

EDCI HOLDINGS, INC.
Form 10-K
March 05, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal period ended December 31, 2009

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____
Commission File Number 001-34015

EDCI HOLDINGS, INC.
(Exact Name of Registrant as Specified in Its Charter)

DELAWARE 26-2694280
(State or Other Jurisdiction of (I.R.S. Employer Identification No.)
Incorporation or Organization)

11 East 44th Street, Suite 1201, New York, New York 10017
(Address of principal executive offices) (Zip Code)

(646) 401-0084
(Registrant's telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock, \$0.02 par value	The NASDAQ Stock Market LLC

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

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment of this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of Registrant, computed by reference to the closing price of the Registrant's common stock on June 30, 2009, was approximately \$29.0 million. The number of shares of the Registrants' common stock outstanding on March 1, 2010 was 6,730,099.

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We, from time to time, make “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements reflect the expectations of management at the time such statements are made. The reader can identify such forward-looking statements by the use of words such as “may,” “will,” “should,” “expects,” “plan,” “anticipates,” “believes,” “estimates,” “predicts,” “intend(s),” “potential,” “continue,” or the negative of such terms, or comparable terminology. Forward-looking statements also include the assumptions underlying or relating to any of the foregoing statements.

Actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors. All forward-looking statements included in this Report on Form 10-K are based on information available to us on the date hereof. We assume no obligation to update any forward-looking statements.

PART I

ITEM 1. BUSINESS

Overview

As of January 2010, EDCI Holdings, Inc. (“EDCI”) is a company engaged in a final Plan of Complete Liquidation and Dissolution (“Plan of Dissolution”) that was approved by EDCI’s shareholders at a Special Meeting held on January 7, 2010. The following overview relates to EDCI’s operations in 2009, prior to the approval of the Plan of Dissolution. In 2009, EDCI was a holding company and parent of Entertainment Distribution Company, Inc. which, together with its wholly owned and controlled majority owned subsidiaries, is a multi-national company that exists to enhance stockholder value by pursuing acquisition opportunities while continuing to oversee its majority investment in Entertainment Distribution Company, LLC (“EDC”), a business operating in the manufacturing and distribution segment of the entertainment industry. EDCI’s principal executive offices are located in New York City at 11 East 44th Street, Suite 1201, New York, New York, 10017 and its telephone number for investor relations is (646) 401-0084. In this Form 10-K, the terms “we,” “us,” “our” and “the Company” each refer to EDCI Holdings, Inc. and its wholly-owned and controlled majority owned subsidiaries on a consolidated bases unless the context requires otherwise. The term “EDCI” refers only to EDCI Holdings, Inc. and its direct and indirect wholly-owned subsidiaries, and the term “EDC” refers only to Entertainment Distribution Company, LLC, and its direct and indirect wholly-owned subsidiaries.

EDCI is currently comprised of the following: First, EDCI, indirectly through certain subsidiaries, owns 97.99% of the Limited Liability Company units of EDC, which was formed through the acquisition of the U.S. and central European CD and DVD manufacturing and distribution operations of Universal Music Group (“Universal”) in May 2005. Additionally, EDCI has approximately \$50.6 million of cash and cash equivalents that is unencumbered by EDC and U.S. net operating loss carry-forwards (“NOLs”) aggregating approximately \$295.6 million that do not begin to expire until 2019, which may potentially be used to offset future taxable income.

During 2009 we had one reportable business segment operated by our majority owned subsidiary, EDC. EDC provides pre-recorded products and distribution services to the optical disc industry with operations currently serving Central Europe and the United Kingdom (“UK”). EDC was formed by the acquisition of the U.S. and central European CD and DVD manufacturing and distribution operations from Universal in May 2005. As part of the transaction, EDC entered into supply agreements with Universal with initial terms of 10 years under which EDC became the exclusive manufacturer and distributor for Universal’s CD and DVD manufacturing requirements and distribution requirements for the U.S. and central Europe.

EDCI acquired its interest in EDC at a time when it was already apparent that CD volumes would decline over time and continue to be superseded, though at an unknown rate, by digital (vs. physical) means of distribution. At that time, industry forecast decline rates were generally in the mid-to-low single digit range and we believed that at those

decline levels it would be possible to replace lost units and grow the overall profitability of EDC by acquiring new customers, organically and through acquisitions, in both the core CD business as well as in adjacent industries that had long-term growth opportunities. EDC's supply agreements with Universal also provided for the "reversion" of certain units that Universal had outsourced to third parties that would further protect EDC from industry declines in the initial years of the contract. As a result, we believed the EDC business would potentially take advantage of EDCI's NOLs and remained focused on growing the EDC business. In furtherance of that strategy, in July 2006, EDC's presence in the European market was expanded through the acquisition of the largest CD manufacturing operation in the UK. This acquisition allowed EDC to secure all of Universal's UK CD manufacturing business.

