ATLANTIC POWER CORP
Form S-1/A
June 26, 2012

Use these links to rapidly review the document
TABLE OF CONTENTS

Table of Contents

As filed with the Securities and Exchange Commission on June 25, 2012

Registration No. 333-181224

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

AMENDMENT NO. 2
TO
FORM S-1

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

ATLANTIC POWER CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

British Columbia, Canada	**4900**	**55-0886410**
(State or Other Jurisdiction of Incorporation or Organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number)

One Federal Street, Floor 30
Boston, Massachusetts 02110
(617) 977-2400
(Address, Including Zip Code, and Telephone Number, Including Area Code, of Registrant's Principal Executive Offices)

Barry E. Welch
President and Chief Executive Officer
Atlantic Power Corporation
One Federal Street, Floor 30
Boston, Massachusetts 02110
(617) 977-2400
(Name, Address, Including Zip Code, and Telephone Number, Including Area Code, of Agent For Service)

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Approximate date of commencement of proposed sale to the public:
As soon as practicable after this Registration Statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box: o

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

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

Large accelerated filer ý	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until this registration statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

Table of Contents

The information in this preliminary prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is declared effective. This preliminary prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any jurisdiction where the offer or sale of such securities is not permitted.

Subject to Completion
Preliminary Prospectus dated June 25, 2012

PROSPECTUS

5,500,000 Shares

Common Shares

We are offering 5,500,000 common shares, no par value per share.

Our common shares are listed on the New York Stock Exchange under the symbol "AT" and on the Toronto Stock Exchange under the symbol "ATP." On June 22, 2012, the last reported sale price of our common shares on the New York Stock Exchange and the Toronto Stock Exchange was $13.47 and C$13.79, respectively, per share.

Investing in our common shares involves a high degree of risk. Before buying any shares you should carefully read the discussion of material risks of investing in our common shares under the heading "Risk factors" beginning on page 11 of this prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Per Share	Total
Public offering price	$	$
Underwriting discounts and commissions(1)	$	$
Proceeds, before expenses, to us	$	$

(1) For a description of the compensation to be received by the underwriters, see the "Underwriting" section of this prospectus.

The public offering price for common shares offered in the United States and elsewhere outside of Canada is payable in U.S. dollars, and the public offering price for common shares offered in each of the provinces of Canada other than Prince Edward Island and Québec is payable in Canadian dollars, except as may otherwise be agreed by the underwriters. The public offering price, underwriting discounts and commissions and proceeds, before expenses, to the Company are payable in the currency in which the common shares are sold.

The underwriters expect to deliver the common shares on or about , 2012.

Book-Running Manager

Morgan Stanley

The date of this prospectus is , 2012.

TABLE OF CONTENTS

	Page
PROSPECTUS SUMMARY	1
RISK FACTORS	11
CAUTIONARY STATEMENTS REGARDING FORWARD-LOOKING STATEMENTS	14
EXCHANGE RATE INFORMATION	15
USE OF PROCEEDS	16
DIVIDENDS AND DIVIDEND POLICY	17
MARKET PRICE OF THE COMMON SHARES	18
CAPITALIZATION	19
SELECTED HISTORICAL CONSOLIDATED FINANCIAL INFORMATION	21
UNAUDITED PRO FORMA CONDENSED COMBINED CONSOLIDATED STATEMENT OF OPERATIONS	22
SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT	28
DESCRIPTION OF CONCURRENT OFFERING OF CONVERTIBLE DEBENTURES	30
DESCRIPTION OF COMMON SHARES	31
CERTAIN UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS	33
CERTAIN CANADIAN FEDERAL INCOME TAX CONSIDERATIONS	37
UNDERWRITING	39
NOTICE TO INVESTORS	42
LEGAL MATTERS	44
EXPERTS	45
INCORPORATION BY REFERENCE OF CERTAIN DOCUMENTS	45
WHERE YOU CAN FIND MORE INFORMATION	46

You should rely only on information contained in this document or to which we have referred you. We have not, and our underwriters have not, authorized anyone to provide any information or to make any representations other than those contained in this prospectus or in any free writing prospectuses we have prepared or, for purchasers in Canada, the Canadian prospectus relating to this offering. If anyone provides you with different or inconsistent information, you should not rely on it. We take no responsibility for, and can provide no assurance as to the reliability of, any other information that others may give you. We are not, and the underwriters are not, making an offer to sell the securities in any jurisdiction where the offer or sale is not permitted. This document may only be used where it is legal to sell these securities.

As used in this prospectus, the terms "Atlantic Power," the "Company," "we," "our" and "us" refer to Atlantic Power Corporation, together with those entities owned or controlled by Atlantic Power Corporation, unless the context indicates otherwise. Unless otherwise noted, all references to "C$," "Cdn$" and "Canadian dollars" are to the lawful currency of Canada and all references to "$," "US$" and "U.S. dollars" are to the lawful currency of the United States. This prospectus includes our trademarks and other trade names identified herein. All other trademarks and trade names appearing in this prospectus are the property of their respective holders.

Table of Contents

PROSPECTUS SUMMARY

The following summary may not contain all the information that may be important to you or that you should consider before deciding to purchase any common shares and is qualified in its entirety by the more detailed information appearing elsewhere in this prospectus. You should read the entire prospectus, especially the risks set forth under the heading "Risk factors" in this prospectus, as well as the financial and other information included or incorporated by reference herein, before making an investment decision.

Atlantic Power Corporation

Atlantic Power Corporation owns and operates a diverse fleet of power generation and infrastructure assets in the United States and Canada. Our power generation projects sell electricity to utilities and other large commercial customers largely under long-term power purchase agreements ("PPAs"), which seek to minimize exposure to changes in commodity prices. Our power generation projects in operation have an aggregate gross electric generation capacity of approximately 3,397 megawatts (or "MW") in which our aggregate ownership interest is approximately 2,141 MW. Our current portfolio consists of interests in 31 operational power generation projects across 11 states in the United States and two provinces in Canada and a 500-kilovolt 84-mile electric transmission line located in California. In addition, we have one 53 MW biomass project under construction in Georgia and one approximately 300 MW wind project under construction in Oklahoma. We also own a majority interest in Rollcast Energy Inc. ("Rollcast"), a biomass power plant developer in North Carolina. Twenty-three of our projects are wholly-owned subsidiaries.

The following map shows the location of our currently-owned projects, including joint venture interests, across the United States and Canada:

1

Table of Contents

	Project Name	Location	Fuel Type	Total MW	Ownership Interest	Net MW
1	Auburndale	Auburndale FL	Natural Gas	155	100%	155
2	Badger Creek	Bakersfield CA	Natural Gas	46	50%	23
3	Cadillac	Cadillac MI	Biomass	40	100%	40
4	Calstock	Hearst ON	Biomass	35	100%	35
5	Canadian Hills	El Reno OK	Wind	298	99%	295
6	Chambers	Carney's Point NJ	Coal	263	40%	105
7	Curtis Palmer	Corinth NY	Hydro	60	100%	60
8	Delta Person	Albuquerque NM	Natural Gas	132	40%	53
9	Frederickson	Tacoma WA	Natural Gas	250	50%	125
10	Greeley	Greeley CO	Natural Gas	72	100%	72
11	Gregory	Corpus Cristi TX	Natural Gas	400	17%	68
12	Idaho Wind	Twin Falls ID	Wind	183	28%	50
13	Kapuskasing	Kapuskasing ON	Natural Gas	40	100%	40
14	Kenilworth	Kenilworth NJ	Natural Gas	30	100%	30
15	Koma Kulshan	Concrete WA	Hydro	13	50%	6
16	Lake	Umatilla FL	Natural Gas	121	100%	121
17	Mamquam	Squamish BC	Hydro	50	100%	50
18	Manchief	Brush CO	Natural Gas	300	100%	300
19	Moresby Lake	Moresby Island BC	Hydro	6	100%	6
20	Morris	Morris IL	Natural Gas	177	100%	177
21	Naval Station	San Diego CA	Natural Gas	47	100%	47
22	Naval Training Ctr	San Diego CA	Natural Gas	25	100%	25
23	Nipigon	Nipigon ON	Natural Gas	40	100%	40
24	North Bay	North Bay ON	Natural Gas	40	100%	40
25	North Island	San Diego CA	Natural Gas	40	100%	40
26	Orlando	Orlando FL	Natural Gas	129	50%	65
27	Oxnard	Oxnard CA	Natural Gas	49	100%	49
28	Pasco	Tampa FL	Natural Gas	121	100%	121
29	Path 15	California	Transmission	NA	100%	NA
30	Piedmont	Barnsville GA	Biomass	53	98%	53
31	Rockland	American Falls ID	Wind	80	30%	24
32	Rollcast	Charlottesville NC	NA	NA	60%	NA
33	Selkirk	Bethlehem NY	Natural Gas	345	18%	64
34	Tunis	Tunis ON	Natural Gas	43	100%	43
35	Williams Lake	Williams Lake BC	Biomass	66	100%	66

