

HANDLEMAN CO /MI/
Form 10-Q
December 08, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended October 30, 2010

or

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 1-7923

HANDLEMAN COMPANY

(Exact name of registrant as specified in its charter)

MICHIGAN
(State or other jurisdiction of incorporation or organization)

38-1242806
(I.R.S. Employer Identification No.)

500 Kirts Boulevard, Troy, Michigan
(Address of principal executive offices)

48084-5225
(Zip Code)

Registrant's telephone number, including area code: 248-362-4400

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 at least the past 90 days.

YES NO

Indicate by checkmark 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).

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YES NO

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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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 Rule 12b-2 of the Act).

YES NO

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. The number of shares of common stock outstanding as of November 5, 2010 was 20,500,181.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

HANDLEMAN COMPANY

CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

FOR THE PERIOD MAY 1, 2010 TO OCTOBER 30, 2010

(LIQUIDATION BASIS, UNAUDITED)

(in thousands of dollars)

| | |
|---|----------|
| Net assets as of May 1, 2010 | \$ 1,667 |
| Adjust assets and liabilities to fair value | (330) |
| Adjustment to accrued liquidation costs pension | 858 |
| Adjustment to accrued liquidation costs other | (25) |
| Net assets as of July 31, 2010 | \$ 2,170 |
| Adjust assets and liabilities to fair value | 587 |
| Federal income tax provision | (4,100) |
| Adjustment to accrued liquidation costs pension | 3,980 |
| Adjustment to accrued liquidation costs other | (86) |
| Net assets available to shareholders as of October 30, 2010 | \$ 2,551 |

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

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HANDLEMAN COMPANY
 CONSOLIDATED STATEMENTS OF NET ASSETS
 AS OF OCTOBER 30, 2010 AND MAY 1, 2010
 (LIQUIDATION BASIS)
 (in thousands of dollars)

| | October 30, 2010 (Unaudited) | May 1, 2010 |
|--------------------------------------|------------------------------------|----------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 31,592 | \$ 35,194 |
| Other receivables | 1,123 | 1,272 |
| Other current assets | 1,244 | 1,992 |
| Total assets | \$ 33,959 | \$ 38,458 |
| LIABILITIES | | |
| Current liabilities: | | |
| Accounts payable | \$ 49 | \$ 65 |
| Accrued and other liabilities | 15,345 | 11,831 |
| Accrued liquidation costs | 16,014 | 24,895 |
| Total liabilities | \$ 31,408 | \$ 36,791 |
| Net assets available to shareholders | \$ 2,551 | \$ 1,667 |

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

At the annual shareholders' meeting on October 1, 2008, the Company's shareholders approved a Plan of Final Liquidation of the Company and on May 5, 2009, the Company filed a Certificate of Dissolution with the State of Michigan. Through the liquidation period, if the Company is able to realize cash proceeds in excess of what is needed to satisfy all the Company's obligations, the Company will distribute any such proceeds to shareholders. The actual amount and timing of future liquidating distributions, if any, to shareholders is dependent upon the resolution of all open items and periods with taxing authorities; the ultimate settlement amounts of the Company's liabilities and obligations, in particular the Company's pension obligations; actual costs incurred in connection with carrying out the Company's Plan of Final Liquidation, including administrative costs during the liquidation period; and market fluctuations in the discount rate as it relates to the settlement of pension plans.

As a result of the Company's shareholders' approval of the Plan of Final Liquidation, the Company adopted the liquidation basis of accounting as of October 5, 2008, which was the beginning of the fiscal month closest to the shareholders' approval date.

Liquidation Basis of Accounting

The liquidation basis of accounting is appropriate when the liquidation of a company appears imminent and the net realizable value of its assets is reasonably determinable. Under this basis of accounting, assets are stated at their net realizable value, liabilities are stated at their estimated settlement amounts, and estimated costs through the liquidation date are provided to the extent reasonably determinable.

