

Seven Arts Entertainment Inc.  
Form 10-K/A  
September 15, 2014

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-K/A**  
**(Amendment No. 2)**

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

For the fiscal year ended **June 30, 2013**

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: **001-34250**

**SEVEN ARTS ENTERTAINMENT INC.**

**(Formerly Seven Arts Pictures, PLC)**

(Exact name of Registrant as specified in its charter)

**Nevada**                      **45-3138068**  
(State of Incorporation) (I.R.S. Employer Identification No.)

**8439 Sunset Blvd., Suite 402**

**90069**

**Los Angeles, California**

(Address of principal executive offices) (Zip Code)

Registrant's telephone number: Phone: (323) 372-3080; Fax: (323) 389-0664

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

**None**

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

**Common Stock; \$0.01 Par Value**

(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 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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 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

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) 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 to this Form 10-K.

Indicate by a check mark whether the Registrant is a large filer, an accredited filer, non-accredited filer, or a smaller reporting company. See the definitions of "large accredited filer", "accredited filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accredited filer  Accredited filer

Non-accredited filer  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

The aggregate market value of common stock, par value \$0.01 per share, held by non-affiliates of the registrant, based on the average bid and asked prices of the common stock on December 31, 2012 (the last business day of the registrant's most recently completed second fiscal quarter) was approximately \$43,067,018. For purposes of this computation, all officers, directors and 10% beneficial owners of the registrant are deemed to be affiliates. Such determination should not be deemed an admission that such officers, directors or 10% beneficial owners are, in fact, affiliates of the registrant.

Number of common shares outstanding as of October 15, 2013 was 219,276,228.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Listed below are documents incorporated herein by reference and the part of this Report into which each such document is incorporated:

None



**PART II - OTHER INFORMATION**

**EXPLANATORY NOTE**

This Amendment No. 2 on Form 10-K/A amends the Registrant's Amendment No. 1 on Form 10-K/A, filed on October 21, 2013, and Annual Report on Form 10-K filed by the Registrant on October 15, 2013 with the Securities and Exchange Commission. Amendment No. 2 is being filed for the sole purpose of revising the Report of Independent Registered Public Accounting Firm. All other items remain unchanged.

## **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The following discussion should be read in conjunction with the preceding financial statements and footnotes thereto contained in this report. This discussion contains forward-looking statements, which are based on our assumptions about the future of our business. Our actual results may differ materially from those contained in the forward-looking statements.*

#### **Company Overview:**

The following discussion should be read in conjunction with the preceding financial statements and footnotes thereto contained in this report. This discussion contains forward-looking statements, which are based on our assumptions about the future of our business. Our actual results may differ materially from those contained in the forward-looking statements.

We are an independent motion picture production company engaged in developing, financing, producing and licensing theatrical motion pictures with budgets in the range of \$2 million to \$15 million for exhibition in domestic (*i.e.* the United States and Canada) and foreign theatrical markets and for subsequent post-theatrical worldwide release in other forms of media, including DVD, home video, pay-per-view, and free television. Our pictures have in the last few years received only a limited theatrical release (50-300 theaters in the United States), or may even be released directly to post-theatrical markets, primarily DVD. Our pictures that receive limited theatrical release or post-theatrical release typically benefit from lower prints and advertising ("P & A") cost and, in turn, improved gross profit margins.

We determine the size of a theatrical release in the United States based on distributor and our estimates of the commercial prospects of theatrical box office and our own evaluation of the level of expected theatrical release costs as opposed to our estimation of potential theatrical box office in the United States.

No one picture had a principal or controlling share of gross revenues or operating profits in these periods.

We also are now in the business of producing and distributing recorded music and, as of July 1 2012, our post-production facility at 807 Esplanade in New Orleans commenced operations.

### Film Company

We license distribution rights in our motion pictures in the United States and in most foreign territories prior to and during the production or upon the acquisition of rights to distribute a picture. We share in the commissions generated by the sales of the pictures. Sale of a license to distribute a motion picture prior to its delivery is termed a “pre-sale” and may occur at any time during the development and production process. In a typical license agreement, we license a picture to a distributor before it is produced or completed for an advance from the licensee, which advance is recoverable by the distributor from our share of the revenues generated by the distribution of the picture in the licensee’s territory, after deduction of the distributor’s expenses and distributor fee. The advance usually is in the form of a cash deposit plus a letter of credit or “bank letter” for the balance payable 10-20% on execution (*i.e.*, the cash deposit) and the balance on delivery (*i.e.*, the letter of credit or “bank letter”). The license grants the distributor the right to the post-theatrical release of the picture in all or certain media in their territory for a predetermined time period. After this time, the distribution rights revert back to us and we are then free to re-license the picture. The license specifies that the distributor is entitled to recoup its advance from the revenue generated by the release of the picture in all markets in its territory, as well as its release costs and distribution fees.

After the distributor has recouped its advance, costs, and fees, any remaining revenue is shared with us according to a predetermined formula. This is known as an “overage” and can be a significant source of revenue for us from successful films. However, a film’s poor reception in one market does not preclude it from achieving success in another market and generating significant additional revenue for us in the form of an “overage” in that territory. In all of our licensing arrangements, we retain ownership of our films and maintain our control of each copyright. We intend to continue the practice of retaining underlying rights to our film projects in order to continue to build our motion picture library to license or sell in the future.

We create a separate finance plan for each motion picture we produce. Accordingly, the sources of the funds for production of each motion picture vary according to each finance plan. We utilize financing based on state and foreign country tax credits (*e.g.*, Louisiana, United Kingdom and Hungary) and direct subsidies, “mezzanine” or “gap” funds, which are senior to our equity, and senior secured financing with commercial banks or private lenders, together in certain cases with a limited investment from us, which is customarily less than 10% of the production budget. Since each finance plan is unique to each motion picture, we cannot generalize as to the amount we will utilize any of these sources of funds for a particular motion picture. We generally obtain some advances or guarantees prior to commitment to production of a motion picture project, but those amounts may not be substantial on smaller budgeted motion picture (*e.g.*, under \$10,000,000), and in certain cases we have committed to production with an insubstantial amount of advances and guarantees. Unless we can manage the risks of production through the use of these financing techniques, we will not likely commit to production of larger budget motion pictures (*e.g.*, over \$15,000,000), and we have never in the past committed to such productions, without substantial advances or guarantees from third-party distributors, or the equivalent in “non-recourse” financings.

