

Directors' report

The Directors submit their report and audited financial statements for the 52 weeks ended 24 April 2010, which were approved on behalf of the Board on 29 June 2010.

Principal activities and business review

The principal activities of the Group are the retailing of pre-recorded music, video, electronic games and related entertainment products under the HMV and Fopp brands, the retailing of books principally under the Waterstone's brand and the operation of a number of live music venues and festivals. The Group has operations in seven countries, with the principal markets being those of the UK and Canada.

During the period under review the Company purchased the entire issued share capital of MAMA Group Plc for a total consideration of £46.0m. Commentary on the strategy of the Company, the performance of the Group during the year, likely future developments and details of the purchase of MAMA Group Plc can be found in the Chairman's Statement on pages 6 and 7, and the Business and Financial Review on pages 8 to 23, which are deemed to be incorporated by reference in (and shall be deemed to form part of) this report.

Risks and uncertainties

The Board has a policy of continuous identification and review of key business risks and uncertainties. It oversees the development of processes to ensure that these risks are managed appropriately and operational management are delegated with the tasks of implementing these processes and reporting to the Board on their outcomes. The key risks identified by the Board are as follows:

Competition

The Group operates in highly competitive markets where, for certain of its product ranges at certain times in the product life cycle, the Group must adapt and invest in strategies to remain competitive with supermarket and pure Internet retailers. In addition, such is the competitive nature of its markets that at times in the past, pressure has been brought to bear on the Group's weaker competitors which has led to one-off closing or liquidation activity for a limited period of time. In the past, such competitor actions have adversely impacted the Group's pricing, margins and profitability which in the future, may also have an adverse impact on the Group's business and financial condition.

Growth of digital entertainment

Physical entertainment media is a key driver of footfall to the Group's stores and of online customers to its various Internet sites. Technological advances and changing consumer preferences have given rise to new methods of digital delivery, both legal and illegal, of music, film, electronic games and books, thereby reducing the purchase of physical media formats. The Group has responded to these challenges by the launch and development of its own websites and continued investment to grow these businesses, however further unforeseen technological developments could have a further adverse impact on the Group's future profitability and cash flows.

Seasonality

The business of the Group is highly seasonal with the Christmas season being the most important trading period in terms of sales, profitability and cash flow for the HMV and Waterstone's businesses. Lower than expected performance in this period may have an adverse impact on results for a full financial year.

External factors

Both the retail and live music markets are sensitive to economic conditions and if the current economic downturn is prolonged this could further reduce consumer spending which could affect revenue and profit. Other external factors which could affect the Group include acts of terrorism or war or an outbreak of a pandemic disease which could reduce the number of customers visiting the Group's stores and venues, causing a decline in revenue and profit.

Credit risk and liquidity

The Group has adequate medium-term financing in place to support its business operations. The Board regularly reviews and stress tests its liquidity and covenant headroom to ensure compliance with its facilities. In view of the global economic and financial conditions, the Board has assessed its exposure to counterparty risk and its treasury policies have been amended to restrict counterparties with which deposits, investments and other transactions may be made.

Failure of supply

The Group has agreements with key suppliers and an interruption or loss of supply of core category products from these suppliers would affect the Group's ability to trade.

Damage to reputation or brands

The HMV and Waterstone's brands and the brands of the live music and festival companies are material assets of the Group and maintaining their reputation is key to the success of the Group. Failure to protect these brands, an event that materially damaged the reputation of these brands and/or a failure to sustain their appeal to customers could have an adverse impact on the financial performance of the Group.

Information Technology systems

The Group relies on a number of important IT systems, both for its stores and its Internet sites. Any significant system performance problems could affect the Group's ability to trade as well as its profitability.

Key personnel

The performance of the Group depends on its ability to continue to attract, motivate and retain key head office and store staff. The retail sector is very competitive and the Group's people are frequently targeted by other companies for recruitment.

Retail store network

Retaining a portfolio of good quality real estate, in prime retail areas and at commercially reasonable rates remains critical to the performance of the Group. All of the Group's stores are held under operating leases and consequently the Group is exposed to the extent that any stores become unviable as a result of adverse trading or rental inflation. Over the last financial year the Group has looked to limit its exposure by negotiating shorter lease lengths and rents linked to turnover. Where a store location becomes surplus to requirements, the Group's policy of occupying prime, highly marketable locations serves to limit such lease exposure.