The Company is required to make significant estimates and exercise judgment in determining accrued liquidation costs. The Company accrued costs expected to be incurred in liquidation and recorded payments made related to the accrued liquidation costs as follows (in thousands of dollars):

| | As Booked | Adjustments to Reserves | Payments | Balance at October 30, 2010 |
|----------------------------------|------------------|-------------------------------|-------------------|--------------------------------------|
| Accrued Liquidation Costs | | | | |
| U.S. pension plan costs | \$ 17,171 | \$ (4,838) | \$ | \$ 12,333 |
| Outside services | 2,929 | 34 | (834) | 2,129 |
| Contractual commitments | 2,279 | 5 | (2,183) | 101 |
| Payroll related costs | 1,164 | 23 | (413) | 774 |
| Other | 1,352 | 48 | (723) | 677 |
| Total | \$ 24,895 | \$ (4,728) | \$ (4,153) | \$ 16,014 |

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

The Company has a qualified defined benefit pension plan that covers substantially all full-time United States (U.S.) employees. The Company performed an actuarial valuation analysis as of May 1, 2010 assuming the pension plan would be terminated through the purchase of non-participating group annuity contracts. This resulted in an estimated termination cost of \$17,171,000 at May 1, 2010, which was included in accrued liquidation costs as of that date. The estimated cost to settle the U.S. pension plan as of May 1, 2010 was based upon an average discount rate of 4.61% derived from interest rates published by the Pension Benefit Guaranty Corporation (PBGC) for the specific purpose of determining the present value of annuities in involuntary and distress terminations of single-employer plans. As of May 1, 2010, the U.S. pension plan assets totaled \$46,038,000 and the U.S. pension plan termination liability totaled \$63,209,000.

The Company performed an actuarial valuation analysis as of July 31, 2010, which indicated that the estimated termination cost for the U.S. pension plan decreased to \$16,313,000 as of July 31, 2010. The U.S. pension plan assets were \$46,196,000 and the U.S. pension plan termination liability totaled \$62,509,000 at July 31, 2010, using an average discount rate of 4.77% derived from rates published by the PBGC. The decrease in estimated termination cost was primarily driven by the change in the discount rate.

On November 22, 2010, the Company s Board of Director s approved an amendment to the U.S. pension plan that will allow participants to settle their pension with either a lump sum payout or the purchase of a non-participating group annuity contract. Based on actuarial statistics, the Company estimates that a substantial majority of participants will choose the lump sum payout. The Company performed an actuarial valuation analysis as of October 30, 2010 assuming the pension plan would be terminated with lump sum distributions or the purchase of non-participating group annuity contracts. This resulted in an estimated termination cost of \$12,333,000 at October 30, 2010. The U.S. pension plan assets were \$46,558,000 and the U.S. pension plan liability totaled \$58,891,000, using an average discount rate of 4.50% derived from rates published by the PBGC. The decrease in the estimated termination costs is primarily due to the projected payment of lump sum distributions offset by the decrease in the average discount rate for those participants that select the annuity option.

The estimated termination cost for the Canadian pension plan as of October 30, 2010 totaled \$681,000 and has been accrued under Accrued and other liabilities in the Company s Consolidated Statements of Net Assets.

The final settlement amounts of the U.S. and Canadian pension plans could differ from these estimates due to changes in market conditions that could affect discount rates and returns on plan assets and due to the number of participants that elect the lump sum payout.

On a quarterly basis, the Company reviews all other remaining operating expenses and contractual commitments such as payroll and related expenses, lease termination costs, professional fees and other outside services to determine the estimated costs to be incurred during the liquidation period. The Company anticipates that wind down related costs will extend through calendar 2011 at a minimum as it settles the pension plans.

The estimate of other costs in the accrued costs of liquidation was increased by \$48,000 during fiscal 2010.

Federal Income Tax Refund

On November 6, 2009, H.R. 3548, the Worker, Homeownership, and Business Assistance Act of 2009 (the Act) was enacted. Although the Act deals principally with the extension of unemployment benefits and mortgage relief, it also extends to all businesses the five-year net operating loss carryback previously available only to small businesses. The Act provides that a business of any size may elect to carry back net operating losses incurred in 2008 or 2009 (but not both) for three, four or five years.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

During the third quarter of fiscal 2010, the Company determined that it would carry back approximately \$33.0 million of tax-basis net operating losses from fiscal 2008 and filed for a \$10.4 million refund on Form 1139. During the fourth quarter of fiscal 2010, the Company collected the resulting \$10.4 million refund. The IRS began an examination of the tax returns giving rise to the refund during the first quarter of fiscal 2011. In November 2010, Handleman Company and the IRS agreed to settle disputed tax matters through 2009. The Company estimates it will repay \$4.6 million to the IRS related to this settlement, including interest. This amount is not final and is subject to approval by the IRS. \$4.1 million was accrued in the second quarter of fiscal 2011 and the remaining \$0.5 million was previously accrued during the first quarter of fiscal 2011. The full amount is included in Accrued and other liabilities on the Company's Consolidated Statement of Net Assets as of October 30, 2010.