#### Music Company

Seven Arts Music Inc. (“SAM”) became a wholly owned subsidiary of the Company on February 23, 2012, although start-up costs had been incurred as early as September 2011. The delivery of the first of the DMX albums acquired from David Michery was released on September 11, 2012 and initial costs in creating the first album for Bone Thugs-N-Harmony are being incurred for delivery in February, 2013. Several other new artists are being considered by SAM. The agreements under which SAM acquired its music assets were effective as of September 29, 2011 (Big Jake Music) and December 19, 2011 (Michery Assets) publicly announced and business activities commenced on those dates, but definitive agreements were not executed until February 23, 2012.

#### Post-Production Facility

As of June 30, 2012, SAFELA was transferred to the Company. SAFELA, which is 60% owned by the Company, has a 30 year lease to run a production and post-production facility at 807 Esplanade Avenue in New Orleans. The facility commenced operations on July 1, 2012.

#### Company Outlook

The principal factors that affected our results of operations have been:



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1. the number of motion pictures and recorded music delivered in a fiscal period,
2. the distribution rights of motion pictures and recorded music produced by others acquired in a fiscal period,
3. the choice of motion pictures and recorded music produced or acquired by us,
4. management's and talents' execution of the screenplay and production plan for each picture and recorded music the distribution and market reactions to the motion pictures and recorded music once completed,
5. management's ability to obtain financing and to re-negotiate financing on beneficial terms,
6. the performance of our third-party distributors and
7. our ability to take advantage of tax-incentivized financing.

These factors will continue to be, in our opinion, the principal factors affecting future results of operation and our future financial condition. No particular factor has had a primary or principal effect on our operations and financial condition in the periods discussed below.

Our revenues principally consist of amounts we earned from third-party distributors of our motion pictures and recorded music. We recognize revenue from license fees as and when a motion picture is delivered to the territory to which the license relates if we have a contractual commitment and the term of license has begun or upon receipt of a royalty statement or other reliable information from a distributor of the amounts due to us from distribution of that picture. A motion picture is "delivered" when we have completed all aspects of production and may make playable copies of the motion picture for exhibition in a medium of exhibition such as theatrical, video, or television distribution.

We also recognize revenue beyond an initial license fee from our share of gross receipts on motion pictures which we recognize as revenue when we are notified of the amounts that are due to us. In some fiscal periods, a significant portion of our revenue is derived from sources other than motion picture distribution, including the cancellation of debt and interest income on a financing transaction.

We have also benefited significantly from our ability to raise third party film equity investments such as in tax advantaged transactions under which we transfer to third party investor's tax benefits for motion picture production and distribution. These types of investments have enabled us to substantially reduce the cost basis of our motion pictures and even to record significant fee-related revenues.

## **RESULTS OF OPERATIONS**

### **for the Year Ended June 30, 2013 Compared To Year Ended June 30, 2012**

As noted in the accompanying financial statements in Note 15, the Company has restated the years ended June 30, 2012 and 2011, to correct certain errors. The errors included reclassifications of certain amounts that had previously been categorized as "one time change in estimate" to properly be included in cost of revenues, timing differences between years, and corrections in the application of GAAP on certain complex transactions. Please see the detailed discussion and schedule in Note 16. All restated amounts are reflected in the discussion of Results of Operations below.

#### Revenue

Our total revenues decreased from \$4,058,006(Restated) for the fiscal year ended June 30, 2012 to \$1,522,808 in the fiscal year ended June 30, 2013. Film revenues were basically the same in each year and the Music revenue of \$574,434, as well as the \$106,417 in Post Production revenue, is new to the Company in 2013. However, the 2012 revenue figure included net fee income of \$3,235,000(Restated) earned from SAPLA related to the post-production facility located at 807 Esplanade in New Orleans, Louisiana. The Fee Income from related party in 2012 represented services provided in connection with direction of the rehabilitation of the post production facility as well as consulting in process of obtaining certain Federal and State tax credits. See Note 4 in the accompanying financial statements for a more detailed discussion of the revenue earned.

Revenues derived from the licensing and distribution of motion pictures increased marginally from \$823,006 in the previous fiscal year to \$841,956 in this fiscal year. The majority of 2013 revenue consisted of the US and Brazilian release of "Nine Miles Down" and "Drunkboat" and a spread of film royalties relating to our film library and \$183,000 from settlement of litigation with MGM over "Deal" and Sony with "Johnny Mnemonic".

The majority of 2012 sales included international sales royalties from movies such as “The Pool Boys,” “Deal,” “Autopsy,” “Nine Miles Down” and “Night of the Demons.”

In the 2013 year the music division recorded gross revenues of \$1,027,645, reduced by a provision for returns of \$470,811, from the release of the first DMX album.

### Costs of Revenue

Costs of revenue decreased from \$14,389,888 (Restated) in the fiscal year ended June 30 2012 to \$12,421,711 in the fiscal year ended June 30, 2013. Costs of Revenues in both years consist predominately of amortization and impairment of film and music costs .

The amortization charge represents the amortization of the film assets calculated as the portion of the current year revenue compared to management's estimate of the ultimate future revenue from the films. The amortization of unamortized Film costs in 2013 related to revenue recognized on the films, "Nine Miles Down" and "Deal". For 2012 the amortization related to revenue recognized on the films "Pool Boys", "Nine Miles Down" and "Night of the Demons".

In accordance with our policies, management reviewed the future ultimates on the films in release or production, and adjusted them for actual sales and feedback and orders from the various film markets the Company attends. These adjusted ultimate estimations are then used in determining if any impairments are necessary to recognize. This evaluation resulted in Impairment costs recognized of \$2,054,171 in fiscal year 2013 made and \$6,459,298 (restated) in fiscal year 2012.

A write down of \$2,837,545 was taken against development costs in fiscal year 2013 upon review of the capitalized development costs, in accordance with ASC 926 and our accounting policy, to ensure all "abandoned" costs which management has determined no longer apply to viable development projects.

Consequently, the Group recorded a gross loss of \$10,898,903 in the year-ended June 30, 2013 compared to a gross loss of \$10,331,882 (Restated) in the year-ended June 30, 2012

### General & Administrative expenses

General and administrative expenses increased to \$7,289,919, in the fiscal year ended June 30 2013 from \$2,558,620 in the previous year.

\$3,582,919 of the G&A expenses in 2013 is bad debt expense, which includes a \$1,180,000 reserve recognized for the Fee Income receivables due from related party, due to some delays in SAPLA receiving their State tax credit (please

see more detailed discussion in Note 4 in accompanying financial statements), and \$1,868,547 determined to no longer be collectible due from SAP, Inc., a related party, due to its' current parent company, PLC, being in liquidation.

In 2013, the full operation of the music division has added \$356,061 to the general and administration expenses and the new post production operation has increased these costs by \$197,430, plus building improvement amortization of \$164,526.