The following charts show, based on MW, the diversification of our portfolio by geography, reporting segment and fuel type:

Table of Contents

We sell the capacity and energy from our power generation projects under PPAs with a number of utilities and other parties. Under the PPAs, which have expiration dates ranging from 2012 to 2037, we receive payments for electric energy delivered to our customers (known as energy payments), in addition to payments for electric generating capacity (known as capacity payments). We also sell steam from a number of our projects to industrial purchasers under steam sales agreements. The transmission system rights associated with our power transmission project entitle us to payments indirectly from the utilities that make use of the transmission line.

Our power generation projects generally have long-term fuel supply agreements, typically accompanied by fuel transportation arrangements. In most cases, the term of the fuel supply and transportation arrangements corresponds to the term of the relevant PPAs. Many of the PPAs and steam sales agreements provide for the indexing or pass-through of fuel costs to our customers. In cases where there is no pass-through of fuel costs, we often attempt to mitigate the market price risk of changing commodity costs through the use of hedging strategies.

We directly operate and maintain more than half of our power generation fleet. We also partner with recognized leaders in the independent power industry to operate and maintain our other projects, including Caithness Energy, LLC ("Caithness"), Colorado Energy Management ("CEM"), Power Plant Management Services ("PPMS") and the Western Area Power Administration ("Western"). Under these operation, maintenance and management agreements, the operator is typically responsible for operations, maintenance and repair services.

Our common shares trade on the Toronto Stock Exchange ("TSX") under the symbol "ATP" and on the New York Stock Exchange ("NYSE") under the symbol "AT."

Our registered office is located at 355 Burrard Street, Suite 1900, Vancouver, British Columbia, Canada V6C 2G8 and our headquarters is located at One Federal Street, Floor 30, Boston, Massachusetts, 02110 USA. Our telephone number in Boston is (617) 977-2400 and the address of our website is www.atlanticpower.com. We make available, free of charge, on our website our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Additionally, we make available on our website, our Canadian securities filings.

Our Competitive Strengths

We believe we distinguish ourselves from other independent power producers through the following competitive strengths:

- ***Diversified projects.*** Our power generation projects have an aggregate gross electric generation capacity of approximately 3,397 MW, and our net ownership interest in these projects is approximately 2,141 MW. These projects are diversified by fuel type, electricity and steam customers, and geography. The majority are located in the deregulated and more liquid electricity markets of California, the U.S. Mid-Atlantic and New York. We also have a power transmission project, known as the Path 15 project, that is regulated by the Federal Energy Regulatory Commission ("FERC"). Additionally, we have a 53 MW biomass project under construction in Georgia and an approximately 300 MW wind project under construction in Oklahoma.

- ***Experienced management team.*** Our management team has a depth of experience in commercial power operations and maintenance, project development, asset management, mergers and acquisitions, capital raising and financial controls. Our network of industry contacts and our reputation allow us to access acquisition opportunities on a regular basis.

Table of Contents

Stability of project cash flow. Many of our power generation projects currently in operation have been in operation for over ten years. Cash flows from each project are generally supported by PPAs with investment-grade utilities and other creditworthy counterparties. We believe that each project's combination of PPAs, fuel supply agreements and/or commodity hedges help stabilize operating margins.

Access to capital. Our shares are publicly traded on the NYSE and the TSX. We have a history of successfully raising capital through public offerings of equity and debt securities in Canada and the U.S., issuing public convertible debentures in Canada and bonds in the United States. We have also issued securities by way of private placement in the U.S. and Canada. In addition, we have used non-recourse project-level financing as a source of capital. Project-level financing can be attractive as it typically has a lower cost than equity, is non-recourse to Atlantic Power and amortizes over the term of the project's PPA. Having significant experience in accessing all of these markets provides flexibility such that we can pursue transactions in the most cost-effective market at the time capital is needed.

Strong in-house operations team complemented by leading third-party operators. We operate and maintain 17 of our power generation projects, which represent 44% of our portfolio's generating capacity, and the remaining 14 generation projects are operated by third-parties, who are recognized leaders in the independent power business. Affiliates of Caithness, CEM and PPMS operate projects representing approximately 19%, 14% and 8%, respectively, of the net electric generation capacity of our power generation projects. No other operator is responsible for the operation of projects representing more than 3% of the net electric generation capacity of our power generation projects.

Strong customer base. Our customers are generally large utilities and other parties with investment-grade credit ratings. The largest customers of our power generation projects, including projects recorded under the equity method of accounting, are Public Service Company of Colorado ("PSCo"), Progress Energy Florida, Inc. ("PEF") and Ontario Electricity Financial Corp. ("OEFC"), which purchase approximately 17%, 15% and 9%, respectively, of the net electric generation capacity of our projects. No other electric customer purchases more than 9% of the net electric generation capacity of our power generation projects.

Our Objectives and Business Strategies

Our corporate strategy is to increase the value of the Company through accretive acquisitions in North American markets while generating stable, contracted cash flows from our existing assets to sustain our dividend payout to shareholders. In order to achieve these objectives, we intend to focus on enhancing the operating and financial performance of our current projects and pursuing additional accretive acquisitions primarily in the electric power industry in the United States and Canada.

Organic growth

Since the time of our initial public offering on the TSX in late 2004, we have twice acquired the interest of another partner in one of our existing projects and will continue to look for additional such opportunities. We intend to enhance the operation and financial performance of our projects through:

- achievement of improved operating efficiencies, output, reliability and reduced operation and maintenance costs through the upgrade or enhancement of existing equipment or plant configurations;
- optimization of commercial arrangements such as PPAs, fuel supply and transportation contracts, steam sales agreements, operations and maintenance agreements and hedge agreements; and
- expansion of existing projects.

4

Table of Contents

Extending PPAs following their expiration

PPAs in our portfolio have expiration dates ranging from 2012 to 2037. In each case, we plan for expirations by evaluating various options in the market. New arrangements may involve responses to utility solicitations for capacity and energy, direct negotiations with the original purchasing utility for PPA extensions, "reverse" requests for proposals by the projects to likely bilateral counterparties, arrangements with creditworthy energy trading firms for tolling agreements, full service PPAs or the use of derivatives to lock in value. We do not assume that revenues or operating margins under existing PPAs will necessarily be sustained after PPA expirations, since most original PPAs included capacity payments related to return of and return on original capital invested, and counterparties or evolving regional electricity markets may or may not provide similar payments under new or extended PPAs. Also PPA extensions are subject to current pricing and market conditions. Based on these factors, we believe that the pricing for PPA extensions for certain of our projects, such as the Auburndale and Lake projects whose PPAs expire in 2013, will be substantially lower than the current PPAs.

Acquisition and investment strategy

We believe that new electricity generation will continue to be required in the United States and Canada as a result of growth in electricity demand, transmission constraints and the retirement of older generation projects due to obsolescence or environmental concerns. In addition, Renewable Portfolio Standards in over 31 states as well as renewables initiatives in several provinces have greatly facilitated attractive PPAs and financial returns for significant renewable project opportunities. While we are not greenfield developers ourselves, we work with experienced development companies to acquire pipelines of late stage development investment opportunities. There is also a very active secondary market for the purchase and sale of existing projects.