Dissolution

On May 5, 2009, Handleman Company filed a Certificate of Dissolution with the State of Michigan. As a dissolved company, Handleman is continuing its corporate existence, but is not conducting business, except for the purpose of winding down the business. Accordingly, Handleman's activities are now limited to: selling, collecting or otherwise realizing the value of its remaining assets; making tax and other regulatory filings; winding down the Company's remaining business activities; paying (or adequately providing for the payment) of all non-barred, valid claims and obligations; and making distributions to Handleman's shareholders. Based on the Company's net asset balance as of October 30, 2010, proceeds from the liquidation of assets are expected to be sufficient to provide payment in full to its creditors and a distribution to shareholders. Payments during the liquidation period will be prioritized in the following hierarchy: (i) wind down related costs, including supplier costs necessary to the wind down of the business and employee obligations such as on-going salaries, fringe benefits and retention costs; (ii) Handleman Company income tax and other regulatory filing fees; (iii) payments of other unsecured valid creditor claims and obligations, including the purchase of non-participating group annuity contracts or lump sum payments to supplement the terminated U.S. and Canadian pension plans; and (iv) shareholder distribution. Creditors will be paid according to their priority in the hierarchy and pro rata, if necessary, within the priority category.

On May 6, 2009, Handleman Company petitioned the Circuit Court for Oakland County, State of Michigan, for an Order of Limited Supervision over the Liquidation of Handleman post-dissolution. On May 20, 2009, the court order was granted and declared that shares of Handleman common stock became non-transferable 30 days after notification to shareholders. Accordingly, Handleman Company's common shares became non-transferable on June 20, 2009. This allows the Company to reduce costs during liquidation and maximize the liquidated value of the Company for the benefit of its creditors and potential benefit to its shareholders. The Company will distribute proceeds, if any, to shareholders in proportion to their interests as of the close of business on June 20, 2009, the date of record.

The Company anticipates that payment of creditor claims and distribution to shareholders is likely to occur in the next nine to twelve months. The actual amount and timing of future liquidating distributions, if any, to creditors and shareholders is dependent upon the resolution of all open items and periods with taxing authorities; the ultimate settlement amounts of the Company's liabilities and obligations, in particular the Company's pension obligations; actual costs incurred in connection with carrying out the Company's Plan of Final Liquidation, including administrative costs during the liquidation period; and market fluctuations in the discount rate as it relates to the settlement of pension plans.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

2. Other Current Assets

The Other current assets line item in the Company's Consolidated Statements of Net Assets as of October 30, 2010 consisted of taxes receivable of \$610,000, estimated net settlement of worker compensation activities of \$528,000, the AP Services, LLC (APS) prepaid retainer of \$100,000 and other current assets of \$6,000.

3. Pension Plan

The Company has two qualified defined benefit pension plans (pension plans) that cover substantially all full-time U.S. and Canadian employees.

During the first quarter of fiscal 2007, the Company's Board of Directors approved amendments to freeze the U.S. pension plan. Subsequently, on March 11, 2009, the Company's Compensation Committee of the Board of Directors approved the termination of the U.S. pension plan in fiscal 2010, or thereafter. On November 22, 2010, the Company's Board of Directors approved an amendment to the U.S. pension plan that will allow participants to settle their pension with either a lump sum payout or the purchase of a non-participating group annuity contract. Approval from the Internal Revenue Service and Pension Benefit Guaranty Corporation is required and will be solicited in the third quarter of fiscal 2010. Under the liquidation basis of accounting, the Company has \$12,333,000 accrued in the costs of liquidation as of October 30, 2010 assuming that a substantial majority of participants will elect the lump sum payout settlement option. This settlement is subject to the same payout percentage and same timing as all other unsecured creditors under the liquidation basis of accounting. See Note 1 of Notes to Consolidated Financial Statements for additional information related to the U.S. pension plan termination.