Legal and professional costs were increased substantially in the current year to \$1,504,763 from \$879,503 in the prior year. This consists of increased attorney fees related to our ongoing and new litigation discussed in detail previously in the Litigation section. Additional legal fees were also incurred in connection with increased volume of conversions and share activity requiring legal opinions.

There has been an accrual of \$350,000 for a judgment for the Company to pay legal fees on Jones Film (see Litigation section above)

Rent and office costs increased by almost \$190,000 in the year due to the music division and the post production facility. Management have taken action and closed down the UK office and merged the music division into the original US office to bring overhead back in line

Wages and salaries have reduced by approximately \$182,000 during the year as the London office was closed and the US office was downsized plus the music team were reduced substantially and the few that are left are now consultants not employees which accounts for the increase in consultancy charges year on year (Approximately \$102,000).

Approximately \$528,000 less overhead was capitalized to movies in the 2013 fiscal year than the comparable period in 2012

Net interest expense increased from \$2,752,681 to \$4,227,472, resulting from increased loan balances and some penalties in negotiating extended terms. The 2013 interest expense also includes amounts related to SAFELA for the mortgage and construction loan not included in 2012..

Other income in 2012 includes forgiveness of debt income previously charged in 2011 in error. See Note 16 on restatement of accounts.

We recorded no tax provision in the fiscal year ended June 30, 2012, because we had no taxable income.

As result of the aforementioned results, we recorded a net loss of \$ 22,062,539 in the fiscal year ended June 30, 2013 compared to a net loss of \$11,153,463 for the fiscal year ended June 30, 2012.

## **RESULTS OF OPERATIONS**

### **for the Year Ended June 30, 2012 (Restated) Compared To Year Ended June 30, 2011**

Our total revenues increased from \$3,328,388 for the fiscal year ended June 30, 2011 to \$4,058,006 in the fiscal year ended June 30, 2012. This increase principally relates to the fee income earned from SAPLA related to the production/post-production facility located at 807 Esplanade in New Orleans, Louisiana, offset by reduced film revenue. The Fee income – related party revenue of \$3,235,000 represents services provided in connection with direction of the rehabilitation of the post production facility as well as consulting in process of obtaining certain Federal and State tax credits. See Note 4 in the accompanying financial statements for a more detailed discussion of the revenue earned.

Revenues derived from the licensing and distribution of motion pictures decreased from \$2,758,359 in the previous fiscal year to \$823,006 in this fiscal year, due to a decrease in sales on the motion pictures Deal and American Summer. The digital release of Pool Boys (American Summer) in the Autumn of 2011 was less than management expectation.

Fee-related revenues in the fiscal year ended June 30, 2011 derived from:

- a) Producer's fees of \$70,029 resulting from excess tax credits received on Night of the Demons.
- b) \$500,000 of production fees related to the production and preproduction of three films in Louisiana.

There are no such revenues in the fiscal year ended to June 30, 2012.

Costs of revenue increased from \$3,447,996 to \$14,389,888(Restated) including certain distribution costs, producers' costs and other third party payments, and amortization of film costs of \$3,996,576 and Film cost impairment of \$6,459,248 and Music cost impairment of \$3,035,000. The amortization charge represents the amortization of the film assets calculated as the portion of the current year revenue compared to management's estimate of the ultimate future revenue from the films. The Impairment is a result of our evaluation of the ultimate future revenue on the films in release or production, and adjusted them for actual sales and feedback and orders from the various film markets the Company attends. These adjusted ultimate estimations are then used in determining if an impairments are necessary to recognize.

Consequently, the Group recorded a gross loss of \$10,331,882 in the year-ended June 30, 2012 compared to a gross loss of (\$119,608) in the year-ended June 30, 2011

General and administrative expenses increased to \$2,251,139, from \$1,852,303. External legal and professional fees were significantly increased by approximately \$400,000, as a result of investigations carried out in the year by government authorities, as well as a significant increase in NASDAQ compliance matters. The acquisition of the music assets has increased general and administrative expense although a substantial proportion of such expenses was capitalized into music assets, with the development of the DMX album and videos.

Management's reserve for doubtful accounts increased to \$307,481 compared to \$234,429 due to the continued consolidation in the international film business.

We recorded \$4,458,621(Restated) in other income for the fiscal year ended June 30, 2012 reflecting forgiveness of debt mainly from a Workout Agreement reached with Palm Finance Inc. and Arrowhead Consulting Group.

Net interest expense increased from \$758,197 to \$2,752,681, reflecting settlement agreements with senior lenders Blue Rider, Cold Fusion and 120db, and accrual of a full year's interest charge on the Pool Boys, Autopsy and Nine Miles Down production loans. Interest of these production loans was forgiven in the prior fiscal year ended June 30, 2011. The Company disputes \$957,696 of the interest expense charged to the Pool Boys/Autopsy and Nine Miles Down loans as it has a different interpretation of the contract to that of Palm. Management believes this dispute will be resolved in the near future.



We recorded no tax provision in the fiscal years ended June 30, 2012 and 2011, because we had no taxable income.

As result of the aforementioned results, we recorded a net loss of \$11,153,463 in the fiscal year ended June 30, 2012 compared to a net profit of \$1,461,554 for the fiscal year ended June 30, 2011.

### Foreign Currency Transactions and Comprehensive Income

The Company's functional currency, as well as the Company's subsidiaries, is the US Dollar. The functional currency of PLC, was the Pound Sterling ("GBP"), and some transactions which are generated in the United Kingdom are denominated in GBP.

Assets and liabilities generated in a currency other than the functional currency are translated at exchange rates as of the balance sheet date. Revenues and expenses are translated at average rates in effect for the periods presented. The cumulative translation adjustment is included in the accumulated other comprehensive gain (loss) within shareholders' equity (deficit). Foreign currency transaction gains and losses arising from exchange rate fluctuations on transactions denominated in a currency other than the functional currency are included in the consolidated results of operations.

Where possible, the Company seeks to match GBP income with GBP expenditures. To date, the Company has not hedged any transactional currency exposure but will keep such exposures under review and where appropriate may enter into such transactions in future.

### Segment Reporting

The Company now operates in three business segments as a motion picture producer and distributor and as a music label managing the assets acquired from Mr Michery. The Company believes that its businesses should be reported as two business segments.

In accordance with ASC 280 *Segment Reporting*, operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker, or decision-making group, in making decisions how to allocate resources and assess performance. Our chief decision maker, as defined under the FASB's guidance, is a combination of the Chief Executive Officer and the Chief Financial Officer.