We intend to expand our operations by making accretive acquisitions with a focus on power generation, transmission and related facilities in the United States and Canada. We may also invest in other forms of energy-related projects, utility projects and infrastructure projects, as well as make additional investments in development stage projects or companies where the prospects for creating long-term predictable cash flows are attractive. In 2010, we purchased a 60% interest in Rollcast, a biomass developer out of North Carolina with a pipeline of development projects, in which we have the option but not the obligation to invest capital. We continue to assess development companies with strong late-stage development projects, and believe that there are opportunities in the market to enter into joint ventures with strong development teams.

Our management has significant experience in the independent power industry and we believe that our experience, reputation and industry relationships will continue to provide us with enhanced access to future acquisition opportunities.

Asset Management

Our asset management strategy is to ensure that our projects receive appropriate preventative and corrective maintenance and incur capital expenditures, if required, to provide for their safety, efficiency, availability and longevity. We also proactively look for opportunities to optimize power, fuel supply and other agreements to deliver strong and predictable financial performance. In conjunction with our indirect acquisition of 18 power generation assets of Capital Power Income L.P. (subsequently renamed Atlantic Power Limited Partnership on February 1, 2012) (the "Partnership") through our direct and indirect acquisition of all of the issued and outstanding limited partnership units of the Partnership, the personnel that operated and maintained the assets of the Partnership became employees of Atlantic Power. The staff at each of the facilities has extensive experience in managing, operating and maintaining the assets. Personnel at Capital Power Corporation regional offices that provided support in operations management, environmental health and safety, and human resources also joined Atlantic

Table of Contents

Power. In combination with the existing staff of Atlantic Power, we have a dedicated and experienced operations and commercial management organization that is well regarded in the energy industry.

For operations and maintenance services at the 14 projects in our portfolio which we do not operate, we partner with recognized leaders in the independent power business. Most of our third-party operated projects are managed by Caithness, CEM, PPMS and, in the case of Path 15, Western, a U.S. Federal power agency. On a case-by-case basis, these third-party operators may provide: (i) day-to-day project-level management, such as operations and maintenance and asset management; (ii) partnership level management, such as insurance renewals and annual budgets; and (iii) partnership level management, such as acting as limited partner. In some cases these project managers or the project partnerships may subcontract with other firms experienced in project operations, such as General Electric, to provide for day-to-day plant operations. In addition, employees of Atlantic Power with significant experience managing similar assets are involved in all significant decisions with the objective of proactively identifying value-creating opportunities such as contract renewals or restructurings, asset-level refinancings, add-on acquisitions, divestitures and participation at partnership meetings.

Caithness is one of the largest privately-held independent power producers in the United States. For over 25 years, Caithness has been actively engaged in the development, acquisition and management of independent power facilities for its own account as well as in venture arrangements with other entities. Caithness operates our Auburndale, Lake and Pasco projects and provides asset management services for our Orlando, Selkirk and Badger Creek projects.

CEM is an energy infrastructure management company specializing in operations and maintenance, asset management and construction management for independent power producers and investors. With over 25 years of experience in operations and maintenance management, CEM focuses on revenue growth through continuous operational improvement and advanced maintenance concepts. Clients of CEM include independent power producers, municipalities and plant developers. CEM operates our Manchief facility.

PPMS is a management services company focused on providing senior level energy industry expertise to the independent power market. Founded in 2006, PPMS provides management services to a large portfolio of solid fuel and gas-fired generating stations including our Selkirk and Chambers facilities. Previously, Cogentrix provided services to these facilities. Western owns and maintains the Path 15 transmission line. Western transmits and delivers hydroelectric power and related services within a 15-state region of the central and western United States. They are one of four power marketing administrations within the U.S. Department of Energy whose role is to market and transmit electricity from multi-use water projects. Western's transmission system carries electricity from 57 power plants. Together, these plants have an operating capacity of approximately 8,785 MW.

Recent Developments

Acquisition of Capital Power Income L.P.

On November 5, 2011, we directly and indirectly acquired all of the issued and outstanding limited partnership units of the Partnership, in exchange for approximately Cdn$506.5 million in cash and 31.5 million of our common shares. The Partnership's portfolio consisted of 19 wholly-owned power generation assets located in both Canada and the United States, a 50.15% interest in a power generation asset in the state of Washington, and a 14.3% common ownership interest in Primary Energy Recycling Holdings LLC ("PERH"). At the acquisition date, the transaction increased the net generating capacity of our projects by 143% from 871 MW to approximately 2,116 MW. We did not purchase two of the Partnership's assets located in North Carolina. We remain headquartered in Boston, Massachusetts and added offices in Chicago, Illinois, Toronto, Ontario, Richmond and Vancouver, British Columbia. Additionally, the Capital Power Corporation employees that operated and

Table of Contents

maintained the Partnership's assets and most of those who provided management support of operations, accounting, finance, and human resources became employees of Atlantic Power.

Acquisition of Rockland Wind

On December 28, 2011, we purchased a 30% interest for $12.5 million in the Rockland Wind Project ("Rockland"), an 80 MW wind farm near American Falls, Idaho, that began operations in early December 2011. The Rockland Wind Project sells power under a 25-year PPA with Idaho Power. Rockland is accounted for under the equity method of accounting.

Acquisition of Canadian Hills Wind Power Development Project

On January 31, 2012, Atlantic Oklahoma Wind, LLC ("Atlantic OW"), a Delaware limited liability company and a wholly owned subsidiary of Atlantic Power, entered into a purchase and sale agreement with Apex Wind Energy Holdings, LLC, a Delaware limited liability company ("Apex"), pursuant to which Atlantic OW acquired a 51% interest in Canadian Hills Wind, LLC, an Oklahoma limited liability company ("Canadian Hills") for a nominal sum. Canadian Hills is the owner of a 298.45 MW wind energy project under construction in the State of Oklahoma. On March 30, 2012, we completed the purchase of an additional 48% interest in Canadian Hills for a nominal amount, bringing our total interest in the project to 99%. Apex retained a 1% interest in the project. At the time, we also closed a $310 million non-recourse, project-level construction financing facility for the project. The facility includes a $290 million construction loan and a $20 million 5-year letter of credit facility. Proceeds from the construction loan were used, in part, to repay Atlantic Power $29.3 million in member loans that were made to the project to fund construction prior to closing the construction financing facility. The construction loan is structured to be repaid with a tax equity investment, which we are actively pursuing, by institutional investors at the time Canadian Hills commences commercial operations. In the event that we are unable to secure such tax equity investment, we may be required to raise additional debt or equity capital in order to repay the loan.

In connection with the closing of the construction financing facility on March 30, 2012, we committed to invest approximately $180 million in equity (net of financing costs) to cover the balance of the construction and development costs, expected to be drawn following the final disbursement of the construction loan. We have received an approximately $360 million bridge facility commitment (the "Bridge Facility") from Morgan Stanley to provide flexibility in the timing of the tax equity investment and our own equity commitment in the project.

Canadian Hills executed PPAs for all of its output with Southwestern Electric Power Company (201.25 MW), Oklahoma Municipal Power Authority (49.2 MW), and Grand River Dam Authority (48 MW).

PERH Interest Sale

On February 16, 2012, we entered into an agreement with Primary Energy Recycling Corporation ("PERC"), whereby PERC will purchase our 14.3% common membership interests in PERH for approximately $24 million, plus a management agreement termination fee of approximately $6.1 million for a total price of $30.1 million. The transaction closed on May 31, 2012 and we received proceeds of approximately $30.2 million.