During the fourth quarter of fiscal 2008, the Company's Board of Directors approved amendments to freeze the Canadian pension plan. On July 31, 2008, the Company's Compensation Committee of the Board of Directors approved the termination of the Canadian pension plan. The estimated settlement amount of the Canadian pension plan is \$681,000 as of October 30, 2010 based on an updated termination cost. Approval to terminate the Canadian pension plan was received from the Financial Services Commission of Ontario in fiscal 2010; however, the Company will not settle the plan until it is fully funded. Settlement is subject to the same payout percentage and same timing as all other unsecured creditors under the liquidation basis of accounting.

During the first six months of fiscal 2011, the Company made no contributions to the Canadian pension plan. Final contributions to the U.S. and Canadian pension plans will not be determined until the net assets of the Company are distributed.

4. Contingencies

Contingencies

The Company had a contingent liability with a certain state taxing authority related to the filing and payment of franchise taxes. The Company believed that it filed and paid these taxes appropriately, and filed a protest with this taxing authority. The state court ruled in the Company's favor on this matter in February 2009. In the fourth quarter of fiscal 2009, the state taxing authority filed an appeal to this state court decision and in the first quarter of fiscal 2011, oral arguments were heard by the State Court of Appeals. The Court has issued their decision in favor of the Company and because no reserves were previously established there is no accounting impact.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

During the second quarter of fiscal 2011, the Company identified a contingent liability with a certain taxing authority related to the acquisition of Crave Entertainment Group, Inc. ("Crave"). The 2004 and 2005 tax records of Crave are currently being reviewed by said taxing authority and, as such, Handleman may have exposure in the range of \$150,000 to \$1,100,000. At the time of acquisition in fiscal 2006, the former owners of Crave provided the Company with tax indemnification agreements. Under the terms of the agreements, Handleman is potentially liable for a maximum of \$150,000 for any tax issues that arise subsequent to the acquisition date. The Company has established a reserve of \$150,000 in the accrued liquidation costs as of October 30, 2010 related to this contingent liability.

The Company has tax indemnification agreements related to the sale of each subsidiary company. Under the terms of the agreements, the Company may be responsible for any tax liabilities identified subsequent to the sale of those companies.

Litigation

The Company is not currently involved in any legal proceedings that are material or for which it does not believe it has adequate reserves. Any other legal proceedings in which the Company is involved are routine legal matters that are incidental to the wind down of business operations. The Company establishes reserves for all claims and legal proceedings based on its best estimate of the amounts it expects to pay.

5. Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. As of October 30, 2010 and May 1, 2010, the Company had disposed of substantially all of its operations and has significant accumulated net operating losses and related deferred tax assets. The Company has no expectation of generating future profits. As a result, the Company established a valuation allowance against all of its net deferred tax assets except those existing at its Canadian operating subsidiary. A valuation allowance has been recognized to offset deferred tax assets because the Company cannot conclude that it is more likely than not that the deferred tax assets will be realized in the foreseeable future. With respect to its Canadian operations, the Company has a net deferred tax asset as of October 30, 2010 of approximately \$231,000 relating to the Company's Canadian pension. A valuation allowance was not established against this net deferred tax asset as the Company is eligible to file a carryback claim to recover taxes paid in prior years.

The Company's estimated net tax liability was \$12,758,000 as of October 30, 2010. The Company's estimates of tax implications related to the liquidation of the Company are subject to change, perhaps significantly, as the Company continues to finalize tax matters.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

6. Related Party Transactions

In November 2007, the Board of Directors appointed Mr. Albert A. Koch as Handleman's President and Chief Executive Officer (CEO) through Handleman's engagement of AP Services. APS is affiliated with AlixPartners, a financial advisory and consulting firm, where Mr. Koch is a Vice Chairman, Managing Director and Partner.

All APS staffing was approved, in advance of their engagement by Handleman, by the CEO Governing Committee, which was a Committee of the Board that was formed to oversee the AlixPartners engagement. The Company now engages Mr. Koch on a part-time basis.

In addition to an hourly rate and time commitment for services, Handleman's agreement, as amended, provides that Handleman will pay APS a success fee based on 5% of the fair value of cash and/or other assets that is distributed to shareholders if such a distribution is approved by the Company's Board of Directors. The success fee shall be paid in cash, concurrent with the date or dates that distributions are made to Handleman Company's shareholders. As of October 30, 2010, the Company has accrued \$128,000 for the success fee, which is included in the accrued liquidation costs in the Company's Consolidated Statements of Net Assets.