The table below presents the financial information for the two reportable segments for the year ended June 30, 2012.

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The tables below present the financial information for the reportable segments for the years ended June 30, 2013 and 2012:

|                      | Film           | Music       | Year ended<br>June 30,<br>2013<br>Production<br>facility | Total        |
|----------------------|----------------|-------------|--|--------------|
| Revenue              | \$841,956      | \$574,434   | \$106,417  | \$1,522,807  |
| Cost of Revenue      | (7,004,141 )   | (5,395,410) | (22,160 )  | (12,421,711) |
| Gross profit/(loss)  | (6,162,185 )   | (4,820,975) | (84,257 )  | (10,898,903) |
| Operating expenses   | (6,447,117 )   | (480,620 )  | (361,955 )   | (7,860,492 ) |
| Loss from operations | \$(12,609,302) | (5,301,595) | (277,698 )   | (18,188,596) |

|                      | Year ended<br>June 30, 2012<br>(Restated) |             |                |
|----------------------|---|-------------|----------------|
|                      | Film                                      | Music       | Total          |
| Revenue              | \$4,052,029                               | \$5,977     | \$4,058,006    |
| Cost of revenue      | 14,350,858                                | 39,031      | 14,389,889     |
| Gross profit/(loss)  | \$(10,364,937)                            | \$(33,054 ) | \$(10,331,883) |
| Operating expenses   | 2,467,111 )                               | 91,505      | 2,558,620      |
| Loss from operations | \$(12,765,944)                            | \$(124,559) | \$(12,890,503) |

Assets

|                        | June 30,<br>2013 | June 30,<br>2012<br>(Restated) |
|------------------------|------------------|--------------------------------|
| Film assets            | \$8,368,686      | \$14,612,609                   |
| Music assets           | 296,795          | 4,289,158                      |
| Post-production assets | 4,102,525        | 4,551,270                      |

**LIQUIDITY AND CAPITAL RESOURCES**

Management assesses the Company's liquidity in terms of its ability to generate cash to fund its operating, investing and financing activities and whether it will be sufficient to allow it to continue investing in existing businesses, consummating strategic acquisitions, paying interest and servicing debt and managing its capital structure on a short and long-term basis.

### Short Term Liquidity

The Company has an accumulated deficit of \$38,154,995 and negative working capital of \$19,844,307 as of June 30, 2013. Management believes that, based on historical revenues generated from the licensing of the distribution rights on our motion pictures and the new revenues generated from the release of two albums in the music division in our 2014 fiscal year, as well as expanding business at the post-production facility, we will have sufficient working capital to operate for the next twelve months. Included in the revenue expected in our film division will be the release of a new film, Schism, in March 2014, which will see revenues generated during the next year. In addition, the Company has scaled back on administrative expenses through the closing of our UK office. The Company also will continue to raise capital, or pay off existing debt, through the issuance of convertible debentures.

We currently borrow funds for the financing of each of our motion pictures from several production lenders. There can be no assurances given that the Group will be able to borrow funds to finance our motion pictures in the future

### Long Term Liquidity

The long term liquidity needs of the Company, are projected to be met primarily through the cash flow provided by operations, **with any additional funds necessary raised by the sale of debt or equity.**

### Cash Flows

Operating Activities: Net cash used in operating activities in the year ended June 30, 2013 was \$(547,939). This is mainly attributable to a mixture of cash received on revenue and receivables compared to \$1,051,378 of cash used in additions to film costs, payment on accounts payable and other operating expenses of the Company. While the accounts payable increased by a net \$1,546,377, the overall increase also reflects payments on balances owing, as well as exchanges of existing accounts payable balances to notes payable.

Investing Activities: Net cash used in investing activities in the year ended June 30, 2013 was \$(466,066) which is attributable to additions to building improvements for the post-production facility.

Financing Activities: Net cash provided by financing activities during the year ended June 30, 2013 was \$898,232, mainly due to the proceeds from additional debt of \$1,872,772 and the issuance of common stock for cash

of \$300,000, less amounts paid on outstanding debt.

### Capital Resources

As of June 30, 2013, the Company did not have any outstanding capital commitments. As of the date of this filing the Company had no other commitments than disclosed in the Company's financial statements and notes to the financial statements.

Negative working capital at June 30, 2013 was \$19,844,307, versus negative working capital at June 30, 2012 (Restated) of \$13,561,333. The change is mainly a decrease in current assets from the year ended June 30, 2012 to June 30, 2013, while current liabilities stayed fairly consistent. The decrease in assets is constituted by:

- An approximately \$1,190,000 reserve recognized for the Fee Income receivables due from related party , due to
- a) some delays in SAPLA receiving their State tax credit (please see more detailed discussion in Note 4 in accompanying financial statements.
- b) Impairments recognized on Film costs in the amount of \$2,054,171 and Music Assets in the amount of \$4,718,205.
- c) The Film and Music asset balances were also reduced by the standard amortization for the year of \$2,452,477.

Working capital is negative due to the fact that all the loans are classified as current, while some of them have longer-term workout agreements. Additionally, the mortgage and construction loans on 807 Esplanade are current liabilities with corresponding Building improvements being recorded as non-current assets.

The majority of the other loans are convertible to stock so will have little or no cash impact.

Shareholders' Deficit contributed to Seven Arts Entertainment, Inc. at June 30, 2013 was \$6,715,314 which is a decrease of \$16,573,154 from the restated June 30, 2012 Shareholders' equity. The change was primarily due to the loss in the current year, offset by increases in common stock and the related additional paid in capital.

The Company had approximately \$15,632,000 in debt as of June 30, 2013, comprised of Convertible debentures of approximately \$4,074,000, Mortgage and construction loans of approximately \$3,744,000 and Film and Production loans of approximately \$7,814,000. Please refer to Note 9 in the accompanying financial statements to see a detailed list of the indebtedness and expanded disclosures.

## **CRITICAL ACCOUNTING POLICIES**

Our management selects accounting principles generally accepted in the United States of America and adopts methods for their application. The application of accounting principles requires the estimating, matching and timing of revenue and expense. It is also necessary for management to determine measure and allocate resources and obligations within the financial process according to those principles. The accounting policies used conform to generally accepted accounting principles which have been consistently applied in the preparation of our financial statements.

The financial statements and notes are representations of our management, which is responsible for their integrity and objectivity. Management further acknowledges that it is solely responsible for adopting sound accounting practices, establishing and maintaining a system of internal accounting control and preventing and detecting fraud. Our system of internal accounting control is designed to assure, among other items, that (i) recorded transactions are valid; (ii) valid transactions are recorded; and (iii) transactions are recorded in the proper period in a timely manner to produce financial statements that present fairly the financial condition, results of operations and cash flows of our Company for the respective periods being presented.

### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. The most significant estimates made by management in the preparation of the financial statements relate to ultimate revenue and costs of its films which are used in the amortization and impairment of film costs, estimates for allowances and income taxes. Accordingly, actual results could differ from those estimates.

### Revenue Recognition

### FILM

The Company recognizes revenue from the sale (minimum guarantee or non-refundable advances) or licensing arrangement (royalty agreements) of a film in accordance with ASC 605-15 "*Revenue Recognition*". Revenue will be recognized only when all of the following criteria have been met:

a) Persuasive evidence of a sale or licensing arrangement with a customer exists.

The film is complete and, in accordance with the terms of the arrangement, has been delivered or is available for immediate and unconditional delivery. (i.e. the "notice of delivery" ("NOD") has been sent and there is a master negative available for the customer).

c) The license period of the arrangement has begun and the customer can begin its exploitation, exhibition, or sale.

d) The arrangement fee is fixed or determinable.

e) Collection of the arrangement fee is reasonably assured.



A written agreement with clients (purchase order, letter, contract, etc.), indicating the film name, territory and period is required for the recognition of revenue. Revenue is recognized when the performance criteria in the contracts have been met. The customer generally confirms agreement by their signature on the contract.

Minimum guarantee revenue (i.e., non-refundable advances) is recognized as and when the film is available for delivery to the respective territories. Cash deposits received on the signing of the contracts are recorded as deferred revenue until the film is available for delivery (as described above) at which point the deferred revenue is recognized.

Royalty revenue, which equates to an agreed share of gross receipts of films, is recognized as income as and when the Company is notified of the amounts by the customers through their royalty reports. Revenue is recorded net any of sales or value added taxes charged to customers.

#### MUSIC

Revenue, which equates to an agreed share of gross receipts, is recognized as income as and when the Company is notified of the amounts by the distribution agent through their distribution reports.

Revenue is recorded:

- a) net of any sales or value added taxes charged to customers
- b) net of discounts agreed with customers
- c) net of returns provision agreed with the distributor and
- d) grossed up for the distribution fee charged by the distribution agent.

Revenue from digital distribution will be reported by the various digital platforms such as iTunes in their periodic reports and posted as received.

#### Fee-related revenues

Many countries make tax credits available to encourage film production in the territory. Seven Arts benefits from tax credits in:

- a) The UK and several other European territories for their European productions
- b) Canada for their Canadian productions
- c) Louisiana for their US productions
- d) Tax preferred financing deals

These tax credits may be treated as a reduction in the capitalized costs of the film assets they are financing or as producer fees to us if the tax credits are earned and owned by a company in the Group and paid to us as overhead or producer fees.

### SAPLA Revenue – sharing fees

Revenue in the form of fee-income is due to the Company from the related company SAPLA (owned by the wife of Peter Hoffman, the Company's CEO) by virtue of an agreement between SAPLA and the Company guaranteeing that all net revenue's earned by SAPLA are the property of the Company. The agreement was established as the Company guaranteed the loans SAPLA took on to restore and rebuild the property 807 Esplanade, New Orleans as a post-production facility.

### Income Taxes

The Company has adopted ASC 740-10 "*Income Taxes*", which requires the use of the liability method in the computation of income tax expense and the current and deferred income taxes payable.

### Cash and Cash Equivalents

Cash and cash equivalents includes cash in banks with original maturities of three months or less and are stated at cost which approximates market value, which in the opinion of management, are subject to an insignificant risk of loss in value. The cash and cash equivalents of the Company consisted of cash balances held on deposit with banks, including various accounts denominated in US Dollars, Pounds Sterling and Euros.

### Accounts Receivable

Accounts Receivable are carried at their face amount, less an allowance for doubtful accounts. On a periodic basis, the Company evaluates accounts receivable and establishes an allowance for doubtful accounts based on a combination of specific customer circumstances and credit conditions, and on a history of write offs and collections. The Company's policy is generally not to charge interest on trade receivables after the invoice becomes past due. A receivable is considered past due if payments have not been received within agreed upon invoice terms. Write offs are recorded at a time when a customer receivable is deemed uncollectible. The Company's allowance for doubtful accounts was \$131,062 and \$171,062 at June 30, 2013 and June 30, 2012, respectively.

### Due to/Due from Related Parties

In September 2004, the Company entered into an agreement with SAP under which SAP provided the services of Peter Hoffman for the amount of his contracted salary and the Los Angeles office and staff of SAP Inc. to us at cost. Pursuant to two inter Company agreements, SAP also from time-to-time owned limited liability companies in the United States which distributed the Company's motion pictures for a fee, with all profits ensuing to the benefit of the Company. These companies also provided other services to the Company at no fee other than Mr. Hoffman's salary and the direct third-party costs of SAP's Los Angeles office, all of which were reflected in the Company's financial statements.

These other services may include accounting services, audits of distribution statements, collection of accounts receivable, supervision of production of motion pictures and similar day-to-day aspects of the Company's business.

SAP assigned to the Company any proceeds arising from services performed by SAP on its behalf. SAP was granted the power and authority to enter into agreements on the Company's behalf. These agreements have terminated as of December 31, 2011.

SAP, Inc. directly or through related various Louisiana limited liability companies, have from time-to-time made non-interest bearing advances to the Company or its subsidiaries or have received advances back from the Company or paid expenses on each other's behalf.

Peter Hoffman has contributed cash to the Company, as well as had salary accrued but unpaid on occasion over the last several years. These amounts are reflected as Due To Related Parties.

### Fee Income Receivable from Related Party

Revenue in the form of fee income is due to the Company from a related party, SAPLA (owned by the wife of Peter Hoffman, the Company's former CEO) for developer, advisory and financial services provided by the Company as concerns infrastructure and historic rehabilitation tax credits earned by SAPLA. In accordance with an intercompany agreement between SAE and SAPLA, the cash proceeds from the disposition of the tax credits earned by SAPLA are due to SAE. The Company has recognized the fair value of the services as revenue with any excess received as a capital contribution by the related party.

### Film Costs

Film costs include the unamortized costs of completed films which have been produced by the Company or for which the Company has acquired distribution rights, libraries acquired as part of acquisitions of companies and films in progress and in development. For films produced by the Company, capitalized costs include all direct production and financing costs, capitalized interest and production overhead.

Costs of acquiring and producing films are amortized using the individual-film-forecast method, whereby these costs are amortized and participations and residuals costs are accrued in the proportion that current year's revenue bears to management's estimate of ultimate revenue at the beginning of the current year expected to be recognized from the exploitation, exhibition or sale of the films. The majority of a film's costs (approximately 80% or more) are generally amortized within three years of the picture's initial release.

