

Institutional Distressed Debt Research

Blockbuster, Inc.

Performance Plus Advisors, Inc.

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Distressed Debt Research

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Blockbusted

Much has been written about how poorly Blockbuster has addressed the digital age and how successful everyone else is. Performance expectations for Blockbuster are very low. Blockbuster has expanded its mail rentals, rolled out 7000 NCR kiosks, and has added valuable store offerings such as the Comcast and TIVO ventures.

Blockbuster filed for Chapter 11 Bankruptcy protection on September 23, 2010. The company plans to reduce its \$900 million in debt to \$350 million and close 500-800 stores. Blockbuster will try and differentiate itself from its competitors, as the only company to provide customers with multiple ways to rent movies, with access to 125,000 titles.

Most professionals agree DVD sales will peak in 2012. Streaming and on demand will continue to grow. Movies will be watched on TV and computers. Content will be delivered from the networks and studios to a dozen different vendors. Content will be available from everyone.

Blockbuster has a major advantage over competition, with an exclusive arrangement with the studios to get first run releases 28 days earlier than its competitors. Several studios including Universal, Warner and Fox, which represent over 50% of new releases, have granted Blockbuster a 28 day advantage to rent new releases before their competition. Sony is considering a similar arrangement and with its involvement the vast majority of new releases will be in the 28 day window. This same agreement changed Blockbuster's payment terms. Blockbuster is not required to pay retail for movies up front; they have negotiated a revenue share agreement that allows Blockbuster to pay between \$1.00 and \$1.50 per movie after it is sold or destroyed.

Blockbuster has tried to change their footprint and adapt to a digital world. Blockbuster is on the Droid and T-Mobile and is the first company into cell phone delivery. By the end of 2010 there will be 7500 blue NCR kiosks, which have more inventory than Redbox's version. Blockbuster signed a huge partnership with Comcast. Blockbuster on Demand comes in many high definition devices made by Samsung, Philips and TIVO. New movies are \$1.00 cheaper than cable carriers' on demand service.

See Important Disclosures

Stores

Blockbuster had 3,070 stores as of March 2010. Blockbuster stated (Management Presentation dated June 2010, DEFA14A) they had 64 thousand each in EBITDA from these stores. Core stores averaged 136 thousand in EBITDA. Blockbuster stores were profitable prior to Hollywood Video's bankruptcy, and prior to the 28 day window taking effect.

Blockbuster by Mail

Blockbuster's advantages over Netflix are:

- The 28 day window extends to Blockbuster by Mail.
- Blockbuster offers Blu-Ray at no extra charge.
- Game rentals by mail, Netflix does not offer games.
- Blockbuster by Mail customers can exchange their by mail movies or games at stores five times a month for free.

Kiosk Business

As of October 2010, Blockbuster and NCR had over 7,000 kiosks deployed. NCR announced plans to start a second production line to build Blockbuster kiosks. Blockbuster kiosks built by NCR hold 100% more product and have built in digital download capability to rent or sell movies. The 28 day window extends to the Blockbuster kiosks. NCR has stated they would like to sell DVD's, Blu-Rays and games through the kiosks.

Video on Demand

The internet provides streaming video on demand not only to the computer but to set top boxes and video game consoles. There are many VOD services, such as Netflix, Amazon Video on Demand and Apple TV. Netflix rules the VOD battle.

Blockbuster's video on demand service offers a digital media player made by 2Wire. Movies and TV shows can be enjoyed on your television. Blockbuster offers a deal of renting 25 movies on demand for \$99 in advance, the media player is free. The service uses progressive playback, not streaming, video quality is consistent no matter the speed of the internet connection. The device up scales to 1080i resolution if used with an HDMI connection. There is no long term storage available. Rentals are only made available for a maximum of 30 days after download. Once the movie is played, there is a 24 hour license issued to play the movie as many times as you wish. The files are auto deleted either when the 30 day period ends or the 24 hour watch period expires.