During 2007, physical music CD unit sales for the industry in the United States declined 16% on a year over year basis. This severe decline rate materially affected the near-term profitability of EDC's U.S. business and also limited the long-term potential benefit of utilizing EDCI's NOLs. As it became evident during 2007 that these levels of declines were not abating, we determined that acquisitions by EDC, especially acquisitions requiring further investments of EDCI's cash in EDC, were no longer prudent. We therefore began to explore a sale or other divestiture of the EDC business with the expectation that after such a sale EDCI would then use its cash, NOLs and any additional cash resulting from the sale of EDC for another acquisition that would better utilize its NOLs.

When it became evident in early 2008 that there were no acquirers of EDC on acceptable terms, EDCI determined to concurrently explore acquisitions in alternative industries using EDCI's cash, while overseeing the EDC business, with a focus on cash flow and continuing to explore strategic alternatives for EDC as they become available.

Due to the decline in physical music CD unit sales, on December 31, 2008, the Company completed the sale of substantially all of the U.S. business of EDC to Sony DADC U.S., Inc ("Sony DADC") for \$26.0 million in cash and certain other consideration. Following the transaction, EDC continued to operate and serve its international customers through its facilities in Hannover, Germany and Blackburn, UK. All information related to EDC's U.S. operations is reflected as discontinued operations in this document, including information from prior periods.

On March 20, 2009, the Board of Directors of EDC approved a plan to consolidate EDC's Blackburn, UK and Hannover, Germany manufacturing volumes within the Hannover facility (the "Consolidation"). As a result of the Consolidation, EDC ceased substantially all of the operations presently conducted at its Blackburn facility in the United Kingdom as of December 31, 2009, with the intention of producing all of the manufacturing volume for Universal, its largest customer, in EDC's Hannover plant and plan to do so through the expiration of the Universal manufacturing agreements in May 2015. However, Universal has objected to EDC producing certain UK related volume at its Hannover plant and EDC has submitted the matter for arbitration. See Note 21. Final closure of the Blackburn facility is planned to occur prior to the next break option under the Blackburn facility lease on June 18, 2010, notice for which was given during the third quarter of 2009.

On September 9, 2009, the Board of Directors unanimously approved recommending a dissolution process to EDCI's stockholders, and on October 14, 2009 approved the final Plan of Dissolution of the Company. At a Special Meeting held on January 7, 2010 the voluntary dissolution and liquidation of EDCI pursuant to the Plan of Dissolution was approved by 99% of the stockholders voting in favor of the Plan of Dissolution. Delaware law provides that a corporation may dissolve upon the recommendation of the Board of Directors of the corporation, followed by the approval of its stockholders. As the Plan of Dissolution was approved by the requisite vote of our stockholders at the Special Meeting, we filed a certificate of dissolution with the Delaware Secretary of State in January 2010. The Plan of Dissolution provides for the voluntary dissolution, liquidation and winding up of EDCI. As of January 2010, we have ceased all of EDCI's business activities except for those relating to winding up EDCI's business and affairs during a minimum three-year period required under Delaware law, including, but not limited to, gradually settling and closing its business, prosecuting and defending suits by or against EDCI, seeking to convert EDCI's assets into cash or cash equivalents, discharging or making provision for discharging EDCI's known and unknown liabilities, making cash distributions to our stockholders, withdrawing from all jurisdictions in which EDCI is qualified to do business and, if EDCI is unable to convert any assets to cash or cash equivalents by the end of the three-year period, distributing EDCI's remaining assets in-kind among our stockholders according to their interests or placing them in a liquidating trust for the benefit of our stockholders, and, subject to statutory limitations, taking all other actions necessary to wind up the Company's business and affairs. On February 1, 2010, EDCI made an initial dissolution cash distribution of \$3.12 per share of its common stock. In the aggregate, approximately \$21.0 million of EDCI's cash was returned to shareholders pursuant to this initial distribution.

