**2008**	2007
	£'000	£'000	**£'000**	£'000
Wages and salaries	**7,025**	6,476	**4,091**	5,127
Social security costs	**1,323**	1,108	**468**	515
Share based payments	**1,044**	771	**830**	771
Other pension costs	**181**	115	**30**	30
	9,573	8,470	**5,419**	6,443

9. Exceptional items

In April 2008 the Group acquired the online DVD rental businesses of Amazon EU Sarl. Certain incremental, one-off, operating costs were incurred in the integration of the businesses which would not have been incurred had the acquisition never occurred.

In May 2008 the Group undertook a restructuring of its Scandinavian operations. The restructuring involved redundancy terms for employees who could not be redeployed within the Group.

In December 2008 the Group replaced previous borrowings and obligations under finance leases with a term loan from Lloyds Banking Group. The re-financing incurred one-off advisory fees.

Exceptional items comprised the following:

	2008	2007
	£'000	£'000
Acquisition integration costs	**788**	-
Professional fees	**509**	-
Redundancy costs	**262**	-
	1,559	-

Notes to the financial statements for the year ended 31 December 2008

10. Finance costs

	2008	2007
	£'000	£'000
Interest payable on debt facilities and bank overdrafts	841	1,451
Foreign exchange loss on settlement of borrowings	777	-
Interest payable on obligation under finance leases	724	340
Financing charge on settlement of borrowings and finance leases	362	-
Amortisation of discount of borrowings and finance leases	298	-
Deemed interest on discounting of borrowings	388	359
	3,390	2,150

In December 2008 the Group replaced previous borrowings and obligations under finance leases with a term loan from Lloyds Banking Group. The re-financing incurred an exchange loss on settlement.

11. Finance income

	2008	2007
	£'000	£'000
Interest on cash and cash equivalents	132	186
	132	186

Notes to the financial statements for the year ended 31 December 2008

12. Taxation

(a) Tax on loss on ordinary activities:

	2008	2007
	£'000	£'000
Current tax		
UK corporation tax	-	-
Overseas tax	161	260
Total tax charge	161	260
Deferred tax		
Origination and reversal of timing differences	(182)	(856)
Adjustments in respect of prior periods	(6,168)	-
Total deferred tax credit	(6,350)	(856)
Tax on loss on ordinary activities	(6,189)	(596)

(b) Reconciliation of the total tax credit:

The tax charge in the income statement for the year is different to the standard rate of Corporation tax in the UK of 28.5% (2007: 30%). The differences are reconciled below:

	2008	2007
	£'000	£'000
Loss on ordinary activities before taxation	(7,421)	(9,398)
Loss on ordinary activities multiplied by the standard rate of tax for the year of 28.5% (2007: 30%)	(2,115)	(2,819)
Utilisation of tax losses	-	(538)
Depreciation in excess of capital allowances	-	1,117
Expenses not deductible for tax purposes	164	114
Share-based payments	298	231
Non-deductible amortisation	-	30
Overseas tax	161	207
Tax losses not recognised	1,471	1,062
Adjustment in respect of prior periods	(6,168)	-
Total tax credit	(6,189)	(596)

(c) The deferred tax included in the balance sheet is as follows:

Deferred tax asset	2008	2007
	£,000	£,000
Accelerated capital allowances	2,397	-
Losses	2,848	-
	5,244	-

Notes to the financial statements for the year ended 31 December 2008

12. Taxation (continued)

Deferred tax liability	2008	2007
	£,000	£,000
Intangibles	1,367	60
	1,367	60

(d) Factors that may affect future tax charges:

The Group has accumulated tax losses of approximately £7.5 million (2007: £13.6 million) which resulted in an unrecognised deferred tax asset of £2.1 million (2007: £3.8 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 £nil (2007: £2.9 million) arises as the NBV of fixed assets is different to the tax written down value. A potential deferred tax asset of £0.7 million has arisen as a result of share options issued in 2006, 2007 and 2008 (2007: £0.4 million). This has not been recognised.