TIVO and Blockbuster have also teamed up. Blockbuster on Demand is available on TIVO DVR boxes. TIVO DVR's are also available for purchase at Blockbuster stores and online.

Recommendation - Senior Secured Notes

The 11.75% Senior Secured Notes, currently trading at 50, will be converted to stock. The notes are senior secured obligations and are guaranteed by Blockbuster's domestic subsidiaries. The notes and guarantees are secured by first priority liens on substantially all of Blockbuster's assets. Holders were entitled to be a DIP lender. Holders are to receive all or any portion as "Roll Up Notes", up to an amount not to exceed \$125 million, with a super priority ahead of other debt. The \$125 million DIP will be converted to exit financing. The exit loan will pay interest at 8 ½% above Libor (min. 2 %). Also, a \$50 million revolving credit line will be put in place.

The vast majority of the 11.75% debt is held by Icahn Associates, Owl Creek Asset Management LP, Monarch Alternative Capital LP, Varde Partners Inc and Stonehill Capital Management LLC.

We rate the senior debt of Blockbuster, a **BUY**, currently trading at 50 cents on the dollar. For Institutional Investors these 11.75% Secured Notes due 2014 are undervalued in relation to our estimation of possible recovery values. Our recommendation is based on the senior position the security has in the capital structure of the company and on a moderate improvement in financial variables such as EBITDA and a successful emergence out of bankruptcy. Institutional investors may wish to review the Disclosure Agreement and the Plan of Reorganization to determine an exact recovery. The risk reward ratio makes sense at this time. This is the pivot security in the distressed debt of Blockbuster.

Unsecured Creditors

Unsecured creditors are expected to receive 3% of the new Blockbuster in the form of warrants. The Blockbuster 9% notes due in 2012 are considered in this class.

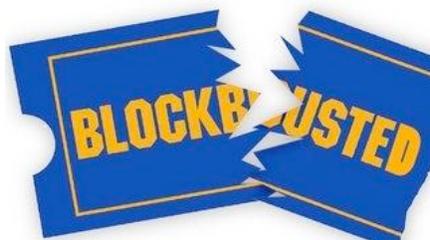
Recovery Estimates for 11.75% Senior Notes
Various EBITDA Projections (5 Multiple)

| | | | | | | |
|------------------------|-----|-----|-----|------|------|------|
| EBITDA | 130 | 140 | 150 | 160 | 170 | 180 |
| Enterprise Value | 650 | 700 | 750 | 800 | 850 | 900 |
| Less Dip And Fees | 125 | 125 | 125 | 125 | 125 | 125 |
| Value for Senior Notes | 525 | 575 | 625 | 675 | 725 | 775 |
| Estimated Recovery | 83% | 91% | 99% | 100% | 100% | 100% |

Recovery Estimates for 11.75% Senior Notes

Various EBITDA Projections (4.5 Multiple)

| | | | | | | |
|------------------------|-----|-----|-----|-----|------|------|
| EBITDA | 130 | 140 | 150 | 160 | 170 | 180 |
| Enterprise Value | 585 | 630 | 675 | 720 | 765 | 810 |
| Less Dip And Fees | 125 | 125 | 125 | 125 | 125 | 125 |
| Value for Senior Notes | 460 | 505 | 550 | 595 | 640 | 685 |
| Estimated Recovery | 73% | 80% | 87% | 94% | 100% | 100% |



Discloser – Certification

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Rating System Explanation

Buy: We generally expect “Buy” rated investment returns to be greater than or equal to plus + 20% from date of the original recommendation.

Neutral: We generally expect “Neutral” rated investment returns to deviate plus or minus + or - 20 % from the date of the original recommendation.

Sell: We generally expect “Sell” rated investment returns to be equal to or greater than minus - 20% from the date of the original recommendation.

Analyst Rating Distribution as of 11/26/2010

| | Number of Companies | Percent of Total |
|---------|---------------------|------------------|
| Buy | 2 | 67% |
| Neutral | 1 | 33% |
| Sell | 0 | |
| Total | 3 | 100% |