EDCI's indirect ownership of 97.99% of the membership units of EDC is an asset of EDCI that is subject to the Plan of Dissolution. The Plan of Dissolution does not directly involve the operating business, assets, liabilities or corporate existence of EDC and its subsidiaries, however, beginning in January 2010, EDCI's consolidated financials are required to reflect the value of EDC's assets and liabilities under liquidation accounting. During EDCI's three-year dissolution period, EDCI will continue to seek value for its investment in EDC by exploring strategic alternatives and seeking, as appropriate, cash distributions, subject to applicable legal requirements. While EDC is currently examining the possibility of making a dividend distribution from EDC's German subsidiaries to EDC, such a dividend remains subject to the future operating performance of EDC's German subsidiaries and compliance with German law, and the distribution of any cash from EDC to EDCI is subject to additional security obligations and additional U.S. legal considerations. However, EDCI is unable to provide any assurance that its efforts to seek value for its investment in EDC will result in any additional proceeds. In particular, the cooperation of Universal, EDC's largest customer, is critical to any sale of EDC's German subsidiaries and based on negotiations with a potential acquirer during the fourth quarter of 2009 and first quarter of 2010, EDC does not believe Universal will cooperate with any such transaction. As a result, any transaction involving the sale of EDC's German subsidiaries in the near term is unlikely. If EDCI continues to own any interest in EDC at the end of the three year dissolution period, EDCI anticipates transferring such interests to a liquidating trust, for the benefit of our stockholders.

EDC Business

EDC's core competencies are CD and DVD replication and logistic services, a market in decline. As an independent service provider, EDC is pursuing opportunities to increase revenue by providing a wider range of physical manufacturing, distribution and value added services to entertainment content owners and their customers. These opportunities consist of manufacturing and/or distribution services agreements with existing or new customers. The rate of decline experienced in EDC's international markets remains not nearly as severe as that experienced in the U.S. market, but continues to accelerate. On March 20, 2009, the Board of Directors of EDC approved a plan to consolidate EDC's Blackburn, UK and Hannover, Germany manufacturing volumes within the Hannover facility. As a result, EDC ceased substantially all of the operations presently conducted at its Blackburn facility in the United Kingdom as of December 31, 2009 with the intention of producing all of the manufacturing volume for Universal, its largest customer, in EDC's Hannover plant through the expiration of the Universal manufacturing agreements in May

2015. However, Universal has objected to EDC producing certain UK related volume at its Hannover plant and EDC has submitted the matter for arbitration. See Note 21.

Products

EDC's products include pre-recorded CDs and DVDs and manufactured jewel boxes and trays for the entertainment industry. Piracy and downloading of music through web sites have caused CD volumes to decline. EDC expects that file sharing and downloading, both legal and illegal, and portable personal digital devices will continue to exert downward pressure on the demand for CDs.

The digital transfer and downloading of video files has also become more widespread in large part due to improvement in the speed and quality with which video files can be transferred and downloaded. As a result, file sharing and downloading has exerted significant downward pressure on the demand for DVDs.

Professional Services

EDC offers an array of professional services including:

Distribution Services: product delivery to mass merchants' regional distribution centers and wholesalers. EDC provides direct to retail distribution in Europe and is well positioned to deliver pre-recorded products throughout Europe. The services provided are an integral part of EDC's customers' supply chain.

Printed Components and Packaging Services: purchase of printed components and assembly of shelf ready packages. In response to customer demand for more environmentally friendly packaging, EDC added the assembly of ECOPAK products to its service line.

Value Added Services: custodial responsibilities for inventory storage and control, returns processing, fulfillment of promotional product, retail price stickering, product quality evaluations, logistics advice, claims administration, data interfaces and cash collections.

Assembly Services: assembly of independently manufactured components for distribution to retail outlets.

Markets, Sales and Marketing

EDC provides CD and DVD manufacturing and distribution services to entertainment content providers in central Europe. EDC has sales personnel in Hannover, Germany covering Germany, Austria and Switzerland and the Benelux territories.

Competition

EDC's competitors include subsidiaries of media conglomerates that produce content while others, like EDC, are purely manufacturers and/or distributors. Competitors include:

Manufacturing only: MPO, OK Media, DocData and CD-A.

Manufacturing and Distribution: Arvato Digital Services, Cinram, Sony DADC/Sony Entertainment Distribution, MPO Fiege and Optimal Media Production.

Competition in the pre-recorded multimedia industry is intense and winning new customers, as well as maintaining existing customers, is based on a combination of price, capacity, quality and the level of service and support. EDC believes that its competency in providing complete end-to-end manufacturing and distribution supply chain services differentiates it from many of its competitors. However, some of EDC's competitors are larger and may have more resources available to them to help them manage their business and respond as the industry continues to experience a decline in demand.