Path 15

In February 2011, we filed a rate application with the FERC to establish Path 15's revenue requirement at $30.3 million for

Performance shares/units

153 2 (2,628) 4,220 1,594

Stock options

10 628 (850) (222)

Restricted stock and other

24 141 365 506

Common stock repurchased

(978) (9) (13,870) (13,879)

Reclassification of additional paid-in capital to retained earnings

10,135 (10,135)

Cash dividends, $.16 per share

(3,400) (3,400)

October 29, 2005

20,655 $207 $12,524 $(8,610) $(10,254) $ $292,405 $286,272

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

HANDLEMAN COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE SIX-MONTH PERIODS ENDED OCTOBER 29, 2005 AND OCTOBER 30, 2004

(UNAUDITED)

(in thousands of dollars)

	Six Months (26 weeks) Ended	
	October 29, 2005	**October 30, 2004**
Cash flows from operating activities:		
Net income	$ 6,126	$ 9,078
Adjustments to reconcile net income to net cash used by operating activities:		
Depreciation and amortization	8,868	8,468
Gain on sale of investment	(3,844)	
Unrealized investment income	(306)	(566)
Loss on disposal of property and equipment	321	842
Stock-based compensation	1,816	2,424
Changes in operating assets and liabilities:		
Increase in accounts receivable	(46,601)	(17,421)
Increase in merchandise inventories	(98,136)	(93,130)
(Increase) decrease in other operating assets	2,950	(87)
Increase in accounts payable	136,939	80,417
Decrease in other operating liabilities	(8,333)	(13,173)
Total adjustments	(6,326)	(32,226)
Net cash used by operating activities	(200)	(23,148)
Cash flows from investing activities:		
Additions to property and equipment	(7,592)	(10,733)
Proceeds from disposition of properties and equipment	231	342
Proceeds from sale of investment	3,844	
Cash investment in REPS LLC	(19,107)	
Net cash used by investing activities	(22,624)	(10,391)
Cash flows from financing activities:		
Issuances of debt	373,715	44,415
Repayments of debt	(338,815)	(19,415)
Checks issued in excess of cash balances	1,902	
Cash dividends	(3,400)	(3,245)
Repurchases of common stock	(13,879)	(30,481)
Cash proceeds from stock-based compensation plans	62	529
Net cash provided from (used by) financing activities	19,585	(8,197)
Effect of exchange rate changes on cash	(491)	2,767

Net decrease in cash and cash equivalents	(3,730)	(38,969)
Cash and cash equivalents at beginning of period	30,826	73,713
Cash and cash equivalents at end of period	$ 27,096	$ 34,744

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Accounting Policies

In the opinion of management, the accompanying Consolidated Balance Sheets and Consolidated Statements of Income, Shareholders Equity and Cash Flows contain all adjustments, including normal recurring adjustments, necessary to present fairly the financial position of the Company as of October 29, 2005, and the results of operations and changes in cash flows for the six months then ended. Because of the seasonal nature of the Company s business, revenues and earnings results for the six months ended October 29, 2005 are not necessarily indicative of what the results will be for the full year. The Consolidated Balance Sheet as of April 30, 2005 included in this Form 10-Q was derived from the audited consolidated financial statements of the Company included in the Company s fiscal year 2005 Annual Report on Form 10-K filed with the Securities and Exchange Commission. Reference should be made to the Company s Form 10-K for the year ended April 30, 2005, including the discussion of the Company s critical accounting policies.

2. New Accounting Pronouncements

In December 2004, Statement of Financial Accounting Standards (SFAS) No. 123R, Share-Based Payment (revised 2004), was issued by the Financial Accounting Standards Board. SFAS No. 123R requires public companies to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award, usually the vesting period. The Company adopted SFAS No. 123, Accounting for Stock-Based Compensation, effective May 4, 2003. All stock-based awards issued after May 3, 2003 are expensed over the vesting period using the fair value method. The Company is currently reviewing the requirements of SFAS No. 123R to determine the impact on its financial statements. The Company will adopt the provisions of SFAS No. 123R at the beginning of its fiscal year 2007, as required.

3. Acquisitions

REPS LLC

On June 24, 2005, Handleman Company acquired all of the operating assets and certain liabilities of REPS LLC (REPS). REPS provides in-store merchandising for home entertainment and consumer product brand owners at mass merchant, warehouse club and specialty retailers in the United States (U.S.). The in-store merchandising structure of REPS is similar to the Company s in-store merchandising structure, thus providing the opportunity to consolidate certain functions and generate cost savings and synergies. This acquisition has been recorded in accordance with the provisions of SFAS No. 141, Business Combinations, and the operating results of REPS have been included in the Company s consolidated financial statements since the date of acquisition.

The purchase price for the assets of REPS totaled $20,459,000, of which $18,750,000 was paid at closing. A promissory note in the amount of $1,000,000 is payable on June 24, 2006 subject to any indemnification claims. A second promissory note in the amount of $250,000 and the remaining $459,000 of the purchase price is payable within 151 business days from the date of acquisition subject to finalization of working capital amounts. In addition, the Company incurred $357,000 of legal and accounting fees related to the REPS acquisition. The Company has obtained a third-party valuation of certain intangible assets acquired from REPS; thus, the allocation of the purchase price was adjusted during the second quarter of fiscal 2006 to reflect the results of this valuation.

5

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The following table summarizes the fair values, as adjusted, of the REPS assets acquired and liabilities assumed at the date of acquisition (in thousands of dollars):

Current assets	$ 4,212
Property and equipment, net	227
Intangible assets	
Goodwill	6,903
Trademark	2,200
Customer relationships	6,300
Non-compete agreements	1,800
Other assets	10
Total assets acquired	21,652
Total current liabilities assumed	(836)
Total net assets acquired	$ 20,816

The trademark and customer relationships will be amortized, for book and tax purposes, over a period of 15 years, while the non-compete agreements will be amortized, for book and tax purposes, over a four-year period. The entire amount of goodwill related to this acquisition is deductible for tax purposes over a 15-year period.

4. Discontinued Operations

In the second quarter of fiscal 2004, the Company sold its Anchor Bay Entertainment subsidiary companies. In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the financial results of these subsidiary companies were reported separately as discontinued operations in the Company s Consolidated Statements of Income for all periods presented, since the operations and cash flows of these companies were eliminated from the ongoing operations of the Company. The Company does not have any continuing involvement in the operations of these companies after the disposal transaction.

The Company has contingent liabilities related to Anchor Bay Entertainment. In the fourth quarter of fiscal 2004, the purchaser requested certain adjustments to the sale proceeds which remain unresolved. The Company does not believe there is a reasonable basis for these adjustments and therefore the potential exposure is in the range of zero to $6,400,000. However, since no assurance can be given to the resolution of these unresolved requested adjustments, as they are neither probable nor estimable, no accrual has been recorded for these items.

Also, in the fourth quarter of fiscal 2004, a licensor of Anchor Bay Entertainment exercised its right to audit its royalty statements. As a result of this audit, the licensor asserted a claim against Anchor Bay Entertainment for royalties it believed were due them, in the amount of $5,600,000, including interest. Pursuant to the Anchor Bay Entertainment sale agreement, the Company was potentially liable for certain royalty audit claims. During the second quarter of fiscal 2005, the Company recorded a pre-tax charge of $758,000 ($483,000 after tax), which represented settlement of certain components of the claim. During the third quarter of fiscal 2005, this licensor initiated legal proceedings related to this matter. The Company settled these legal proceedings during the second quarter of fiscal 2006 and recorded an additional pre-tax charge of $563,000 ($362,000 after tax), representing final settlement costs and legal fees. These charges were included in Income from discontinued

operations in the Company s Consolidated Statements of Income.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. Goodwill and Intangible Assets

REPS Acquisition

As discussed in Note 3 of Notes to Consolidated Financial Statements, on June 24, 2005 the Company acquired all of the operating assets and certain liabilities of REPS LLC. None of the intangible assets recorded as a result of this acquisition have significant residual values. The Company has obtained a third-party valuation of these intangible assets; thus, allocation of the purchase price was adjusted during the second quarter of fiscal 2006 to reflect the results of this valuation.

Goodwill

The Company accounts for goodwill and intangible assets in accordance with SFAS No. 142, Goodwill and Other Intangible Assets. Accordingly, the Company performs an annual impairment test for goodwill and other intangible assets with indefinite lives in the fourth quarter of each fiscal year. The goodwill test for impairment is conducted on a reporting unit level, whereby the carrying value of each reporting unit, including goodwill, is compared to its fair value. Fair value is estimated using the present value of free cash flows method.