13. Intangible assets

Group	Goodwill	Subscriber base	Brand	Technology platform	Total
	£'000	£'000	£'000	£'000	£'000
Cost					
At 1 January 2008	37,960	8,154	2,221	900	49,235
Additions	-	-	-	327	327
Arising on acquisition	43,679	8,050	3,230	-	54,959
Foreign exchange	2,251	317	421	49	3,038
At 31 December 2008	83,890	16,521	5,872	1,276	107,559
Accumulated amortisation					
At 1 January 2008	-	8,154	2,221	860	11,235
Amortisation for the period	-	3,235	1,018	145	4,399
Foreign exchange	-	59	119	40	218
At 31 December 2008	-	11,448	3,359	1,045	15,852
Net book value					
At 31 December 2008	**83,890**	**5,073**	**2,513**	**231**	**91,707**
At 31 December 2007	37,960	-	-	40	38,000

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.

Notes to the financial statements for the year ended 31 December 2008

13. Intangible assets (continued)

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 15%.

Group	Goodwill	Subscriber base	Brand	Technology platform	Total
	£'000	£'000	£'000	£'000	£'000
Cost					
At 1 January 2007	37,331	8,154	2,221	882	48,588
Foreign exchange	629	-	-	18	647
At 31 December 2007	37,960	8,154	2,221	900	49,235
Accumulated amortisation					
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
At 31 December 2007	-	8,154	2,221	860	11,235
Net book value					
At 31 December 2007	**37,960**	-	-	**40**	**38,000**
At 31 December 2006	37,331	2,691	5	292	40,319

14. Property, plant and equipment

Group	DVDs	Computer equipment	Fixtures and fittings	Motor vehicles	Leasehold improvements	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Cost						
At 1 January 2008	16,247	1,055	701	10	879	18,892
Additions	15,079	451	417	-	295	16,242
Arising on acquisition	3,166	-	-	-	-	3,166
Disposals	(6,721)	-	(93)	-	-	(6,814)
Exchange adjustments	1,518	21	75	-	14	1,628
At 31 December 2008	29,289	1,527	1,100	10	1,188	33,114
Depreciation						
At 1 January 2008	5,211	735	318	8	180	6,452
Charge for period	6,280	292	165	2	221	6,960
Disposals	(2,377)	-	(46)	-	-	(2,423)
Exchange adjustments	685	5	33	-	3	726
At 31 December 2008	9,799	1,032	470	10	404	11,715
Net book value						
At 31 December 2008	**19,490**	**495**	**630**	-	**784**	**21,399**
At 31 December 2007	11,036	320	383	2	699	12,440

The net book value of DVDs includes £nil (2007: £2.8 million) in relation to assets held under finance leases.

Notes to the financial statements for the year ended 31 December 2008

14. Property, plant and equipment (continued)

Company	DVDs	Computer equipment	Fixtures and fittings	Motor vehicles	Leasehold improvements	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Cost						
At 1 January 2008	10,999	928	273	10	875	13,085
Additions	8,508	310	157	-	199	9,174
Disposals	(3,312)	-	-	-	-	(3,312)
Disposal on reorganisation	(16,195)	(1,238)	(430)	-	(1,074)	(18,937)
At 31 December 2008	-	-	-	10	-	10
Depreciation						
At 1 January 2008	3,419	622	143	8	198	4,390
Charge for period	2,520	229	61	2	171	2,983
Disposals	(1,182)	-	-	-	-	(1,182)
Disposal on reorganisation	(4,757)	(851)	(204)	-	(369)	(6,181)
At 31 December 2008	-	-	-	10	-	10
Net book value						
At 31 December 2008	-	-	-	-	-	-
At 31 December 2007	7,580	306	130	2	677	8,695

The net book value of DVDs includes £nil (2007: £2.5 million) in relation to assets held under finance leases.

Group	DVDs	Computer equipment	Fixtures and fittings	Motor vehicles	Leasehold improvements	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Cost						
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
At 31 December 2007	16,247	1,055	701	10	879	18,892
Depreciation						
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
At 31 December 2007	5,211	735	318	8	180	6,452
Net book value						
At 31 December 2007	**11,036**	**320**	**383**	**2**	**699**	**12,440**
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.