Service and Support

EDC is an integral part of its customers' supply chain, managing and delivering products to mass merchant regional distribution centers and wholesalers, including direct to retail distribution. EDC coordinates the printed material and packaging functions and ships shelf-ready packages worldwide on demand. EDC generally does not own finished goods inventory. It provides custodial responsibilities for inventory management, and storage of finished goods and component parts, product quality evaluations, logistics advice, claims administration and data interfaces for its customers.

Customers

EDC's major customers are Universal, Navteq and Activision Blizzard.

Universal: EDC's manufacturing and distribution agreements with Universal accounted for approximately 84% and 73% of our 2009 and 2008 revenues, respectively. EDC plans, manages and monitors the use of resources based on regular forecasts provided by Universal. Because EDC is dependent on Universal for a significant amount of its revenues, if market or other factors cause Universal to reduce or postpone significant levels of current or expected purchase commitments for EDC's products, EDC's operating results and financial condition may be adversely affected. EDC is currently in arbitration with Universal on various matters which could significantly impact future revenues from Universal. See Note 21.

Other: All other customers of EDC accounted for, in the aggregate, approximately 16% and 27% of our 2009 and 2008 revenues, respectively. EDC has a business development and sales and marketing team focused on providing a high level of service to Universal as well as attracting new customers in the music, video, audio book and gaming markets.

International Sales

EDC's international sales, which in 2009 originated in Germany and the UK, are denominated in Euros and British pounds, respectively. See Note 22 to the consolidated financial statements for information concerning revenues and long-lived assets by geographic area.

Operations

Manufacturing: EDC currently manufactures its products for the European market at its facility in Hannover, Germany. EDC has an option to purchase the Hannover facility, which it currently leases from Universal. EDC believes that this facility is adequate for its current manufacturing needs.

Distribution: EDC distributes products for the European market at its facility in Hannover.

EDC believes in setting high standards of quality throughout its operations. EDC's Hannover, Germany, facility is registered Germany ISO 9001:2000 the international standard for quality assurance and ISO 14001 for environmental management. EDC believes that adhering to the stringent ISO 9001 and 14001 procedures not only creates efficiency in operations, but also positions EDC to meet the exacting standards required by its customers.

EDC is also a member of the Content Delivery and Storage Association (CDSA) and fully supports and complies with the worldwide CDSA Anti-Piracy program. This compliance program ensures that EDC only provides services to those intellectual property owners who have certified and documented ownership and proper use of content, thus ensuring the legitimacy of customer products.

Raw Materials and Components

EDC's principle raw materials are polystyrene used in the manufacture of jewel boxes and trays (in Germany only) and polycarbonate used in the manufacture of CDs and DVDs. EDC has a limited number of suppliers who are able to provide raw materials. In Germany, EDC purchases polystyrene, polycarbonate and any jewel boxes and trays, not internally manufactured, from several suppliers. These inputs are crucial to the production of CDs and DVDs and, while there are alternative suppliers of these products, it would be disruptive to EDC's production if any of its suppliers were unable to deliver its product to EDC.

Proprietary Technology

EDC has non-exclusive DVD replication licensing agreements with MPEG LA, the 3-C and AC-3 Groups (both administered by Philips Electronics), the 6-C Group (administered by Toshiba Corporation) and Discovision Associates.

Registered Trademarks

EDC's trademarks and service marks are also valued corporate assets protected through registrations in various foreign countries.

Government Regulation

EDC's manufacturing and distribution operations are subject to a range of federal, state, local and international laws and regulations relating to the environment. These include laws and regulations that govern discharges into the air, water and landfills and the handling and disposal of hazardous substances and wastes. EDC does not anticipate any material effect on its capital expenditures, earnings or competitive position in order to remain in compliance with government regulations involving environmental matters.

Seasonality

EDC typically manufactures and distributes approximately 53% to 58% of its annual demand by volume in the second half of the calendar year due to seasonality in the entertainment business. Variability is also experienced on a quarterly basis with the lowest demand typically being experienced in the first calendar quarter and with the highest demand occurring in the last calendar quarter. This seasonality cycles year over year and is influenced by EDC's customers' product release schedules.

Employees

At December 31, 2009, EDC employed approximately 800 persons. In Germany, approximately 43% of the workforce of 763 employees is unionized and all employees, including exempt staff, which represents approximately 4% of the total employees, are represented by a works council. Collective bargaining agreements and works council agreements cover all labor relations. In February 2008, EDC reached an agreement with the works council on an eight year tariff agreement which runs through 2015.