Goodwill represents the excess of consideration paid over the estimated fair values of net assets of businesses acquired. Goodwill included in the Consolidated Balance Sheets as of October 29, 2005 and April 30, 2005 was $10,309,000 and $3,406,000, respectively, which were net of amortization of $1,224,000 at each of these balance sheet dates.

The following table summarizes the changes in carrying amount of goodwill for the six months ended October 29, 2005 (in thousands of dollars):

Balance as of April 30, 2005	$ 3,406
Goodwill acquired during the period related to REPS LLC	6,903
Balance as of October 29, 2005	$ 10,309

The Company does not have any intangible assets, other than goodwill that are not subject to amortization.

Intangible Assets

The intangible assets acquired during the first quarter of fiscal 2006 are related to the acquisition of REPS LLC and represent all of the intangible assets of the Company. On an annual basis, the Company will perform impairment analyses comparing the carrying value of its intangible assets with the future economic benefit of these assets. Based on such analyses, the Company will adjust, as necessary, the value of its intangible assets.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The following information relates to intangible assets subject to amortization as of October 29, 2005 (in thousands of dollars):

Amortized Intangible Assets	Gross Carrying Amount	Accumulated Amortization	Net Amount	Weighted Average Amortization Period
Trademark	$ 2,200	$ 49	$ 2,151	180 mos.
Customer relationships	6,300	140	6,160	180 mos.
Non-compete agreements	1,800	150	1,650	48 mos.
Total	$ 10,300	$ 339	$ 9,961	157 mos.

The Company had no intangible assets subject to amortization as of, and during, the fiscal year ended of April 30, 2005.

The Company s aggregate amortization expense for the three and six-month periods ended October 29, 2005 was $248,000 and $339,000, respectively. The Company estimates future aggregate amortization expense as follows (in thousands of dollars):

Fiscal Years	Amounts
2006	$ 1,295
2007	2,084
2008	1,822
2009	1,519
2010	875

6. Accounts Receivable

The table below summarizes the components of accounts receivable balances included in the Company s Consolidated Balance Sheets (in thousands of dollars):

	October 29, 2005	April 30, 2005
Trade accounts receivable	$ 293,433	$ 243,218
Less allowances for:		
Gross profit impact of estimated future returns	(9,588)	(8,356)
Doubtful accounts	(4,016)	(2,453)

Accounts receivable, net	$ 279,829	$ 232,409

7. Pension Plan

The Company has two defined benefit pension plans (pension plans) that cover substantially all full-time U.S. and Canadian employees**.** In addition, the Company has two nonqualified post retirement plans, U.S. and Canadian Supplemental Executive Retirement Plans (SERP) that cover select employees. The information that follows, for all periods presented, combines U.S. and Canadian pension plans and U.S. and Canadian SERP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Components of net periodic benefit cost are as follows (in thousands of dollars):

	Pension Plans		SERP	
	Three Months Ended		Three Months Ended	
	October 29, 2005	October 30, 2004	October 29, 2005	October 30, 2004
Service cost	$ 475	$ 454	$ 62	$ 143
Interest cost	684	765	102	145
Expected return on plan assets	(815)	(759)		
Amortization of unrecognized prior service cost, actuarial gain and other	522	412	(487)	128
Net periodic benefit cost	$ 866	$ 872	$ (323)	$ 416

	Pension Plans		SERP	
	Six Months Ended		Six Months Ended	
	October 29, 2005	October 30, 2004	October 29, 2005	October 30, 2004
Service cost	$ 1,041	$ 904	$ 231	$ 286
Interest cost	1,491	1,526	261	290
Expected return on plan assets	(1,774)	(1,515)		
Amortization of unrecognized prior service cost, actuarial gain and other	1,133	824	(334)	255
Net periodic benefit cost	$ 1,891	$ 1,739	$ 158	$ 831

For the six months ended October 29, 2005, contributions to the Company s defined benefit pension plans were $2,184,000. The Company anticipates contributing an additional $3,191,000 to the pension plans in the remainder of fiscal 2006, for a total contribution of $5,375,000. The Company contributed $1,067,000 to the SERP plans in the first six months of fiscal 2006 and anticipates contributing an additional $500,000 in the remainder of fiscal 2006 for a total contribution of $1,567,000.

8. Income Taxes

The effective income tax rates for the second quarters of fiscal 2006 and 2005 were 1.8% and 34.5%, respectively. The effective income tax rate for the first six months of fiscal 2006 was (40.6%), compared to 33.4% for the same period last year. The significantly lower income tax rates in both the second quarter and first six months of this year were due to the partial release of a valuation allowance related to a capital loss and the tax benefit from the cancellation of a worthless debt from an insolvent subsidiary, both occurring in the second quarter of this fiscal year, in the amounts of $2,118,000 and $1,028,000, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

9. Stock Plans

The Company has stock-based compensation plans in the form of stock options, performance shares/units and restricted stock. Stock options issued prior to fiscal 2004 are accounted for under the recognition and measurement provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees and Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 44, Accounting for Certain Transactions Involving Stock Compensation (an Interpretation of APB Opinion No. 25). Compensation expense for the Company s stock-based plans accounted for under APB Opinion No. 25 has been reflected in the Company s Consolidated Statements of Income for all periods presented, as all awards granted under these plans have been accounted for under the variable accounting method. Under variable accounting, the excess of market value over the option price of outstanding stock options is determined at each reporting period and aggregate compensation expense is adjusted and recognized over the vesting period. Compensation expense associated with vested options issued prior to fiscal year 2004 continues to be adjusted to the market value of the options until the options are either exercised or terminated. Effective May 4, 2003, the Company adopted the fair value recognition provisions of SFAS No. 123. The Company selected the prospective transition method, as defined in SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, an amendment to SFAS No. 123. Under the prospective method, all stock-based awards issued after May 3, 2003 are accounted for utilizing the fair value provisions of SFAS No. 123 and are expensed over the vesting period.

The amounts related to stock-based compensation included in the determination of net income for the three and six months ended October 29, 2005 and October 30, 2004 was income of $293,000 and expense of $1,252,000, respectively, and expenses of $1,816,000 and $2,424,000, respectively. The following table illustrates the effect on net income and earnings per share if the fair value recognition provisions of SFAS No. 123 had been applied to all stock-based awards for each period presented (in thousands of dollars except per share data):

	Three Months Ended		Six Months Ended	
	October 29, 2005	October 30, 2004	October 29, 2005	October 30, 2004
Net income	$ 9,774	$ 8,153	$ 6,126	$ 9,078
Add: Stock-based employee compensation (income) expense included in reported net income, net of related tax effects	(293)	823	1,055	1,738
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(792)	(995)	(2,092)	(2,284)
Proforma net income	$ 8,689	$ 7,981	$ 5,089	$ 8,532
Net income per share:				
Reported basic	$ 0.46	$ 0.36	$ 0.29	$ 0.39
diluted	0.46	0.36	0.29	0.39
Proforma basic	0.41	0.35	0.24	0.37
diluted	0.41	0.35	0.24	0.37

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

10. Contingencies

See Note 4 of Notes to Consolidated Financial Statements for contingencies related to Anchor Bay Entertainment.

There are no additional pending legal proceedings to which the Registrant or any of its subsidiaries is a party, other than routine legal matters that are incidental to the business and the ultimate outcome of which is not expected to be material to future results of consolidated operations, financial position and cash flows. The Company has provided for all claims and legal proceedings based on its best estimate of the amounts it expects to pay.