Ultimate revenue includes estimates over a period not to exceed ten years following the date of initial release. Film costs are stated at the lower of amortized cost or estimated fair value. Individual film costs are reviewed on a title-by-title basis, when an event or change in circumstances indicates that the fair value of a film is less than its unamortized cost. The fair value of the film is determined using management's future revenue and cost estimates and a discounted cash flow approach. Impairment is recorded in the amount by which the unamortized costs exceed the estimated fair value of the film. Estimates of future revenue involve measurement uncertainty, and it is therefore possible that reductions in the carrying value of investment in films may be required as a consequence of changes in management's future revenue estimates. Films are included in the general "library" category when initial release dates are at least three years prior to the acquisition date.

Films in progress include the accumulated costs of productions which have not yet been completed. Films in development include costs of acquiring film rights to books, stage plays or original screenplays and costs to adapt such projects. Such costs are capitalized and, upon commencement of production, are transferred to production

costs. Projects in development are written off at the earlier of the date they are determined not to be recoverable or when abandoned.

### Music Costs/Assets

The initial material assets that were acquired comprise 52 completed sound recordings including two completed albums with DMX, up to two additional albums from DMX and up to five albums from Bone Thugs-N-Harmony.

Music assets include the unamortized costs of completed albums, singles and videos which have been produced by the Company or for which the Company has acquired distribution rights, libraries acquired as part of acquisitions and albums in progress and in development. For albums produced by the Company, capitalized costs include all direct production and financing costs, capitalized interest and production overhead.

### Costs of

acquiring and producing music assets will be amortized using the individual-album-forecast method, whereby these costs are amortized in the proportion that current year's revenue bears to management's estimate of ultimate revenue at the beginning of the current year expected to be recognized from the exploitation or sale of the music.

### Building Improvements

On June 30, 2012, the Company acquired SAFELA, which was previously a related party company. SAFELA owns, in its capacity, a 30 year lease on 807 Esplanade, New Orleans, Louisiana, which was constructed as a production and post-production facility for the Company's use. The Company has since assumed the liability for \$1,000,000 of these loans plus a contingent sum of \$750,000 (contingent on receipt of the tax credit revenue of at least \$5,000,000 in cash proceeds from the tax credits to be earned by SAPLA) due to an agreement with the now mortgagor Palm Finance. Additionally, a construction loan of \$1,850,000 previously guaranteed by the Company has now been assumed by the Company for the property at 807 Esplanade. The Company did not receive any consideration or benefit when they assumed the mortgage and construction loans, and have looked to the authoritative guidance on guarantees as an analogy. As the guidance on financial guarantees does not address which account would be set up as an offsetting entry when the liability is recognized at the inception of the guarantee, the Company has determined to call this asset balance created upon assumption of the debt "Building Improvements related to indebtedness" The Building Improvements will be amortized in a manner similar to leasehold improvements, over the life of the lease (30 years).

The post production facility commenced operations on July 1, 2012.

**Emerging Growth Company Critical Accounting Policy Disclosure:**

The JOBS Act contains provisions that relax certain requirements for "emerging growth companies" for which we qualify. For as long as we are an emerging growth company, which may be for up to five years after the first sale of our common equity securities pursuant to an effective registration statement under the Securities Act., unlike other public companies, we will not be required to: (i) comply with any new or revised financial accounting standards applicable to public companies until such standards are also applicable to private companies under Section 102(b)(1) of the JOBS Act; (ii) provide an auditor's attestation report on management's assessment of the effectiveness of our system of internal control over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act; (iii) comply with any new requirements adopted by the PCAOB requiring mandatory audit firm rotation or a supplement to the auditor's report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer; or (iv) comply with any new audit rules adopted by the PCAOB after April 5, 2012 unless the SEC determines otherwise.

Under the JOBS Act, emerging growth companies can delay adopting new or revised accounting standards that have different effective dates for public and private companies until such time as those standards apply to private companies. We currently intend to take advantage of such extended transition period. Since we are not required to comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for other public companies, our financial statements may not be comparable to the financial statements of companies that comply with public company effective dates.

### **Off-Balance Sheet Arrangements**

Not applicable.

### **ITEM 6. EXHIBITS**

#### **EXHIBIT NO. DESCRIPTION**

- |      |   |
|------|---|
| 31   | Certification of Chief Executive Officer, pursuant to Rule 13a-14(a) of the Exchange Act, as enacted by Section 302 of the Sarbanes-Oxley Act of 2002 . |
| 31.2 | Certification of Chief Financial Officer, pursuant to Rule 13a-14(a) of the Exchange Act, as enacted by Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1 | Certification of Chief Executive Officer, pursuant to 18 United States Code Section 1350, as enacted by Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 32.2 | Certification of Chief Financial Officer, pursuant to 18 United States Code Section 1350, as enacted by Section 906 of the Sarbanes-Oxley Act of 2002.  |



## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

**Seven Arts Pictures,  
Inc.**

Date: September 15, 2014 By: /s/ *Kate Hoffman*  
Kate Hoffman  
Chief Executive Officer  
(Principal Executive  
Officer)

Date: September 15, 2014 By: /s/ *Candace Wernick*  
Candace Wernick  
Chief Financial Officer  
(Principal Financial and  
Accounting Officer)

CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2013 and 2012

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Management of

Seven Arts Entertainment, Inc. (formerly Seven Arts Pictures, Plc.)

We have audited the accompanying consolidated balance sheets of Seven Arts Entertainment, Inc. (formerly Seven Arts Pictures, Plc.) as of June 30, 2013 and 2012, and the related consolidated statements of operations and comprehensive income, cash flows and stockholders' equity for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits of these financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

We were not engaged to examine management's assertion about the effectiveness of Seven Arts Entertainment, Inc.'s internal control over financial reporting as of June 30, 2013 and 2012 and, accordingly, we do not express an opinion thereon.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency that raises substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

As discussed in Note 15 to the financial statements, the June 30, 2012 financial statements have been restated to correct a misstatement. Our opinion is not modified with respect to this matter.