14. Property, plant and equipment (continued)

Company	DVDs	Computer equipment	Fixtures and fittings	Motor vehicles	Leasehold improvements	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Cost						
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)
At 31 December 2007	10,999	928	273	10	875	13,085
Depreciation						
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)
At 31 December 2007	3,419	622	143	8	198	4,390
Net book value						
At 31 December 2007	**7,580**	**306**	**130**	**2**	**677**	**8,695**
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.

15. Investments

	Trade investments	Investments in subsidiaries	Total
	£'000	£'000	£'000
At 1 January 2008	77	43,261	43,338
Investments in subsidiary undertakings	-	110,228	110,228
At 31 December 2008	**77**	**153,489**	**153,566**

On 1 November 2008 the Company disposed of its online DVD rental business to its wholly-owned subsidiary Lovefilm UK Limited for a share consideration of £85.0 million. On the same day the Company converted £25.0 million of debt with Lovefilm UK Limited to equity.

15. Investments (continued)

The Company has the following principal subsidiary undertakings.

Name	Country of incorporation and operations	Principal activity	Proportion of ordinary shares held by the Group
Video Island Inc.	US	Holding Company	100%
Lovefilm UK Limited *	UK	On-line film rentals	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%

^ 25% of ordinary shares in Video Island Entertainment Limited are held by Video Island Inc.
* These companies are held by intermediate subsidiaries.

The shares included above in Trade Investments 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 3% in Home Entertainment Services SA. The shares are held on the balance sheet at cost.

The shares included above in Investments in subsidiaries represent an investment by the Company in subsidiary Group undertakings. The movement during the year represents the Company's investment in Lovefilm UK Limited, further details of which are disclosed in note 29.

16. Stock

	Group 2008 £'000	Group 2007 £'000	**Company 2008 £'000**	Company 2007 £'000
Finished goods – DVDs	**338**	-	-	-
	338	-	-	-

The cost of stock recognised as an expense and included in cost of sales amounted to £104,000 (2007: £nil)

Notes to the financial statements for the year ended 31 December 2008

17. Trade and other receivables

	Group 2008 £'000	Group 2007 £'000	Company 2008 £'000	Company 2007 £'000
Current				
Trade receivables	1,188	1,113	435	566
Provision for doubtful debts	(161)	(71)	-	(7)
	1,027	1,042	435	559
Amounts owed by Group undertakings	-	-	-	3,935
Taxes receivable	1,090	82	1,040	-
Other receivables	415	1,113	318	872
Prepayments and accrued income	1,846	1,488	-	1,281
	4,378	3,725	1,793	6,647

	Group 2008 £'000	Group 2007 £'000	Company 2008 £'000	Company 2007 £'000
Non current				
Amounts owed by Group undertakings	-	-	39,209	-
	-	-	39,209	-

Trade receivables
Trade receivables held by the Group at 31 December 2008 primarily comprise amounts due from advertising sales agencies, amounts due from third parties on purchases of tangible fixed assets, 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, 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, £0.3 million (2007: £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 2008 £'000	Group 2007 £'000	Company 2008 £'000	Company 2007 £'000
60 – 90 days	163	308	148	308
90 – 120 days	330	21	287	195
	493	329	435	503

17. Trade and other receivables (continued)

Movement in the provision for doubtful debts

	Group 2008 £'000	Group 2007 £'000	Company 2008 £'000	Company 2007 £'000
Opening	(71)	(154)	(7)	-
Amounts provided against as uncollectible	(112)	(9)	-	(7)
Amounts recovered during the year	22	92	7	-
Closing	(161)	(71)	-	(7)

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.

18. Trade and other payables

	Group 2008 £'000	Group 2007 £'000	Company 2008 £'000	Company 2007 £'000
Current				
Trade payables	8,822	7,467	1,394	4,800
Amounts owed to Group undertakings	-	-	1,895	-
Other taxation and social security	2,141	1,340	-	499
Other payables	399	9	-	-
Accruals	3,075	1,938	285	1,131
Loan from a director	102	102	102	102
Deferred income	4,716	3,106	-	1,482
	19,255	13,962	3,676	8,014

	Group 2008 £'000	Group 2007 £'000	Company 2008 £'000	Company 2007 £'000
Non current				
Loan from a director	42	144	42	144

Trade creditors and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases for the Group and Company 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.