At December 31, 2009, EDC employed approximately 20 employees at its Blackburn, UK location for the specific purpose of winding down the business affairs of that operation and ensuring that the transition of business affairs from Blackburn to EDC's Hannover, Germany facility is completed. It is expected that EDC will employ certain personnel at its Blackburn facility through June 2010 at which point there will be no remaining business.

At December 31, 2009, EDCI had a core corporate staff of 11 employees.

SEC Filings

We make available all annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to such reports free of charge through our Internet website at www.edcih.com as soon as reasonably practicable after they are filed with, or furnished to, the Securities and Exchange Commission. These reports are also available on the Securities and Exchange Commission's Internet website at www.sec.gov.

Our code of ethics is posted on our Internet website at www.edcih.com. You can also receive a copy free of charge by sending an email request to investor.relations@edcih.com or by sending a written request to our offices at 11 East 44th Street, Suite 1201, New York, NY 10017, Attention: Investor Relations.

ITEM 1A. RISK FACTORS.

Not Applicable.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES

The following table sets forth certain information regarding EDCI's principal facilities used in its continuing operations:

Location	Size (Square Feet)	Owned Or Leased	Lease Expiration Date	Used
Blackburn, Lancashire, UK (1)	148,869	Leased	2010	Manufacturing facility and administrative offices for EDC UK information services, finance and accounting.
Fishers, Indiana, U.S.A.	2,600	Leased	2010	EDCI and EDC information services and corporate accounting and finance.
New York, New York, U.S.A.	1,323	Leased	2011	EDCI Corporate Headquarters
Hannover, Germany	738,000	Leased	2015	Manufacturing facility and full stocking warehouse and distribution center and administrative offices for EDC central Europe information services, finance and accounting.

(1) Final closure of EDC's UK manufacturing facility is planned to occur prior to the next break option for the majority of the facility under the Blackburn lease on June 18, 2010, notice for which was given during the third quarter of 2009. The lease break option on a small portion of our leased facility does not occur until September 2011.

In addition to the properties above, EDC owns the idle manufacturing facility located in Kings Mountain, North Carolina that was formerly used in EDC's U.S. manufacturing operations. We are taking steps towards selling the facility in 2010 and thus, the facility is classified and recorded in assets held for sale in the accompanying consolidated balance sheets and is valued at its fair value at December 31, 2009.

ITEM 3. LEGAL PROCEEDINGS

In addition to the legal proceedings discussed below, we are, from time to time, involved in various disputes and legal actions related to our business operations. While no assurance can be given regarding the outcome of these matters, based on information currently available, we believe that the resolution of these matters will not have a material adverse effect on our financial position or results of our future operations.

Arbitration Claim under the International Distribution Agreement. On February 27, 2009, EDC, at its election, provided notice to Universal International Music (“UIM”) of its demand to arbitrate certain allegations by UIM, which EDC believes lack any merit, that EDC had triggered certain “Key Failures” (or defaults) as defined in the International Distribution Agreement between EDC and UIM dated May 31, 2005 as amended (the “International Distribution Agreement”). UIM is part of Universal, which is EDC’s largest customer. EDC’s demand to arbitrate was in response to a notice from UIM dated February 19, 2009 alleging certain Key Failures related to EDC’s performance levels in July through December of 2008. In connection with the February 19, 2009 notice, UIM withdrew a prior Failure Notice issued on December 11, 2008, which notice EDC had also objected to and which EDC and UIM had been attempting to resolve in an amicable manner. The February 19, 2009 notice from UIM purported to be a substitution and restatement of many of the same underlying allegations set forth in the withdrawn December 11, 2008 notice, EDC determined that further attempts to resolve the matter amicably would not be successful. Accordingly, EDC determined to proceed to binding arbitration under the International Distribution Agreement and a hearing is scheduled for June 2010.

Under the International Distribution Agreement, EDC has various service level obligations it is required to maintain. Repeated failures to meet those service level obligations can result in Key Failures. In its February 19, 2009 notice, UIM alleged that EDC had incurred two Key Failures. EDC believes neither of the Key Failures are valid. Even if a Key Failure had been validly established by UIM, EDC is generally provided with a contractual opportunity to cure such, although as described below, based upon the nature of the Key Failures alleged by UIM and the timeframes in which they occurred, EDC would also face penalties for those two Key Failures – if they are both held to be valid – even if both Key Failures were cured.