Strategic initiatives

In March 2010, a strategic plan was laid out for the continued transformation of the Group, which included a number of key initiatives for improving the financial performance of the Group over a three-year period. The failure of one or more of these initiatives could result in an adverse impact on the profitability and cash flows of the Group.

Results and dividends

The consolidated profit after deducting taxation amounted to £49.2m (2009: £44.2m). The Board of Directors recommends a final dividend of 5.6p per Ordinary Share. This together with the interim dividend of 1.8p, already declared and paid, makes a total for the year of 7.4p per Ordinary Share (2009: 7.4p per Ordinary Share). Subject to approval at the forthcoming Annual General Meeting the final dividend will be paid on 9 November 2010 to those shareholders whose names are on the register of members on 1 October 2010.

Directors

Orna Ni-Chionna was appointed as a Non-Executive Director on 30 September 2009, Gerry Johnson resigned as a Director on 14 January 2010 and Lesley Knox resigned as a Non-Executive Director on 1 February 2010. All other Directors served throughout the year under review and details for all present Directors are listed, together with their biographical details, on pages 24 and 25. The Directors have decided, to comply with the requirement introduced by the new UK Corporate Governance Code, that directors should be subject to annual election by shareholders. Accordingly, all the Directors will be retiring and seeking re-election at the forthcoming AGM.

With regards to the appointment and replacement of Directors, the Company is governed by its Articles of Association, the Combined Code, the Companies Act 2006 and related legislation. The Articles themselves may be amended by special resolution of the shareholders. The powers of the Directors are detailed in the Corporate Governance Report on page 26.

The Directors' interests in the shares of the Company, together with their remuneration (where applicable) and further details of their service agreements are detailed in the Directors' Remuneration Report on pages 30 to 39.

No Director, at any time during the period under review, had a material interest in any contracts with the Company or any of its subsidiary undertakings, other than the Executive Directors who had such an interest through their service agreements with the Company, details of which are summarised on pages 33 and 39.

None of the Directors or their families at any time during the period under review, or subsequently, were interested in any shares of the Company's subsidiary undertakings.

Each Director has been given an unlimited indemnity from the Company in respect of certain losses which they may incur to third parties in the course of acting as Directors of the Company and any subsidiary undertaking in which they hold a directorship.

Principal shareholders

As at 28 June 2010 the Company had been advised of the following holdings representing 3% or more in its issued Ordinary Shares:

	Number of Ordinary Shares	Percentage of issued share capital
UBS Global Asset Management	54,821,697	12.94
Standard Life Investments Ltd	45,390,160	10.71
Schroders plc	34,619,783	8.17
Blackrock Inc	24,022,040	5.67
Fidelity International Ltd	23,068,556	5.44
Artemis Fund Managers	19,450,931	4.59
Legal & General Investment Management Ltd	18,450,931	4.47

Directors' report continued

Policy on payment of creditors

The Group does not impose standard payment terms on its suppliers but agrees specific terms with each and ensures that each supplier is made aware of such terms. It is the Group's policy to pay its suppliers in accordance with the terms that they have agreed. The Group had 62 days purchases outstanding at 24 April 2010 (2009: 59 days), based on the trade creditors at that date and purchases made during the year. The Company is a holding company and therefore has no trade creditors.

Financial instruments

The Group's Treasury Department is principally responsible for managing financial risks to which the Group is exposed, such as funding risk, liquidity risk, interest rate risk, credit risk and foreign exchange risk. Treasury manages these risks using policies approved by the Board.

Details of the Group's financial risk management policies can be found in Note 25 to the Accounts, a breakdown of the Group's net debt position is found in Note 26 and interest charges can be found in Note 10 to the Accounts.

Employee policies

The Group aims to employ and develop the best people, putting them in the right positions with a significant level of delegated authority and supporting them with the infrastructure and technology required to perform at the highest levels and at the lowest costs with the quickest response time.

Responsibility for employment rests primarily with each business operation under the general guidance of central policy and procedural guidelines. Group companies are committed to the maintenance of a work environment free of discrimination on the grounds of age, gender, nationality, ethnic or racial origin, non-job related disability, sexual orientation or marital status.

The Group gives full consideration to applications from disabled persons where a disabled person can adequately fulfil the requirements of the job. Where existing employees become disabled, it is the Group's policy, wherever practicable, to provide continuing employment under normal terms and conditions and to provide training, career development and promotion to disabled employees wherever appropriate.