Restricted 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 2008

19. Financial liabilities – borrowings

	Group 2008 £'000	Group 2007 £'000	Company 2008 £'000	Company 2007 £'000
Current				
Bank overdrafts	-	1,254	-	-
Borrowings	-	2,853	-	2,853
Obligations under finance leases	-	1,710	-	1,518
	-	5,817	-	4,371
Non current				
Borrowings				
- Between one to two years	3,000	2,845	3,000	2,845
- Between two to five years	7,542	2,058	7,542	2,058
Obligations under finance leases				
- Between one to two years	-	1,032	-	967
- Between two to five years	-	1,027	-	1,028
	10,542	6,962	10,542	6,898

Analysis of borrowings by currency

Group

	Sterling £'000	Euros £'000	Swedish Krona £'000	Total £'000
At 31 December 2008				
Bank overdrafts	-	-	-	-
Borrowings	10,542	-	-	10,542
Obligations under finance leases	-	-	-	-
	10,542	-	-	10,542
At 31 December 2007				
Bank overdrafts	-	-	1,254	1,254
Borrowings	7,756	-	-	7,756
Obligations under finance leases	1,773	1,996	-	3,769
	9,529	1,996	1,254	12,779

Company

	Sterling £'000	Euros £'000	Total £'000
At 31 December 2008			
Bank overdrafts	-	-	-
Borrowings	10,542	-	10,542
Obligations under finance leases	-	-	-
	-	-	10,542
At 31 December 2007			
Bank overdrafts	-	-	-
Borrowings	7,756	-	7,756
Obligations under finance leases	1,517	1,996	3,513
	9,273	1,996	11,269

19. Financial liabilities - borrowings (continued)

The Group successfully refinanced its borrowings during the year. The Group replaced its previous borrowings and obligations under finance leases with a term loan from Lloyds Banking Group of £10.5 million, which was advanced on 31 December 2008. Repayments are due in two instalments, the first of £3 million on 1 January 2010 and the balance of the loan on 1 January 2011. The loan carries an interest rate of 2.95 per cent above 3 months sterling LIBOR and is secured over the assets of certain members of the Group.

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

	Group 2008 %	Group 2007 %	**Company 2008 %**	Company 2007 %
Bank overdrafts	**7.1%**	7.6%	-	-
Borrowings	**13.8%**	13.8%	**13.8%**	13.8%
Obligations under finance leases	**12.9%**	12.9%	**12.9%**	12.8%

In 2006, the Company granted 14,155 warrants to Kreos Capital II Limited in respect of borrowings incurred during that year. The fair value of the warrants was calculated as £7.45, based on the Black-Scholes option-pricing model. The deemed interest that has been charged against income in respect of these warrants was £18,000 (2007: £41,000). This charge was included in finance costs.

In 2007, the Company issued 38,921 shares to Kreos Capital II Limited in respect of borrowings incurred during that year. The fair value of the shares was calculated as £21.33, based on the estimated market value of the shares at the date of grant. The deemed interest that has been charged against income in respect of these shares was £300,000 (2007: £318,000). This charge was included in finance costs.

In 2008, the Company issued 7,275 shares to Kreos Capital II Limited in respect of borrowings incurred during that year. The fair value of the shares was calculated as £21.33. The deemed interest that has been charged against income in respect of these shares was £70,000 (2007: £nil). This charge was included in finance costs.

Undrawn overdraft facility

At 31 December 2008, the Group had available £1.5 million of an undrawn overdraft facility, secured by a fixed charge over the Company's DVD stock and a floating charge over its assets. The overdraft carries an interest rate at 3.0 per cent above Lloyds Banking Group's base rate.

Notes to the financial statements for the year ended 31 December 2008

20. Provisions

(i) Provisions	Group 2008 £'000	Group 2007 £'000	Company 2008 £'000	Company 2007 £'000
Opening balance	480	536	480	506
Provided in the period	-	64	-	64
Transferred from disposals	-	-	(405)	-
Amount utilised in the period	(90)	(120)	(75)	(90)
Closing balance	390	480	-	480

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

Current	57	147	-	147
Non-current	333	333	-	333
	390	480	-	480

Provisions comprise future rents payable on onerous leases and provisions for terminal dilapidations.