This relationship results in a related party transaction because the APS consultants may control or significantly influence the management and operating policies of the Company.

The Company had originally prepaid \$250,000 related to the CEO retainer. During the second quarter of fiscal 2010, the Company received a refund of \$150,000 of the retainer. The remaining \$100,000 prepaid retainer is included in Other current assets in the Company's Consolidated Statements of Net Assets. For the six months ended October 30, 2010, the Company has recorded total costs of \$25,000 related to the APS agreement and has another \$465,000 included in accrued liquidation costs in the Company's Consolidated Statements of Net Assets as of October 30, 2010.

7. Subsequent Events

Events and transactions have been evaluated subsequent to October 30, 2010 for items that could potentially be recognized or disclosed in these financial statements.

On November 22, 2010, the Company's Board of Directors approved an amendment to the U.S. pension plan that will allow participants to settle their pension with either a lump sum payout or the purchase of a non-participating group annuity contract. See Note 1 of Notes to Consolidated Financial Statements for additional information.

On November 22, 2010, the Company's Board of Directors also approved a change in the employment status for Rozanne Kokko effective January 2, 2011. Ms. Kokko will continue to serve as the Company's Senior Vice President and Chief Financial Officer, but will do so on a consulting basis due to the reduced workload during the wind down period.

On November 12, 2010, Handleman Company and the IRS agreed to settle disputed tax matters through 2009. The Company estimates it will repay \$4.6 million to the IRS, including interest. This amount is not final and is subject to IRS approval. \$4.1 million was accrued in the second quarter of fiscal 2011 and the remaining \$0.5 million was previously accrued during the first quarter of fiscal 2011.

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Item 2.

Handleman Company
Management's Discussion and Analysis of
Financial Condition and Results of Operations

At the Company's annual shareholders' meeting on October 1, 2008, the Company's shareholders approved a Plan of Final Liquidation of the Company. As a result of this approval, the Company adopted the liquidation basis of accounting as of October 5, 2008. This basis of accounting is appropriate when the liquidation of a company appears imminent and the net realizable value of its assets is reasonably determinable. Under this basis of accounting, assets and liabilities are stated at their net realizable value, and estimated costs through the liquidation date are provided to the extent reasonably determinable.

On May 5, 2009, Handleman Company filed a Certificate of Dissolution with the Michigan Department of Energy, Labor and Economic Growth, Bureau of Commercial Services, Corporate Division. As a dissolved company, Handleman is continuing its corporate existence, but is not conducting business, except for the purpose of winding down its affairs. Under State of Michigan law, before making any distribution to shareholders, a dissolved corporation must pay or make provision for its non-barred, valid debts, including those obligations that arise after the effective date of dissolution, but before the bar date and before the distribution. Accordingly, Handleman's activities are now limited to: selling, collecting or otherwise realizing the value of its remaining assets; making tax and other regulatory filings; winding down the Company's remaining business activities; paying (or adequately providing for the payment) of all non-barred, valid creditor claims and obligations; and making a distribution to Handleman's shareholders.

The Company must complete the termination of the U.S. and Canadian pension plans. Pursuant to Board of Directors' approval on March 11, 2009 for the termination of the United States (U.S.) pension plan, and the subsequent approval of an amendment on November 22, 2010, the Company will terminate this pension plan and will pay participants either in a lump sum payout or through the purchase of an annuity contract, dependent upon the participant's selection of payment. The Canadian pension plan, which received Board of Directors approval for termination early in fiscal 2009, will also be paid to participants, either by lump sum payout or through the purchase of an annuity contract, dependent upon the participant's selection of payment. These pension initiatives are expected to be completed, subject to regulatory approval and at the same payout percentage and at the same timing as other unsecured creditor claims. The final settlement amounts of the U.S. and Canadian pension plans could differ from these estimates due to changes in market conditions, which could affect discount rates and returns on plan assets and due to the number of participants that elect the lump sum payout. The Company must also resolve tax matters that may require management to adjust tax assets and liabilities, perhaps significantly.