11. Comprehensive Income

Comprehensive income is summarized as follows (in thousands of dollars):

	Three Months Ended		Six Months Ended	
	October 29, 2005	October 30, 2004	October 29, 2005	October 30, 2004
Net income	$ 9,774	$ 8,153	$ 6,126	$ 9,078
Change in foreign currency translation adjustments	1,760	3,405	(3,336)	6,238
Total comprehensive income	$ 11,534	$ 11,558	$ 2,790	$ 15,316

The table below summarizes the components of accumulated other comprehensive income included in the Company s Consolidated Balance Sheets (in thousands of dollars):

	October 29, 2005	April 30, 2005
Foreign currency translation adjustments	$ 12,524	$ 15,860
Minimum pension liability, net of tax	(8,610)	(8,610)
Total accumulated other comprehensive income	$ 3,914	$ 7,250

12. Common Stock Basic and Diluted Shares

A reconciliation of the weighted average shares used in the calculation of basic and diluted shares is as follows (in thousands):

	Three Months Ended		Six Months Ended	
	October 29, 2005	October 30, 2004	October 29, 2005	October 30, 2004
Weighted average shares during the period basic	21,027	22,681	21,240	23,032
Additional shares from assumed exercise of stock options	115	23	165	39
Weighted average shares adjusted for assumed exercise of stock options diluted	21,142	22,704	21,405	23,071

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

13. Subsequent Events

Crave Entertainment Group Acquisition

On November 22, 2005, Handleman Company acquired the stock of privately-owned Crave Entertainment Group, Inc. (Crave). Crave is a distributor of video game software, hardware and accessories and Crave-brand exclusively distributed video game software to major retailers throughout the United States. This acquisition expands the Company s customer base, broadens its product lines and provides growth opportunities for both organizations through cross-selling customers, services and products. The maximum purchase price for the acquisition of Crave totaled approximately $95,000,000 consisting of: (i) a $61,800,000 promissory note at closing (which is due and payable November 28, 2005) that is subject to certain adjustments based upon Crave s working capital and net assets, and is subject to increase to reimburse Crave s shareholders for increased taxes they will incur as a result of electing to treat the transaction as an asset purchase for tax purposes (the amount of which reimbursement has not yet been determined); (ii) approximately $5,300,000 representing a loan to Crave to repay term, subordinated and affiliate indebtedness; (iii) $5,000,000 paid into an escrow account to be distributed to the Crave shareholders 24 months after the closing date, subject to indemnification claims; (iv) up to $2,000,000 to be paid on or about January 2, 2008, if three certain Crave employees remain with that entity through December 31, 2007; and (v) up to $21,000,000 in earn out payments that are payable based upon Crave s adjusted EBITDA for the calendar years 2005, 2006 and 2007, as those figures are calculated for each of such years. In addition, Handleman Company also loaned $49,100,000 to Crave to repay Crave s revolving line of credit. The Company also paid a portion of the promissory note delivered at closing by loaning $2,900,000 to Crave to pay fees and expenses, and amounts payable to employee option holders. Handleman Company financed the transaction by borrowing against its revolving line of credit, as amended in November 2005.

The acquisition of Crave will be recorded in accordance with the provisions of SFAS No. 141, Business Combinations, and the operating results of Crave will be included in the Company s Consolidated Financial Statements beginning on the date of acquisition. The Company is in the process of obtaining a third-party valuation of the assets acquired from Crave. The valuation is expected to be completed in the third quarter of fiscal 2006.

Debt

On November 22, 2005, the Company entered into an amended and restated credit agreement with a consortium of banks for an unsecured revolving line of credit. The amended agreement extended the facility expiration date from August 2007 to November 2010 and increased the line of credit from $150,000,000 to $250,000,000. This facility will be incrementally reduced to $200,000,000 through 2009 (a $10,000,000 reduction in November 2007, a $20,000,000 reduction in November 2008, and a $20,000,000 reduction in November 2009).

The revolving credit agreement contains certain restrictions and covenants, relating to, among others, minimum debt service ratio, minimum leverage ratio and minimum consolidated net worth. The Company was in compliance with all of these covenants as of October 29, 2005. The Company had borrowings of $34,900,000 against its line of credit at October 29, 2005 and no borrowings as of April 30, 2005.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Handleman Company operates in one business segment as a category manager and distributor of prerecorded music to leading retailers in the United States (U.S.), United Kingdom (UK) and Canada. As a category manager, the Company manages a broad assortment of titles to optimize sales and inventory productivity in retail stores. Services offered include direct-to-store shipments, marketing and in-store merchandising.

During the first quarter of fiscal 2006, the Company acquired all of the operating assets and certain liabilities of REPS LLC (REPS). REPS provides nationwide in-store merchandising for home entertainment and consumer product brand owners at mass merchant, warehouse club and specialty retailers. The in-store merchandising structure of REPS is similar to the Company s in-store merchandising structure, thus providing the opportunity to consolidate certain functions and generate cost savings and synergies. See Note 3 of Notes to Consolidated Financial Statements for additional information related to the acquisition.

On November 22, 2005, the Company acquired the stock of privately-owned Crave Entertainment Group, Inc. (Crave). Crave is a distributor of video game software, hardware and accessories to major retailers throughout the United States. The acquisition of Crave expands the Company s customer base, broadens its product lines and allows growth opportunities for both organizations through cross-selling customers, services and products. The operating results of Crave will be included in the Company s Consolidated Financial Statements from the date of acquisition. See Note 13 of Notes to Consolidated Financial Statements for additional information related to the acquisition.

Overview

Net income for the second quarter of fiscal 2006 was $9.8 million or $0.46 per diluted share, compared to $8.2 million or $0.36 per diluted share for the second quarter of fiscal 2005. Net income for the second quarter of fiscal 2006 included income from continuing operations of $10.1 million or $0.48 per diluted share and a loss from discontinued operations of $0.4 million or $0.02 per diluted share; whereas net income for the second quarter of fiscal 2005 included income from continuing operations of $8.6 million or $0.38 per diluted share and a loss from discontinued operations of $0.5 million or $0.02 per diluted share.

Net income for the first six months of fiscal 2006 was $6.1 million or $0.29 per diluted share, compared to $9.1 million or $0.39 per diluted share for the first six months of fiscal 2005. Net income for the first six months of fiscal 2006 included income from continuing operations of $6.5 million or $0.31 per diluted share and a loss from discontinued operations of $0.4 million or $0.02 per diluted share; whereas net income for the first six months of fiscal 2005 included income from continuing operations of $9.6 million or $0.41 per diluted share and a loss from discontinued operations of $0.5 million or $0.02 per diluted share.

Results of Operations

Unless otherwise noted, the following discussion relates only to results from continuing operations. See Note 4 of Notes to Consolidated Financial Statements for a discussion of discontinued operations.

Revenues for the second quarter of fiscal 2006 improved to $302.2 million from $295.3 million for the second quarter of fiscal 2005. This improvement in revenues was mainly due to higher revenues in the UK and Canadian operations of $6.8 million and $5.9 million, respectively, as well as the addition of $5.0 million of revenue attributable to REPS. The increases in both the UK and Canada were primarily driven by higher consumer purchases of music in mass merchant retailers, although 48% of the increase in Canada was attributable to a strengthening of the local currency. These increases were offset, in part, by a $10.7 million decline in revenues in the U.S., which was principally attributable to a reassignment of 400 stores of a certain customer to another supplier during the first quarter of this year and overall weakness in music industry sales.

Revenues for the first six months of fiscal 2006 were $542.6 million, compared to $527.4 million for the first six months of fiscal 2005. This improvement in year-over-year revenues was mainly due to increased revenues in the UK and Canadian operations of $12.2 million and $8.9 million, respectively, as well as the addition of $6.7 million of revenue attributable to REPS. These increases in both the UK and Canada were the result of higher consumer purchases of music in mass merchant retailers, as previously discussed, although 56% of the increase in Canada was attributable to a strengthening of the local currency. These increases were offset, in part, by a $12.4 million decline in revenues in the U.S., which was related to the reassignment of customer stores.

Direct product costs as a percentage of revenues was 82.1% for the second quarter ended October 29, 2005, compared to 79.8% for the second quarter ended October 30, 2004. The increase in direct product costs as a percentage of revenues for the second quarter of fiscal 2006 was primarily attributable to the following: (i) increased revenues attributable to less than full category management services, which carry a higher direct product cost as a percentage of revenues than full category management services, contributed 1.2% to the overall increase in direct product costs as a percentage of revenues; (ii) increased customer rebates in the UK contributed 0.4% to the overall increase in direct product costs as a percentage of revenues; and (iii) higher than anticipated returns volume of product with a lower direct product cost (i.e. catalog titles) contributed 0.3% to the overall increase in direct product costs as a percentage of revenues. Direct product costs for the second quarters of fiscal 2006 and 2005 included costs associated with acquiring and preparing inventory for distribution of $4.4 million and $4.0 million, respectively.