21. Deferred tax

(i) Deferred tax assets	Group 2008 £'000	Group 2007 £'000	Company 2008 £'000	Company 2007 £'000
Opening balance	-	-	-	-
Recognised in the period	6,168	-	-	-
Amount credited in the period	(924)	-	-	-
Closing balance	5,244	-	-	-

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

Current	-	-	-	-
Non-current	5,244	-	-	-
	5,244	-	-	-

(ii) Deferred tax liabilities	Group 2008 £'000	Group 2007 £'000	Company 2008 £'000	Company 2007 £'000
Opening balance	60	856	-	-
Provided in the period from acquisitions	2,412	60	-	-
Amount credited in the period	(1,105)	(856)	-	-
Closing balance	1,367	60	-	-

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

Current	1,367	-	-	-
Non-current	-	60	-	-
	1,367	60	-	-

Notes to the financial statements for the year ended 31 December 2008

22. Called up share capital

Group and Company

	Number	£'000
Authorised		
At 1 January 2008	6,063,860	6
Authorised during the period	2,309,960	2
At 31 December 2008	**8,373,820**	**8**

	2008 Number	2007 Number
Represented by:		
Ordinary shares of £0.001	**8,309,960**	6,000,000
Redeemable ordinary shares of £0.001	**46,176**	46,176
Deferred shares of £0.001 each	**17,684**	17,684
	8,373,820	6,063,860

	Number	£'000
Allotted, called up and fully paid		
At 1 January 2008	3,552,990	4
Allotted during the period	1,858,174	1
At 31 December 2008	**5,411,164**	**5**

	2008 Number	2007 Number
Represented by:		
Ordinary shares of £0.001	**5,356,930**	3,492,501
Redeemable ordinary shares of £0.001	**36,550**	42,805
Deferred shares of £0.001 each	**17,684**	17,684
	5,411,164	3,552,990

	Number	Nominal value £'000	Consideration £'000
Allotted during the period			
Amazon EU Sarl	**1,850,899**	1	**58,821**
Kreos Capital II Limited	**7,275**	-	**155**
	1,858,174	**1**	**58,976**

The holders of ordinary shares are entitled to one vote per share at meetings of the Company. Included within ordinary shares are 13,482 shares (2007: 27,531) which have restricted voting rights. The holders of redeemable and deferred shares have no voting rights. On 19 June 2008 6,255 redeemable ordinary shares were transferred to certain existing ordinary shareholders and converted to ordinary shares on transfer.

The Company is permitted to grant up to 345,760 ordinary shares (or options to acquire ordinary shares) to directors, employees or consultants to secure or retain their services. As at 31 December 2008 the Company had issued 51,147 (2007: 51,147) restricted ordinary shares to directors and employees. As at 31 December 2008 35,794 (2007: 39,900) such ordinary shares remained available for granting options to acquire ordinary shares.

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 2008 32,404 (2007: 32,404) 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 2008

22. Called up share capital (continued)

On 25 April 2008 the Group acquired the online DVD rental businesses of Amazon EU Sarl. In connection with the acquisition the Company issued 1,850,899 ordinary shares to Amazon EU Sarl. In February 2008, the Company issued 7,275 shares to Kreos Capital II Limited in respect of borrowings incurred during that year.

23. 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 between 1 and 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 and options are only exercisable on an exit.

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 between 1 and 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 and options are only exercisable on an exit.

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 only exercisable on an exit.

For the year ending 31 December 2008

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 2008	19,061	£14.78	212,042	£22.21	23,610	£0.81
Granted during the period	31,598	£13.05	25,065	£27.61	-	-
Exercised during the period	-	-	-	-	-	-
Forfeited during the period	-	-	(38,595)	£21.37	(13,962)	£0.81
At 31 December 2008	**50,659**	**£13.70**	**198,512**	**£23.06**	**9,648**	**£0.81**
Weighted average remaining contractual life	9 years		7.75 years		6.25 years	

No options were exercisable at the end of the period.