In order to promote employee involvement in the Group, regular meetings are held between local management and employees to allow a free flow of information and ideas.

The Company encourages staff involvement in the Group's performance via a combination of employee bonus and share schemes. During the year under review the Group operated a Share Incentive Plan, which ceased in April 2010 but which is being replaced by a new Save as You Earn share option scheme for all UK employees subject to shareholder approval at the forthcoming Annual General Meeting.

Share capital

At the Annual General Meeting held in September 2009, shareholders authorised the Company to purchase up to a maximum of 42.3 million of its own Ordinary Shares, representing 10% of the issued share capital of the Company. During the period under review the Company did not purchase any of its own shares for cancellation.

Details of the Company's share capital can be found in Note 27 which is incorporated by reference and deemed to be part of this report. Since the end of the period under review the Company has not increased its issued share capital.

The Company has one class of Ordinary Shares which carry no right to fixed income. Each share carries the right to one vote at general meetings of the Company. The percentage issued nominal value of the Ordinary Shares is 100% of the total issued nominal value of all share capital. There are no specific restrictions on the size of a holding nor on the transfer of shares, which are both governed by the general provisions of the Articles of Association of the Company and prevailing legislation. The Directors are not aware of any agreements between holders of the Company's shares that may result in restrictions on the transfer of securities or on voting rights. No person has any special rights of control over the Company's share capital and all issued shares are fully paid.

Details of the employee share schemes are set out in Note 28 and in the Directors' Remuneration Report on pages 30 to 39 both of which are incorporated by reference in (and shall be deemed to form part of) this report.

Charitable donations

The Group made charitable donations of £13,000 in the period under review (2009: £18,000). It is Group policy not to make donations to political parties or independent election candidates and therefore no political donations were made during the period. The Group is also involved in charitable fundraising, details of which can be found in the Corporate Responsibility Statement on page 45.

Significant agreements

The Company's Senior Bank Facility agreement, details of which can be found in Note 25 to the financial statements, contains provisions entitling the counterparties to exercise termination or other rights in the event of a change of control of the Company.

The rules of the Company's Annual Bonus Plan and share plans set out consequences of a change of control of the Company on the employees rights under the plans. All outstanding awards on the change of control will vest immediately to employees to the extent that any performance conditions are satisfied and, unless the Remuneration Committee otherwise decides, will be pro-rated to the extent that the vesting period for each outstanding award has been completed at that time.

Details of payments to the Executive Directors under their service contracts as a result of a change of control can be found in the Directors' Remuneration Report on page 33 and are deemed to be incorporated by reference in (and shall be deemed to form part of) this report.

Auditors

The Directors who were members of the Board at the time of approving the Directors' report are listed on pages 24 and 25. Having made enquiries of fellow Directors and of the Company's auditors, each of these Directors confirms that:

- to the best of each Director's knowledge and belief, there is no information relevant to the preparation of their report of which the Company's auditors are unaware; and
- each Director has taken all steps a director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Company's auditors are aware of that information.

A statement of the Directors' responsibility for the consolidated and Company financial statements can be found on page 50, which is deemed to be incorporated by reference in (and shall be deemed to form part of) this report.

Ernst & Young LLP have indicated their willingness to continue in office and ordinary resolutions reappointing them as auditors and authorising the Directors to fix their remuneration will be proposed at the forthcoming Annual General Meeting.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Business and Financial Review on pages 8 to 23. In addition, this report describes the management of risks and uncertainties, including credit risk and liquidity, with further information on the Group's borrowing facilities detailed in the financial statements (see Note 25).

The Directors report that having reviewed current performance and forecast they have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements.

Annual General Meeting

The Annual General Meeting of the Company will be held at 2.30pm on 9 September 2010 at Nomura House, 1 St Martin's-le-Grand, London EC1A 4NT. The special business to be proposed at that meeting will be the renewal of the Directors' authority to allot new Ordinary Shares and to disapply pre-emption rights in certain circumstances; the renewal of the Directors' authority to buy back the Company's shares in the market; to avoid an inadvertent breach of Companies Act 2006, the renewal of the Group's authority to make political donations; the adoption of the HMV Group Share Option Scheme 2010 and the amendment of the Company's articles of association. The Notice of Meeting and details of the special business to be proposed can be found in the accompanying letter to shareholders.

By order of the Board

Elaine Marriner

Company Secretary

29 June 2010

Shelley House, 2-4 York Road, Maidenhead, Berkshire SL6 1SR