Direct product costs as a percentage of revenues was 82.6% for the first six months of fiscal 2006, compared to 80.5% for the first six months of fiscal 2005. The increase in direct product costs as a percentage of revenues for the first six months of this year versus last year was mainly attributable to increased revenues from less than full category management services, as previously discussed, as well as a year-over-year increase of $1.6 million in costs associated with acquiring and preparing inventory for distribution. Direct product costs for the first six months of fiscal years 2006 and 2005 included costs associated with acquiring and preparing inventory for distribution of $8.2 million and $6.6 million, respectively.

Selling, general and administrative (SG&A) expenses were $47.4 million or 15.7% of revenues for the second quarter of fiscal 2006, compared to $47.6 million or 16.1% of revenues for the second quarter of fiscal 2005. The decrease in SG&A expenses over the comparable prior year period was due to (i) lower stock-based compensation expense of $1.5 million primarily resulting from a reduction in the market price of the Company s stock, and (ii) a reduction in compensation related costs of $1.3 million. These amounts were largely offset by the addition of REPS expenses of $2.5 million. SG&A expenses for the first six months of this year were $94.9 million or 17.5% of revenues, compared to $90.4 million or 17.2% of revenues for the first six months of last year.

Operating income for the second quarter of fiscal 2006 was $6.5 million, compared to operating income of $11.9 million for the second quarter of fiscal 2005. This decrease in operating income was principally due to increased direct product costs as previously discussed. The Company incurred an operating loss for the first six months of this fiscal year of $0.2 million, compared to operating income $12.3 million for the first six months of last fiscal year.

Investment income, net for the second quarter of fiscal 2006 was $3.8 million, compared to $1.3 million for the second quarter of fiscal 2005. During the second quarter of fiscal 2006, the Company recorded investment income of $3.8 million related to a gain on the sale of an investment in PRN, a company that provides in-store media networks. Under the terms of the sale agreement, the Company may receive additional proceeds of up to $2.0 million on the sale as follows: (i) $0.5 million in the third quarter of fiscal 2006 subject to finalization of working capital amounts; (ii) approximately $1.1 million in September 2006 from funds in escrow, subject to general indemnification claims; and (iii) approximately $0.4 million in

September 2009 from funds in escrow, subject to tax indemnification claims. During the second quarter of fiscal 2006, the Company recorded investment expense of $0.2 million related to investment losses on assets held for the Company s Supplemental Executive Retirement Plan compared to investment income related to investment gains of $0.6 million recorded in the second quarter of fiscal 2005. Investment income, net for the first six months of fiscal 2006 was $4.8 million, compared to $2.0 million for the first six months of fiscal 2005.

The effective income tax rates for the second quarters of fiscal 2006 and 2005 were 1.8% and 34.5%, respectively. The effective income tax rate for the first six months of fiscal 2006 was (40.6%), compared to 33.4% for the same period last year. The significantly lower income tax rates in both the second quarter and first six months of this year were due to the partial release of a valuation allowance related to a capital loss and the tax benefit resulting from the cancellation of a worthless debt from an insolvent subsidiary, both occurring in the second quarter of this fiscal year, in the amounts of $2,118,000 and $1,028,000, respectively.

Other

Accounts receivable at October 29, 2005 was $279.8 million, compared to $232.4 million at April 30, 2005. This increase was mainly due to the higher revenues in the second quarter of this year, compared to those in the fourth quarter of last year, which is attributable to the seasonal nature of the Company s business.

Merchandise inventories at October 29, 2005 was $212.7 million, compared to $115.7 million at April 30, 2005. The increase in merchandise inventories was principally due to increased inventory purchases to support the higher sales level anticipated in the third quarter of fiscal 2006 due to the upcoming holiday season.

Goodwill, net at October 29, 2005 was $10.3 million, compared to $3.4 million at April 30, 2005. The increase was due to goodwill associated with the acquisition of REPS during the first quarter of fiscal 2006. See Notes 3 and 5 of Notes to Consolidated Financial Statements for further information related to the REPS acquisition and the related goodwill and intangible assets, respectively.

Intangible assets, net at October 29, 2005 was $10.0 million, compared to zero at April 30, 2005. These intangible assets relate to the Company s newly acquired subsidiary, REPS, and are comprised of trademark, customer relationships and non-compete agreements. See Notes 3 and 5 of Notes to Consolidated Financial Statements for further information related to the REPS acquisition and the related goodwill and intangible assets, respectively.

Accounts payable was $270.2 million at October 29, 2005, compared to $133.3 million at April 30, 2005. The increase in accounts payable was primarily due to the higher inventory purchases and the timing of vendor payments.

Accrued and other liabilities decreased to $22.9 million at October 29, 2005 from $31.0 million at April 30, 2005. The decrease was predominately related to a decrease in accrued compensation related items.

Debt, non-current was $34.9 million at October 29, 2005, compared to zero at April 30, 2005. This increase was due to borrowings against the Company s line of credit in order to meet working capital requirements.

During the second quarter of fiscal 2006, the Company repurchased 688,100 shares of its common stock at an average price of $13.01 per share. As of October 29, 2005, the Company had repurchased 1,374,000 shares, or 42% of the shares under the current 15% share repurchase program authorized by its Board of Directors.

During fiscal 2004, the Company sold its Anchor Bay Entertainment subsidiary companies. In the third quarter of fiscal 2005, a licensor of Anchor Bay Entertainment initiated legal proceedings related to certain

royalty audit claims. The Company settled this matter with the licensor during the second quarter of fiscal 2006. See Note 4 of Notes to Consolidated Financial Statements for further discussion of this matter. There are no additional pending legal proceedings to which the Registrant or any of its subsidiaries is a party, other than routine legal matters which are incidental to the business and the ultimate outcome of which is not expected to be material to future results of consolidated operations, financial position and cash flows. The Company has provided for all claims and legal proceedings based on its best estimate of the amounts it expects to pay.

Liquidity and Capital Resources

The Company has an unsecured line of credit with a consortium of banks. In November 2005, the credit agreement was amended whereby the expiration date was extended from August 2007 to November 2010 and the line of credit was increased from $150.0 million to $250.0 million. This facility will be incrementally reduced to $200.0 million through 2009 (a $10.0 million reduction in November 2007, a $20.0 million reduction in November 2008, and a $20.0 million reduction in November 2009). Management believes that the revolving credit agreement, along with cash provided from operations, will provide sufficient liquidity to finance the acquisition of Crave Entertainment Group, fund the Company s day-to-day operations, including seasonal increases in working capital, as well as payments of cash dividends and repurchases of common stock under the Company s share repurchase program. The Company had borrowings of $34.9 million against its line of credit at October 29, 2005 and no borrowings as of April 30, 2005. As a result of the acquisition of REPS in the first quarter of fiscal 2006, the Company has recorded short-term notes payable totaling $1.3 million subject to any indemnification claims and confirmation of the purchase price, respectively. See Note 3 of Notes to Consolidated Financial Statements for more information related to the acquisition of REPS.

On September 7, 2005 the Company announced a quarterly cash dividend of $0.08 per share. As a result, $1.7 million was paid on October 7, 2005 to shareholders of record at the close of business on September 22, 2005. For the six months ended October 29, 2005, dividends totaling $3.4 million have been paid to shareholders, compared to $3.2 million paid in the comparable six-month period of last year.

Net cash used by operating activities for the six months ended October 29, 2005 was $0.2 million, compared to net cash used by operating activities of $23.1 million for the same six-month period of last year. This improvement was principally due to a favorable year-over-year change in accounts payable of $56.5 million, partially offset by unfavorable year-over-year changes in accounts receivable and inventory balances of $29.2 million and $5.0 million, respectively.