There are various penalties for both cured and uncured Key Failures. Depending on whether one or two Key Failures were found valid at arbitration, and whether EDC were able to cure any such valid Key Failures, EDC could face the following: Upon each of the first two uncured Key Failures occurring within a five-year period, UIM has the right to source 30% of its distribution requirements under the International Distribution Agreement and / or 30% of its manufacturing requirements under the International Manufacturing Agreement between UIM and EDC dated May 31, 2005 (together with the International Distribution Agreement, the “Supply Agreements”) from a third party for a period of 12 months or receive liquidated damages in the amount of \$0.6 million as a credit against its payments under such contract. In addition, based upon the nature of the Key Failures alleged by UIM and the timeframes in which they occurred, EDC would also face penalties for those two Key Failures – if they are both held to be valid – even if both Key Failures were cured. The penalty in such an event, for both uncured Key Failures combined, would be the right by UIM to source 30% of its requirements under the Supply Agreements from a third party for a period of 12 months or receive liquidated damages in the amount of approximately \$0.6 million as a credit against its payments under such contract. EDC expects that UIM's entire contractually committed distribution and manufacturing volume under the Supply Agreements will represent approximately 88% of EDC's total manufacturing and distribution volume in 2010.

Upon the occurrence of additional Key Failures (which UIM has not asserted), additional penalties apply as follows. Upon the occurrence of three Key Failures within a five year period of the same category, UIM has the right to either source 100% of its distribution requirements under the International Distribution Agreement from a third party for the remaining term of the contract, terminate such contract outright or receive liquidated damages in the amount of \$1.7 million as a credit against its payments under such contract. Upon the occurrence of four Key Failures within a five

year period of any category, UIM has the right to either source 30% of its distribution requirements under the International Distribution Agreement from a third party for a period of 12 months, terminate such contract outright or receive liquidated damages in the amount of \$0.6 million as a credit against its payments under such contract. The occurrence of five Key Failures within a five year period of any category, whether cured or uncured, would provide UIM with the same damages as three Key Failures within a five year period of the same category.

As described above, EDC believes that no Key Failures have occurred and intends to vigorously defend its position in arbitration but at this early stage in these matters, EDC is not able to assess the likelihood of a favorable outcome. If EDC is unsuccessful in arbitration, the alleged Key Failures could result in substantial liquidated damages or the loss of volumes that, based on the high fixed cost nature of EDC's distribution operations, would have a material adverse effect on results of operations and cash flows, however, an amount cannot be estimated at this time. EDC may also be successful in its claim that no Key Failures have occurred, but the arbitration panel could reject EDC's interpretation of the underlying service levels as they are applicable to future performance, increasing the risk of future potential Key Failures. As described above, subsequent Key Failures – even if cured – could result in even greater damages and the ultimate right of UIM to terminate the International Distribution Agreement.

Anticipatory Breach of Manufacturing and Related Service Agreement Claim. On July 23, 2009, UIM provided notice to EDC of its claim that EDC was in anticipatory breach of the Manufacturing and Related Services Agreement between EDC and UIM dated May 31st, 2005, as amended (the "Manufacturing Agreement") by taking steps to close EDC's Blackburn facility. UIM claimed that the maintenance by EDC of a facility in the United Kingdom to service UIM's UK manufacturing requirements is a "fundamental implied term of the Manufacturing Agreement." As a result, UIM claimed that EDC forfeited its right to continue to service 100% of UIM's UK manufacturing requirements, and UIM is entitled to sub-contract the entirety of such volume to a UK - located third party of its choice. UIM at that time did not elect to enforce that remedy but reserved the right to do so by written notice. On July 28, 2009, EDC sent written notice to UIM forcefully refuting its claims and also asserting that UIM is attempting to imply a term into the Manufacturing Agreement that has been expressly dealt with in amendments to the agreement providing that EDC "will use its commercially reasonable endeavors to manufacture the majority of UIM's Manufacturing Requirements for the UK at the Blackburn Facility." As previously disclosed in March 2009, management of EDC determined and EDC's Board of Directors confirmed that it was no longer commercially reasonable to continue operating the Blackburn manufacturing facility. EDC stated in its July 28, 2009 response that UIM's claims in its July 23, 2009 letter constitute a gross violation of the covenant of good faith and fair dealing implied into the Manufacturing Agreement. EDC further provided notice to UIM that if UIM did not withdraw its claims in the July 23, 2009 notice within seven days of EDC's July 28, 2009 response, it would refer this matter to arbitration seeking a declaration that there is no breach by EDC of the Manufacturing Agreement as a result of the Blackburn – Hannover Consolidation and seeking damages for the losses incurred by EDC as a direct result of the July 23, 2009 letter and the continued breaches by UIM of the implied covenant of good faith and fair dealing. UIM did not withdraw its claims, and EDC therefore submitted the matter to arbitration in August 2009. An arbitration panel has yet to be agreed to by the parties and no date for the arbitration has been set.