23. Share based payments (continued)

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
At 31 December 2007	**19,061**	**£14.78**	**212,042**	**£22.21**	**23,610**	**£0.81**
Weighted average remaining contractual life	9.25 years		8.75 years		7.25 years	

No options were exercisable at the end of the period.

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.

	2008 Lovefilm Non-plan	**2008 Lovefilm Plan**	2007 Lovefilm Non-plan	2007 Lovefilm Plan
Expected life of options (years)	**-**	**2**	-	3
Exercise price range	**£31.78-£0.81**	**£31.78-£25.25**	£21.33-£0.81	£25.25-£21.33
Share price at grant date	**£31.78**	**£31.78**	£25.25	£25.25
Risk free rate	**2.0%**	**2.0%**	4.5%	4.5%
Expected share price volatility	**48%**	**43%**	47%	47%
Expected dividend yield	**0%**	**0%**	0%	0%
Estimate of % of options vesting	**100%**	**69%**	100%	34%
Weighted average fair value per option granted	**£18.73**	**£10.03**	£13.81	£6.90

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 £1.0 million (2007: £0.8 million). This charge was included in administration expenses.

Notes to the financial statements for the year ended 31 December 2008

24. 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
At 31 December 2006	3	15,905	35,684	1,244	44	(17,302)	35,578
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
At 31 December 2007	**4**	**17,617**	**35,684**	**1,244**	**661**	**(25,333)**	**29,877**
Shares issued in the period	1	58,975	-	-	-	-	58,976
Other issues	-	102	-	2,394	-	-	2,496
Loss for the financial period	-	-	-	-	-	(1,232)	(1,232)
Share based compensation	-	-	-	-	-	1,044	1,044
Exchange adjustments	-	-	-	-	3,286	-	3,286
At 31 December 2008	**5**	**76,694**	**35,684**	**3,638**	**3,947**	**(25,521)**	**94,447**

Company	Share capital £'000	Share premium £'000	Merger reserve £'000	Other reserve £'000	Retained earnings £'000	Total equity £'000
At 31 December 2006	3	15,905	35,684	1,423	(11,739)	41,276
Shares issued in the period	1	1,610	-	-	-	1,611
Other issues	-	102	-	-	-	102
Loss for the financial period	-	-	-	-	(3,480)	(3,480)
Share based compensation	-	-	-	-	771	771
At 31 December 2007	**4**	**17,617**	**35,684**	**1,423**	**(14,448)**	**40,280**
Shares issued in the period	1	58,975	-	-	-	58,976
Other issues	-	102	-	2,394	-	2,496
Profit for the financial period	-	-	-	-	77,644	77,644
Share based compensation	-	-	-	214	830	1,044
At 31 December 2008	**5**	**76,694**	**35,684**	**4,031**	**64,026**	**180,440**

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.

Notes to the financial statements for the year ended 31 December 2008

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

Other reserve
The other reserve has been used to record the fair value of warrants that have been issued (£3.3 million) and shares yet to be issued (£0.3 million). In the Company balance sheet a further £0.4 million relates to a charge relating to share based payments which is posted to retained earnings in the Group. £0.2 million of this charge occurred in the 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.

Retained earnings
£85.0 million of the retained earnings are non distributable as they arose from the profit on disposal of the Company's online DVD rental business to Lovefilm UK Limited.

Parent Company result for the year
As permitted by section 230 of the Companies Act 1985 no income statement has been presented for the Company. The profit for the Company for the year was £77.6 million (2007: £3.5 million loss). The income statement of the Company was approved by the board of directors on 10 June 2009.