Net cash used by investing activities was $22.6 million for the six months ended October 29, 2005, compared to net cash used by investing activities of $10.4 million for the six months ended October 30, 2004. This change was primarily the result of the Company s cash investment in REPS LLC of $19.1 million, offset in part by proceeds from the sale of an investment and lower additions to property and equipment of $3.8 million and $3.1 million, respectively.

Net cash provided from financing activities was $19.6 million for the six months ended October 29, 2005 compared to net cash used by financing activities of $8.2 million for the comparable six-month period of last year. This change was principally due to a decline in the amount used to repurchase the Company s common stock of $16.6 million over the comparable six-month period last year, as well as an increase in net debt issuances of $9.9 million and checks issued in excess of cash balances of $1.9 million.

The following table summarizes the Company s contractual cash obligations and commitments as of October 29, 2005 along with their expected effects on its liquidity and cash flows in future periods (in thousands of dollars):

	Contractual Cash Obligations and Commitments				
	Total	Less than 1 Year	1 3 Years	4 5 Years	After 5 Years
Debt obligations	$ 34,900	$	$ 34,900	$	$
Notes payable	1,250	1,250			
Operating leases	32,216	3,714	18,122	5,127	5,253
Less: operating sub-leases	(1,900)	(204)	(1,221)	(475)	
Purchase obligations	20,782	20,782			
Other obligations	99,071	7,085	38,412	22,809	30,765
Outstanding letters of credit	3,361	3,361			
Total contractual cash obligations and commitments	$ 189,680	$ 35,988	$ 90,213	$ 27,461	$ 36,018

Operating leases represent non-cancelable operating leases entered into by the Company, primarily related to buildings and other equipment. Purchase obligations were those entered into through the normal course of business, principally related to the purchase of inventory. Other obligations mainly include contractual commitments for information technology related services.

Outlook

The Company s current customer base primarily operates in the mass merchant segment of the music industry. Specifically in the United States, music sales in the mass merchant segment declined, on a unit basis, over 6% in the second quarter of this fiscal year compared to the same quarter last year. This is the first decline in this segment in over two years and was driven by an overall weakness in U.S. music industry sales. Despite the unit sales performance, during the Company s second fiscal quarter, mass merchant retailers accounted for 39.5% of all units sold in the U.S., a 1.5% increase from its 38.0% market share during the same quarter last year.

The Company expects revenues for fiscal 2006 to increase by $70-$100 million over fiscal 2005, with the majority of the increase attributable to the inclusion of Crave and REPS. Forecasted revenues assume that the sales performance of new music releases, as well as holiday music sales, will be equal to the prior year s levels. Direct product costs as a percentage of revenues for fiscal 2006 are expected to be comparable to the rate achieved during the second quarter of this fiscal year. The increase over fiscal 2005 s direct product costs as a percentage of revenues is largely the result of increases in non-serviced, promotional and UK revenues, all of which have higher direct product costs as a percentage of revenues than the Company s consolidated direct product costs percentage. The Company expects fully diluted earnings per share from continuing operations for fiscal 2006 to be in the range of $1.36 to $1.40, compared to fully diluted earnings per share of $1.54 from continuing operations during fiscal 2005. This estimate for fiscal 2006 includes the capital gain and tax benefits recognized during the second quarter of this year, as well as $0.08-$0.10 of fully diluted earnings per share expected from Crave s operations.

* * * * * * * * * *

This document contains forward-looking statements, which are not historical facts. These statements involve risks and uncertainties and are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Actual results, events and performance could differ materially from those contemplated by these forward-looking statements including, without limitation, risks associated with achieving the business integration objectives expected with the Crave Entertainment Group acquisition, changes in the music and video game industries, continuation of satisfactory relationships with existing customers and suppliers, establishing satisfactory relationships with new customers and suppliers, effects of electronic commerce inclusive of digital music distribution, success of new music and video game releases, dependency on technology, ability to control costs, relationships with the Company s lenders, pricing and competitive pressures, dependence on third-party carriers to deliver products to customers, the ability to secure funding or generate sufficient cash required to build and grow new businesses, the occurrence of catastrophic events or acts of terrorism, certain global and regional economic conditions, and other factors detailed from time to time in the Company s filings with the Securities and Exchange Commission. Handleman Company notes that the preceding conditions are not a complete list of risks and uncertainties. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date of this document. Additional information that could cause actual results to differ materially from any forward-looking statements may be contained in the Company s Annual Report on Form 10-K.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company has no market risk from derivative instruments that would have a material effect on the Company s financial position, results of operations or cash flows.

Item 4. Controls and Procedures

An evaluation of the Company s disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 (the Act)) as of October 29, 2005 was carried out under the supervision and with the participation of the Company s Chief Executive Officer, Chief Financial Officer and several other members of the Company s senior management. The Company s Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures, as currently in effect, are effective in ensuring that the information required to be disclosed by the Company in the reports it files or submits under the Act is (i) accumulated and communicated to the Company s management (including the Chief Executive Officer and Chief Financial Officer) in a timely manner as appropriate to allow timely decisions regarding required disclosure, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms. There have been no changes in internal control over financial reporting (as defined in Rule 13a-15(f) of the Act) during the second fiscal quarter ended October 29, 2005 that have materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

The Company intends to continually review and evaluate the design and effectiveness of its disclosure controls and procedures and to improve its controls and procedures over time and to correct any deficiencies that it may discover in the future. The Company s goal is to ensure that senior management has timely access to all material financial and non-financial information concerning the Company s business. While the Company believes the present design of its disclosure controls and procedures is effective to achieve its goal, future events affecting its business may cause the Company to modify its disclosure controls and procedures.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

Reference should be made to Note 10 of Notes to Consolidated Financial Statements in this Form 10-Q for information on the Company s legal proceedings.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On February 23, 2005, the Company s Board of Directors authorized a share repurchase program. Under this authorization, which has no expiration date, the Company can repurchase up to 15% of its then outstanding balance of 21,787,611 shares. The table below sets forth information with respect to shares repurchased under the 15% authorization in the second quarter ended October 29, 2005.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs
July 31, 2005 through September 3, 2005	140,000	$ 14.250	140,000	2,442,242
September 4, 2005 through October 1, 2005	298,100	$ 13.164	298,100	2,144,142
October 2, 2005 through October 29, 2005	250,000	$ 12.126	250,000	1,894,142
Total	688,100	$ 13.008	688,100	1,894,142

Item 3. Defaults Upon Senior Securities

None.

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

An Annual Meeting of Shareholders of Handleman Company was held on September 7, 2005. One matter was voted at the Annual Meeting, the election of five directors. Thomas S. Wilson, who was elected for a two-year term, was added to the class expiring in 2007. Eugene A. Miller, P. Daniel Miller, Sandra E. Peterson and Irvin D. Reid were elected for three-year terms expiring in 2008. Messrs. Eugene A. Miller and P. Daniel Miller are not related. Following are the results of the vote: Thomas S. Wilson, 19,161,333 votes for, 711,024 withheld; Eugene A. Miller, 17,970,157 votes for, 1,902,200 votes withheld; P. Daniel Miller, 19,154,205 votes for, 718,152 votes withheld; Sandra E. Peterson, 18,447,419 votes for, 1,424,938 votes withheld; and Irvin D. Reid, 18,446,322 votes for, 1,426,035 votes withheld.

Subsequent to this election, on November 16, 2005 Sandra E. Peterson resigned from the Handleman Company Board of Directors for personal reasons.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit 10.1 Securities Purchase Agreement among Handleman Company and the Shareholders, Optionholders and Warrantholders of Crave Entertainment Group, Inc. dated October 18, 2005

Exhibit 10.2 Amendment to Securities Purchase Agreement dated November 22, 2005

Exhibit 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32 Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 Furnished to the Securities and Exchange Commission

SIGNATURES: Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	HANDLEMAN COMPANY	
DATE: December 8, 2005	BY:	/s/ Stephen Strome STEPHEN STROME
		Chairman of the Board and
		Chief Executive Officer
		(Principal Executive Officer)
DATE: December 8, 2005	BY:	/s/ Thomas C. Braum, Jr. THOMAS C. BRAUM, JR.
		Senior Vice President and
		Chief Financial Officer
		(Principal Financial Officer)