In subsequent correspondence related to this matter, UIM indicated that it would begin to order 40% of its UK manufacturing requirements from third party manufacturers in 2010, while maintaining its claim that EDC had forfeited its right to continue to service 100% of those UK requirements. UIM also advanced additional theories under which EDC's closure of the Blackburn facility and the manufacture of UIM's UK volume out of EDC's Hannover facility would constitute a breach of the Manufacturing Agreement - including that EDC would be unable to meet its contractual service level obligations ("SLAs") for UIM UK requirements manufactured out of Hannover - and EDC's actions constitute a material breach of the Manufacturing Agreement entitling UIM to terminate the entire Manufacturing Agreement. EDC responded that these additional theories also lacked merit, that EDC could satisfy the SLAs and warned UIM of the legal consequences of breaching the Manufacturing Agreement by procuring 40% of its UK requirements from third parties. However, on January 14, 2010 EDC confirmed that UIM had begun to order certain of its UK requirements from third parties.

In consultation with counsel, EDC continues to believe UIM's claims and remedies lack merit. In particular, the Manufacturing Agreement expressly provides that EDC is only obliged to use its "commercially reasonable endeavors" to manufacture the majority of UIM's UK requirements at its Blackburn facility, and as previously disclosed in March 2009, at that time management of EDC determined and EDC's Board of Directors confirmed that it was no longer commercially reasonable to continue operating the Blackburn manufacturing facility. Further, EDC believes it can meet all SLAs for UIM's UK requirements manufactured from its Hannover facility and believes that certain of the UK requirements ordered by UIM were in fact ordered from Austria, a location that is geographically more distant from the UK than EDC's Hannover facility. However, if UIM were successful in its claims in arbitration EDC would face material and adverse consequences. The loss of 40% of UIM's UK requirements, based on the high fixed cost nature of EDC's manufacturing operations, would have a material adverse effect on its profitability. If UIM were to prevail in its new argument that EDC's breach provides UIM with the right to terminate the entire Manufacturing Agreement and UIM so elected, EDC would lose substantially all of its contractually committed manufacturing business. EDC expects that UIM's entire contractually committed manufacturing volume will represent approximately 75% of EDC's total manufacturing volume in 2010, that the UK requirements account for approximately 20% of EDC's total manufacturing volume, and thus 40% of the UK requirements account for approximately 8% of EDC's total manufacturing volume.

EDC believes UIM has breached its obligations to EDC with regard to certain of its UK requirements, and until resolved UIM will likely continue that breach by procuring up to 40% of its UK requirements from third parties. EDC will seek to recover those losses, other losses and punitive damages from UIM in arbitration. However, UIM's actions will also force EDC to evaluate other cost-reduction measures in Hannover to mitigate those damages in the short run.

EDC does not believe UIM's claim has merit and intends to vigorously defend and prosecute its position in arbitration but at this early stage in these matters, EDC is not able to assess the likelihood of a favorable outcome. However, if UIM were successful in its claim and enforced its alleged remedy, EDC could suffer loss of volumes that, based on the high fixed cost nature of EDC's manufacturing operations, would have a material adverse effect on its profitability.

Shareholder Derivative Actions: On September 6, 2006, Vladimir Gusinsky ("Gusinsky"), a Company shareholder, commenced a derivative action (the "Gusinsky Action") in the Supreme Court of the State of New York, New York County, against EDCI (as nominal defendant) and against certain of EDCI's current and former officers and directors as defendants. The complaint, as amended in December 2006 and January 2007, purportedly on behalf of EDCI, contained a variety of allegations relating to the backdating of certain stock option grants. On January 26, 2007 and February 7, 2007, two additional derivative actions were commenced in the United States District Court for the Southern District of New York by two different Company shareholders, Larry L. Stoll and Mark C. Neiswender, respectively (the "Subsequent Actions"). The Subsequent Actions were identical to each other and asserted the same claims as those asserted in the Gusinsky Action regarding a subset of the same option grants at issue in that action along with additional claims alleging violations of federal securities laws.