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In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Seven Arts Entertainment, Inc. (formerly Seven Arts Pictures, Plc.) as of June 30, 2013 and 2012, and the results of its operations, comprehensive income and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ The Hall Group, CPAs

The Hall Group, CPAs

Dallas, Texas

October 15, 2013

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**Seven Arts Entertainment, Inc.****(Formerly Seven Arts Pictures, Plc)****Consolidated Balance Sheets**

|   | June 30,<br>2013    | June 30,<br>2012<br>(Restated) |
|---|---------------------|--------------------------------|
| <b>ASSETS</b>   |                     |                                |
| <b>CURRENT ASSETS:</b>  |                     |                                |
| Cash and cash equivalents   | \$4,884             | \$ 120,658                     |
| Accounts receivable, net of allowance for doubtful accounts of \$40,000 and \$171,062             | 110,042             | 192,035                        |
| Due from related parties  | 205,787             | 2,116,538                      |
| Fee income receivable from related parties, net of allowance for doubtful accounts of \$1,190,000 | 2,055,000           | 3,235,000                      |
| Other receivables and prepayments   | 455,019             | 849,845                        |
| Total Current Assets  | 2,830,732           | 6,514,076                      |
| Film costs, less accumulated amortization of \$13,877,172 and \$11,832,900                        | 8,368,686           | 14,612,609                     |
| Music assets, less amortization of \$408,205 and \$0  | 296,795             | 4,289,158                      |
| Building Improvements, less amortization of \$165,526 and \$0                                     | 4,102,525           | 4,551,270                      |
| Property and equipment, net of accumulated depreciation of \$119,940 and \$111,232                | 7,458               | 16,137                         |
| <b>TOTAL ASSETS</b>   | <b>\$15,606,196</b> | <b>\$29,983,250</b>            |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                     |                                |
| <b>CURRENT LIABILITIES:</b>   |                     |                                |
| Accounts payable  | 1,824,141           | 1,152,978                      |
| Accrued liabilities   | 2,486,514           | 2,758,844                      |
| Due to related parties  | 1,681,701           | 1,712,134                      |
| Shares to be issued   | -                   | 200,000                        |
| Participation and residuals   | 96,819              | 114,215                        |
| Convertible debt  | 4,073,901           | 4,162,460                      |
| Mortgage and construction loans   | 3,743,286           | 3,001,271                      |
| Film & production loans   | 7,814,412           | 6,124,428                      |
| Deferred income   | 954,265             | 849,080                        |
| Total Current Liabilities   | 22,675,039          | 20,075,410                     |

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|   |                     |                     |
|---|---------------------|---------------------|
| Provision for earn-out  | -                   | 50,000              |
| <b>TOTAL LIABILITIES</b>  | <b>\$22,675,039</b> | <b>\$20,125,410</b> |
| <b>STOCKHOLDERS' EQUITY</b>   |                     |                     |
| Convertible redeemable Series A preferred stock at \$10 stated value, 125,125 and 125,125 authorized and outstanding      | \$1,251,250         | \$1,251,250         |
| Convertible redeemable Series B preferred stock at \$100 stated value, 200,000 authorized, 43,850 and 181,850 outstanding | 5,525,458           | 9,163,636           |
| Convertible redeemable Series B shares held in escrow   | -                   | (3,163,636 )        |
| Common stock; \$0.01 par value; 249,000,000 authorized, 46,323,297 and 34,798 issued and outstanding                      | 2,578,521           | 17,399              |
| Additional paid in capital  | 22,072,882          | 18,214,831          |
| Shares held as collateral   | (455,246 )          | -                   |
| Other Comprehensive income  | (13,555 )           | (13,555 )           |
| Accumulated deficit   | (38,154,995)        | (15,612,085)        |
| Warrants to be distributed  | 480,371             | -                   |
| Total Seven Arts Entertainment Inc. equity(deficit)   | (6,715,314 )        | 9,857,840           |
| Non-controlling interest  | (353,530 )          | -                   |
| Total Shareholders' equity(deficit)   | (7,068,843 )        | 9,857,840           |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>   | <b>\$15,606,196</b> | <b>\$29,983,250</b> |

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

**Seven Arts Entertainment, Inc.****(Formerly Seven Arts Pictures, Plc)****Consolidated Statements of Operations and Comprehensive Loss**

|  | Year Ended     |                |
|--|----------------|----------------|
|  | June 30,       |                |
|  | 2013           | 2012           |
|  |                | Restated       |
| Revenue:   |                |                |
| Film revenue   | \$841,956      | \$823,006      |
| Music revenue  | 574,435        | -              |
| Fee Income Revenue - related party                       | -              | 3,235,000      |
| Post production revenue                                  | 106,417        | -              |
| Total revenue  | 1,522,808      | 4,058,006      |
| Cost of revenue:   |                |                |
| Amortization of film costs and music assets              | 2,452,477      | 3,996,576      |
| Impairment of film costs and music assets                | 6,772,376      | 9,494,247      |
| Other cost of revenue                                    | 359,313        | 899,065        |
| Development Costs abandoned                              | 2,837,545      | -              |
| Cost of revenue  | 12,421,711     | 14,389,888     |
| Gross loss   | (10,898,903)   | (10,331,882)   |
| Operating expenses:                                      |                |                |
| General and administrative expenses                      | 3,706,774      | 2,251,139      |
| Bad debt expense   | 3,582,919      | 307,481        |
| Total operating expenses                                 | 7,289,693      | 2,558,620      |
| Loss from operations                                     | (18,188,596)   | (12,890,502)   |
| Non-operating income(expense)                            |                |                |
| Other income   | -              | 4,489,721      |
| Interest expense   | (4,227,472 )   | (2,752,682 )   |
| Total non-operating income (expense)                     | (4,227,472 )   | 1,737,039      |
| Loss before taxes  | (22,416,068)   | (11,153,463)   |
| Provision for income tax                                 | -              | -              |
| Net loss   | (22,416,068)   | (11,153,463)   |
| Less: Net loss attributable to non-controlling interests | (353,530 )     | -              |
| Net loss attributable to Seven Arts Entertainment, Inc.  | \$(22,062,538) | \$(11,153,463) |

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|  |                |                |
|--|----------------|----------------|
| Comprehensive loss:  |                |                |
| Net loss   | (22,416,068)   | (11,153,463)   |
| Other Comprehensive income/loss                                    | -              | (13,555 )      |
| Comprehensive loss   | (22,416,068)   | (11,167,018)   |
| Less: Comprehensive loss attributable to non-controlling interests | (353,530 )     | -              |
| Comprehensive loss attributable to Seven Arts Entertainment, Inc.  | \$(22,062,538) | \$(11,167,018) |
| Weighted average shares of common stock outstanding:               |                |                |
| Basic  | 3,387,041      | 453,057        |
| Diluted  | 3,387,041      | 453,057        |
| Basic profit/ (loss) per share                                     | \$(6.51 )      | \$(24.62 )     |
| Diluted profit/ (loss) per share                                   | \$(6.51 )      | \$(24.62 )     |