25. Cash flow from operating activities

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

	Group 2008 £'000	Group 2007 £'000	**Company 2008 £'000**	Company 2007 £'000
(Loss)/profit before taxation	**(7,421)**	(9,398)	**77,644**	(3,377)
Adjusted for:				
Depreciation of property, plant and equipment	**6,960**	5,561	**2,430**	2,837
Loss on disposal of property, plant and equipment	**4,269**	3,536	**2,130**	1,995
Exceptional gain	**-**	-	**(80,079)**	-
Amortisation and impairment of intangibles	**4,399**	2,957	**-**	5
Finance income	**(132)**	(186)	**(75)**	(61)
Finance costs	**3,390**	2,150	**3,332**	1,775
Share based payments	**1,044**	771	**830**	771
Decrease/(increase) in trade/other receivables	**(653)**	(251)	**919**	(973)
Increase/(decrease) in trade/other payables	**4,868**	1,736	**3,328**	1,945
Increase/(decrease) in provisions	**(90)**	4	**(480)**	(26)
Net cash flow from operating activities	**16,634**	6,880	**8,687**	4,891

The exceptional gain of £80.1 million within the Company's cashflow from operating activities refers to the gain recorded on disposal of its online DVD rental business to Lovefilm UK Limited (£80.1 million).

Notes to the financial statements for the year ended 31 December 2008

26. Cash and cash equivalents

	Group 2008 £'000	Group 2007 £'000	Company 2008 £'000	Company 2007 £'000
Cash and cash equivalents	2,900	3,060	132	1,507
Bank overdrafts	-	(1,254)	-	-
	2,900	1,806	132	1,507

27. Leasing commitments

Future minimum lease payments under finance leases are as follows:

	Group 2008 £'000	Group 2007 £'000	Company 2008 £'000	Company 2007 £'000
Within one year	-	2,036	-	1,836
Between two and five years	-	2,577	-	2,495
Total minimum lease payments	-	4,613	-	4,331
Less future finance charges	-	(684)	-	(658)
Deemed interest on discounting of loan	-	(160)	-	(160)
Present value of minimum lease payments	-	3,769	-	3,513

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

	Group 2008 £'000	Group 2007 £'000	Company 2008 £'000	Company 2007 £'000
Within one year	434	388	320	388
Between two and five years	528	975	491	975
Total minimum lease payments	962	1,363	811	1,363

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

28. 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 19, cash and cash equivalents and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings as disclosed in notes 22 and 24.

Gearing ratio

The Group's Board reviews the capital structure on each occasion that additional debt or equity funding is 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 2008 £'000	Group 2007 £'000	**Company 2008 £'000**	Company 2007 £'000
Debt	**(10,542)**	(11,525)	**(10,542)**	(11,269)
Cash and cash equivalents	**2,900**	1,806	**132**	1,507
Net debt	**(7,642)**	(9,719)	**(10,410)**	(9,762)
Equity	**94,447**	29,877	**180,440**	40,383
Net debt to equity ratio	**8%**	33%	**6%**	24%

Debt is defined as long and short term borrowings, excluding overdrafts, as detailed in note 19. Equity includes all capital and reserves of the Group attributable to the equity holders of the parent.

There are no externally imposed capital requirements on the Group or Company.

Categories of financial instruments

	Group 2008 £'000	Group 2007 £'000	**Company 2008 £'000**	Company 2007 £'000
Financial assets				
Cash and equivalents	**2,900**	3,060	**132**	1,506
Receivables	**4,378**	3,725	**1,793**	6,750
Financial liabilities				
Payables	**19,255**	13,962	**3,676**	8,014
Borrowings	**10,542**	11,525	**10,542**	11,269
Bank overdrafts	**-**	1,254	**-**	-

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. 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 2008

28. 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:

	2008	2007
	£'000	£'000
Scandinavia	**7,127**	4,509
Germany	**2,132**	1,590
	9,259	6,028

Foreign currency risk management
The Group owns subsidiaries in Scandinavia and Germany whose results are translated into sterling at the year end. The Group paid interest on certain borrowings in foreign currencies, hence exposures to exchange rate fluctuations, although limited, arose during the year.

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

	Liabilities		**Assets**	
	2008	2007	**2008**	2007
	£'000	£'000	**£'000**	£'000
Swedish Krona	**1,610**	2,846	**473**	559
Norwegian Krona	**246**	268	**153**	321
Danish Krona	**380**	213	**192**	109
Euro	**1,670**	2,145	**830**	106

The Company paid interest on certain borrowings in foreign currencies, hence exposures to exchange rate fluctuations, although limited, did arise during the year. Following the advancement of a new term loan on 31 December 2008 all future interest payments are in sterling.