A Special Litigation Committee of the Board of Directors of EDCI, following an internal investigation, concluded that there was no conclusive or compelling evidence that any of the named defendants in the lawsuits breached the fiduciary duties of care or loyalty, or acted in bad faith with respect to their obligations to EDCI or its shareholders, and further concluded that it would not be in EDCI's best interest to pursue any claims with respect to these grants. EDCI also restated certain financial statements as a result of this internal investigation.

On January 30, 2008, all parties to the Gusinsky Action and the Subsequent Actions entered into an agreement to settle both actions. The agreement was subject to the approval of the Court. Pursuant to the settlement agreement, EDCI's insurer agreed to pay plaintiffs' counsel in the Gusinsky Action and the Subsequent Actions for their fees and expenses, and to pay for the costs of notifying the Company's shareholders of the settlement. EDCI also implemented certain changes to its Equity Compensation Policy and adopted related reform policies. In exchange, the plaintiffs in both the Gusinsky Action and the Subsequent Actions agreed to dismiss their claims with prejudice, forego any appeals and release all the defendants from all claims that were or could have been asserted in either action and arise out of or are based upon or relate in any way to any of the allegations set forth in the complaints. The papers in support of preliminary approval of the settlement were filed in the Gusinsky Action on January 31, 2008 and on April 30, 2008 the Court granted preliminary approval of the settlement and scheduled a settlement hearing. On September 17, 2008, the Court issued a final order approving the settlement, but denying plaintiffs' counsels' application for fees and expenses. A judgment to that effect was then entered by the Court on September 25, 2008.

On October 23, 2008, plaintiffs in the Subsequent Actions moved for leave to reinstate their appeal of the federal court's dismissal of the Subsequent Actions on the basis that the state court should not have approved the settlement. On January 12, 2009, the federal court denied that motion. On July 13, 2009, the plaintiffs appealed under state law solely from that aspect of the state court decision that denied their application for attorney's fees. Pursuant to the settlement, EDCI's insurer has already agreed to pay plaintiffs' attorney's fees in the amount requested in the July 13, 2009 appeal, subject to approval by the Court, and EDCI agreed not to oppose any such application for attorney's fees. On December 17, 2009, the Court approved the plaintiffs' appeal and awarded the requested attorney's fees, which fees were paid by EDCI's insurer in accordance with the previous settlement agreement. EDCI had further sought reimbursement for the insurable portions of certain fees incurred related to this matter from its insurer, including through the initiation of litigation in 2009. On February 8, 2010, EDCI settled all related claims with its insurer for a payment to EDCI of \$1.5 million.

Patent Litigation: In March 2008, EDC was served as a defendant in an action by Koninklijke Philips Electronics N. V. and U.S. Philips Corporation, pending in the U. S. District Court for the Eastern District of Texas, Beaumont Division, filed on January 18, 2008. This complaint was dismissed without prejudice on April 30, 2008 and a substantially similar action was filed in the U.S. District Court for the Southern District of New York (the "NY Complaint") on April 30, 2008. In the NY Complaint, plaintiffs allege breach of contract for failure to pay royalties and patent infringement and claim unspecified damages and, in addition to naming EDC and the Company, have named James Caparro and Jordan Copland as defendants in their capacities as former CEOs of EDC. In 2009, the Court denied plaintiffs' motion for a summary judgment that EDC breached the contract. Pending before the Court is a motion for summary judgment that there is no patent infringement by EDC. The Court has stayed the motion for summary judgment pending a decision on claim construction, a hearing for which was held in December, 2009. On January 22, 2010, the Court dismissed the action against the individual defendants, Messrs. Caparro and Copland. EDC does not believe the complaint has merit, intends to vigorously defend this action and believes it has indemnification rights under certain contractual arrangements covering a substantial portion of the alleged infringement but at this early stage in the matter, EDC is not able to assess the likelihood of a favorable outcome. The case is still pending and discovery and motion practice are continuing.

In July 2008, Koninklijke Philips Electronics N.V. filed a similar claim with the Brunswick Regional Court in Germany against a subsidiary of EDC, demanding payment of approximately \$1.8 million plus interest. In November 2009, EDC and Koninklijke Philips Electronics N.V. reached a settlement of the dispute in which the full amount of the claim was agreed to be paid. EDC was fully indemnified for the claim under the Manufacturing Agreement with UIM and as such incurred no cost as a result of the settlement.

Michael W. Klin