On November 6, 2009, H.R. 3548, the Worker, Homeownership, and Business Assistance Act of 2009 (the Act) was enacted. Although the Act deals principally with the extension of unemployment benefits and mortgage relief, it also extends, to all businesses, the five-year net operating loss carryback previously available only to small businesses. The Act provides that a business of any size may elect to carryback net operating losses incurred in 2008 or 2009 (but not both) for three, four or five years. During the third quarter of fiscal 2010, Handleman Company determined that it would carry back fiscal 2008 net operating losses and filed for a \$10.4 million refund on Form 1139. On February 22, 2010, the Company received a refund in the amount of \$10.4 million from the IRS. The IRS began an examination of the tax returns giving rise to the refund during the first quarter of fiscal 2011. On November 12, 2010, Handleman Company and the IRS agreed to settle disputed tax matters through 2009. The Company estimates it will repay \$4.6 million to the IRS, including interest. This amount is not final and is subject to approval by the IRS. During the first quarter of fiscal 2011, the Company accrued \$0.5 million and an additional \$4.1 million was accrued during the second quarter. A prepayment of \$4.4 million was made in November 2010 to stop additional interest from being accrued.

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Based on the Company's net asset balance as of October 30, 2010, the Company believes that it will have sufficient liquidity to fund the Company's wind down related costs and provide payment in full to its creditors. These distributions are primarily dependent upon the resolution of all open items and periods with taxing authorities and the costs to fund existing pension obligations. If the Company is unable to resolve outstanding tax issues in a reasonable period of time or if pension costs increase significantly, the Company's ability to settle its liabilities in full while incurring necessary wind down costs would be in doubt. If the Company is able to generate cash proceeds in excess of what is needed to satisfy all of the Company's obligations, the Company will distribute any such proceeds to shareholders. Whether there will be any excess cash proceeds for distribution to shareholders is subject to a number of material risks and uncertainties that may prevent any such distribution from occurring. Accordingly, while the Company believes that a cash distribution is possible, actual results may differ from current estimates, perhaps materially, possibly resulting in no excess cash proceeds available for distribution to shareholders.

Payments during the liquidation period will be prioritized in the following hierarchy: (i) wind down related costs, including supplier costs necessary to the wind down of the business, employee obligations such as on-going salaries, fringe benefits and retention costs; (ii) Handleman Company income tax payments and other regulatory filing fees; (iii) payment of unsecured valid creditor claims and obligations, including settlement of the terminated U.S. and Canadian pension plans; and (iv) distribution to shareholders.

On May 6, 2009, Handleman Company petitioned the Circuit Court for Oakland County, State of Michigan, for an Order of Limited Supervision over the Liquidation of Handleman post-dissolution. On May 20, 2009, the court order was granted and declared that shares of Handleman common stock became non-transferable 30 days after notification to shareholders. Accordingly, Handleman Company's common shares became non-transferable on June 20, 2009. This allows the Company to reduce costs during liquidation and maximize the liquidated value of the Company for the benefit of its creditors and potential benefit to its shareholders. The Company will distribute proceeds, if any, to shareholders in proportion to their interests as of the close of business on June 20, 2009, the date of record.

Prior to the wind down of business operations, Handleman Company operated as a category manager and distributor of prerecorded music and console video game hardware, software and accessories to leading retailers in the U.S., United Kingdom (UK) and Canada. During fiscal 2009, the Company completed sales agreements for certain assets related to the U.S., UK and Canadian category management and distribution operations, as well as the Crave Entertainment Group, Inc. (Crave) video game operations and the REPS LLC (REPS) field service business unit. All of those operations were wound down and the Company has no continuing involvement in those businesses.

Critical Accounting Estimates

The Company's critical accounting estimates under the liquidation basis of accounting for the first quarter of fiscal 2011 are consistent with those included in its annual report on Form 10-K for the fiscal year ended May 1, 2010.

The Company made significant estimates and exercised judgment in determining accrued liquidation costs. The Company accrued costs expected to be incurred in liquidation and recorded payments made related to the accrued liquidation costs as follows (in thousands of dollars):

| | As Booked | Adjustments to Reserves | Payments | Balance at October 30, 2010 |
|----------------------------------|--------------|-------------------------------|------------|--------------------------------------|
| Accrued Liquidation Costs | | | | |
| U.S. pension plan costs | \$ 17,171 | \$ (4,838) | \$ | \$ 12,333 |
| Outside services | 2,929 | 34 | (834) | 2,129 |
| Contractual commitments | 2,279 | 5 | (2,183) | 101 |
| Payroll related costs | 1,164 | 23 | (413) | 774 |
| Other | 1,352 | 48 | (723) | 677 |
| Total | \$ 24,895 | \$ (4,728) | \$ (4,153) | \$ 16,014 |

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Liquidity and Capital Resources

As a result of Handleman Company's filing of a Certificate of Dissolution, its activities are now limited to: selling, collecting or otherwise realizing the value of its remaining assets; making tax and other regulatory filings; winding down the Company's remaining business activities; paying (or adequately providing for the payment) of all non-barred, valid creditor claims and obligations; and making a distribution to Handleman's shareholders.