The carrying amounts of the Company's foreign currency denominated borrowings at the reporting date were as follows:

	Liabilities	
	2008	2007
	£'000	£'000
Euro	**-**	1,996

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**	
	2008	2007	**2008**	2007
	£'000	£'000	**£'000**	£'000
Profit or loss	**-**	-	**-**	47
Other equity	**48**	208	**82**	185

28. 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	
	2008	2007	**2008**	2007
	£'000	£'000	**£'000**	£'000
Profit or loss	**-**	-	**-**	(51)
Other equity	**(126)**	(229)	**(90)**	(204)

The Group's sensitivity to foreign currency has reduced during the current period mainly due to the repayment of Euro denominated borrowings during the year.

Interest rate risk management
At the balance sheet date, the Group and the Company were exposed to interest rate risk as both the term loan and undrawn overdraft facility carry interest payments which are charged at floating rates. Full disclosures of these interest payment calculations are in note 19.

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 have been 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, 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 which are either majority-owned by the Government or whose capital ratios have been stressed tested by the Financial Services Authority.

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 19.

Cashflow risk management
Each trading subsidiary collects cash receipts from customers and manages short term cash requirements from within it own resources. Occasionally the overseas trading subsidiaries require additional cash injections to fund working capital requirements. In these situations cash is transferred from the UK to Germany and Scandinavia via intercompany loans. The Group's executive management reviews cash requirements for the overseas subsidiaries on a regular basis.

Notes to the financial statements for the year ended 31 December 2008

29. Acquisition

On 25 April 2008 the Group acquired the online DVD rental businesses of Amazon EU Sarl for a total consideration of £62.6 million. This transaction has been accounted for by the purchase method of accounting.

	Net book value £'000	Fair value adjustments £'000	Fair value £'000
Intangible assets	-	11,280	11,280
Property, plant and equipment	3,166	-	3,166
Cash and cash equivalents	6,500	-	6,500
Stock	343	-	343
Deferred tax provision	-	(2,412)	(2,412)
	10,009	8,868	18,877

Fair value of assets acquired	18,877
Goodwill	43,679
Total consideration	62,556
Satisfied by:	
Fair value of shares issued	58,821
Fair value of warrants issued	2,394
Acquisition costs	1,341
	62,556

The goodwill arising on the acquisition of the online DVD rental businesses of Amazon EU Sarl is attributable to the anticipated future operating synergies from the combination and the anticipated profitability of the Group's products in existing markets.

The acquired businesses contributed £12 million revenue and a pre-amortisation profit before tax of £4.2 million, which is included in the Group's loss before tax, for the period between the date of acquisition and the balance sheet date.

If the acquisition had been completed on the first day of the financial year, Group revenue for the period would have been £79.6 million and the Group loss attributable to equity shareholders would have been £7.6 million.

Notes to the financial statements for the year ended 31 December 2008

30. Disposal

As part of the Group reorganisation referred to in the Directors' Report, on 1 November 2008 the Company disposed of its online DVD rental business to its wholly-owned subsidiary Lovefilm UK Limited for a share consideration of £85.0 million.

The net assets of the Company's online DVD rental business at the date of disposal and at 31 December 2007 were as follows:

	1 November 2008 £'000	31 December 2007 £'000
Property, plant and equipment	12,756	8,695
Debtors and prepayments	2,881	1,839
Trade payables	(5,867)	(4,780)
Accruals	(2,264)	(1,131)
Deferred income	(2,178)	(1,482)
Other creditors	(393)	(499)
	4,935	2,642
Gain on disposal	80,079	
Total consideration	85,014	
Satisfied by:		
Fair value of shares issued	85,014	

Notes to the financial statements for the year ended 31 December 2008

31. 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 £42,000 (2007: £180,000) and sold goods worth £1,000 (2007: £4,000) 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 £83,000 (2007: £124,000) to dvdrentals.ie Limited.

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

	2008	2007
	£'000	£'000
Transactions with Group undertakings		
Sales of goods and services	**1,870**	4,118
Purchase of goods and services	**118**	-

Amounts owed by Group undertakings are disclosed within note 17 and amounts owed to Group undertakings are disclosed in note 18.

32. Ultimate controlling party

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