Based on the net asset balance as of October 30, 2010, the Company believes proceeds from the liquidation of assets will be sufficient to provide payment in full to its creditors. Payments are estimated as follows (in thousands of dollars):

| Category | Total Liabilities | Percentage Paid | Estimated Assets Available for Distribution |
|--|----------------------|--------------------|---|
| Wind down related costs | \$ 3,389 | 100% | \$ 3,389 |
| Taxes (income and other) | 5,494 | 100% | 5,494 |
| Unsecured creditor claims, including termination costs for the pension plans of \$13,014 | 22,525 | 100% | 22,525 |
| Total liabilities | \$ 31,408 | | \$ 31,408 |
| Available for shareholder distribution | | | 2,551 |
| Total estimated assets for distribution | | | \$ 33,959 |

These projected payments are based on significant estimates and judgments. Through the liquidation period, if the Company is able to realize cash proceeds in excess of what is needed to satisfy all the Company's obligations, the Company will distribute any such proceeds to shareholders. The actual amount and timing of future liquidating distributions, if any, to shareholders is dependent upon the resolution of all open items and periods with taxing authorities; the ultimate settlement amounts of the Company's liabilities and obligations, in particular the Company's pension obligations; actual costs incurred in connection with carrying out the Company's Plan of Final Liquidation, including administrative costs during the liquidation period; and market fluctuations in the discount rate as it relates to the settlement of pension plans. Included in the net assets of \$2.6 million as of October 30, 2010, was \$31.6 million of cash and cash equivalents. The aggregate amount of distributions to shareholders is currently expected to be \$0.12 per share of common stock based on net assets as of October 30, 2010; however, the actual amount of cash remaining for distribution to shareholders following completion of the liquidation, the dissolution of the Company and the settlement of the pension plans could vary significantly from current estimates and could even result in no excess cash available for distribution.

At October 30, 2010, other receivables primarily related to state tax receivables.

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Information in this Form 10-Q 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, resolving open items and periods with taxing authorities, maintaining sufficient liquidity to fund wind down operations, retaining key personnel, satisfactory resolution of any outstanding claims or claims which may arise, and other factors discussed in this document and those 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.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Other than as discussed elsewhere in this Form 10-Q with respect to the Company's pension plan, the Company is not subject to risk resulting from interest rate fluctuations, as the Company has no debt or credit facility.

The Company is not subject to material foreign currency exchange exposure for operations with assets and liabilities that are denominated in currencies other than U.S. dollars.

Item 4. Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. The Company completed 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 30, 2010, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective at the reasonable assurance level as of the end of the period covered by this quarterly report on Form 10-Q.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable and not absolute assurance that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of certain events. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There were no changes in internal control over financial reporting (as defined in Rule 13a-15(f) of the Act) that occurred during the second fiscal quarter ended October 30, 2010, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

The Company is not currently involved in any legal proceedings that are material or for which it does not believe it has adequate reserves. Any other legal proceedings in which the Company is involved are routine legal matters that are incidental to the wind down of business operations. The Company establishes reserves for all claims and legal proceedings based on its best estimate of the amounts it expects to pay.

Item 1A. Risk Factors

The Company is subject to numerous risks and uncertainties that could adversely affect the Company's wind down of business operations and financial condition. Such risks and uncertainties have been disclosed in the Company's most recent Annual Report on Form 10-K for fiscal year ended May 1, 2010. There have been no significant changes in these risks and uncertainties during the second quarter of fiscal 2011.

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

None.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

None.

Item 6. Exhibits

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

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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, 2010

BY: /s/ A. A. KOCH
A. A. KOCH

President and

Chief Executive Officer

(Principal Executive Officer)

DATE: December 8, 2010

BY: /s/ ROZANNE KOKKO
ROZANNE KOKKO

Senior Vice President and

Chief Financial Officer

(Principal Financial Officer)