The accompanying notes are an integral part of these consolidated financial statements

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**Seven Arts Entertainment, Inc.****Statement of Stockholders' Equity**

|  | Preferred<br>Stock Class A |        | Preferred<br>Stock Class B |        | Preferred<br>Stock Class B<br>In Escrow | Common<br>Stock |              | Defer<br>Stock |
|--|----------------------------|--------|----------------------------|--------|---|-----------------|--------------|----------------|
|  | Shares                     | Amount | Shares                     | Amount |   | Shares          | Amount       |                |
| Balance at 30<br>June 2011   | -                          | \$-    | -                          | \$-    |   | 2,643,131       | \$1,121,208  | 2,26           |
| Impact of<br>Asset Transfer<br>Agreement   |                            |        |                            |        |   | (2,643,131 )    | (1,121,208 ) | (2,26          |
| One for one<br>share issue on<br>transfer of<br>assets from<br>Seven Arts<br>Pictures Plc<br>Transfer of<br>Seven Arts<br>Pictures Plc<br>(PLC) assets<br>and liabilities<br>to Seven Arts<br>Entertainment,<br>Inc. |                            |        |                            |        |   | 1,850           | 925          |                |
| Shares issued<br>to Seven Arts<br>Pictures Plc to<br>cover<br>remaining<br>liabilities   |                            |        |                            |        |   | 571             | 286          |                |
| Common stock<br>issued for cash  |                            |        |                            |        |   | 436             | 218          |                |
| Common stock<br>issued for<br>consultancy<br>fees  |                            |        |                            |        |   | 1,503           | 751          |                |
| Common stock<br>issued in<br>exchange for  |                            |        |                            |        |   | 25,372          | 12,686       |                |

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|  |         |           |         |           |           |             |        |        |   |  |
|--|---------|-----------|---------|-----------|-----------|-------------|--------|--------|---|--|
| debt   |         |           |         |           |           |             |        |        |   |  |
| Common stock issued on convertible notes                               |         |           |         |           |           |             | 5,066  | 2,533  |   |  |
| Issued Series A preference stock at \$10 par value                     | 125,125 | 1,251,250 |         |           |           |             |        |        |   |  |
| Issued Series B preference stock at \$100 par value                    |         |           | 181,850 | 4,762,952 |           |             |        |        |   |  |
| Series B preference shares held in escrow                              |         |           |         |           | (120,000) | (3,163,636) |        |        |   |  |
| Options issued for wages and benefits                                  |         |           |         |           |           |             |        |        |   |  |
| Foreign currency translation adjustments                               |         |           |         |           |           |             |        |        |   |  |
| Net loss   |         |           |         |           |           |             |        |        |   |  |
| Balance at 30 June 2012  | 125,125 | 1,251,250 | 181,850 | 4,762,952 | (120,000) | (3,163,636) | 34,798 | 17,399 | - |  |
| Restatement for PS Series B revaluation (Note 15)                      |         |           |         | 4,400,684 |           |             |        |        |   |  |
| Restatement for impairment of music assets (Note 15)                   |         |           |         |           |           |             |        |        |   |  |
| Restatement for reversal of Related Party fee income (Note 15)         |         |           |         |           |           |             |        |        |   |  |
| Restatement for adjusted Related Party fee income recognized (Note 15) |         |           |         |           |           |             |        |        |   |  |
| Adjustment for 25 million shares pledged                               |         |           |         |           |           |             |        |        |   |  |

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in relation to  
debt - Note 15

|  |         |           |           |             |           |             |            |           |   |
|--|---------|-----------|-----------|-------------|-----------|-------------|------------|-----------|---|
| As restated<br>(Note 15)   | 125,125 | 1,251,250 | 181,850   | 9,163,636   | (120,000) | (3,163,636) | 34,798     | 17,399    | - |
| Common<br>shares issued<br>in connection<br>with debt<br>agreement       |         |           |           |             |           |             | 1,714      | 857       |   |
| Common Stock<br>Issued to CEO<br>in connection<br>with debt<br>agreement |         |           |           |             |           |             | 140,000    | 70,000    |   |
| Sales of<br>Common Stock<br>for Cash                                     |         |           |           |             |           |             | 171        | 86        |   |
| Stock warrant<br>dividend<br>declared                                    |         |           |           |             |           |             |            |           |   |
| Preferred stock<br>converted to<br>Common Stock                          |         |           | (38,000 ) | (1,001,819) |           |             | 69,091     | 34,545    |   |
| Preferred stock<br>cancelled in<br>connection<br>with<br>settlements     |         |           | (100,000) | (2,636,363) | 100,000   | 2,636,363   |            |           |   |
| Escrowed<br>Series B PS<br>released                                      |         |           |           |             | 20,000    | 527,273     |            |           |   |
| Common Stock<br>Issued upon<br>conversion of<br>convertible<br>debt      |         |           |           |             |           |             | 40,462,793 | 2,122,541 |   |
| Common Stock<br>Issued for<br>Services                                   |         |           |           |             |           |             | 5,290,438  | 170,947   |   |
|  |         |           |           |             |           |             | 324,292    | 162,146   |   |

Common Stock  
held as  
collateral for  
legal  
settlement

Net loss

|         |              |        |              |   |    |   |            |              |   |
|---------|--------------|--------|--------------|---|----|---|------------|--------------|---|
| 125,125 | \$ 1,251,250 | 43,850 | \$ 5,525,454 | - | (0 | ) | 46,323,297 | \$ 2,578,521 | - |
|---------|--------------|--------|--------------|---|----|---|------------|--------------|---|

The accompanying notes are an integral part of these consolidated financial statements

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**Seven Arts Entertainment Inc.****(Formerly Seven Arts Pictures, Plc.)****Consolidated Statements of Cash Flows**

|   | June 30,<br>2013 | June 30,<br>2012<br>(Restated) |
|---|------------------|--------------------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                  |                                |
| Net Loss  | \$22,416,067     | \$(11,167,019)                 |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: |                  |                                |
| Depreciation  | 8,679            | 8,403                          |
| Amortization of Film Costs and Music Assets   | 2,452,477        | 3,996,574                      |
| Impairment of Film Costs  | 2,054,171        | 6,459,248                      |
| Impairment of Music costs   | 4,718,205        | 3,035,000                      |
| Amortization of Leasehold improvements  | 164,811          | -                              |
| Common Stock Issued for Services  | 1,288,974        | 640,527                        |
| Stock Option Expense  | -                | 173,797                        |
| Bad debt  | 3,538,580        | -                              |
| Development costs abandoned   | 3,196,858        | -                              |
| Forgiveness of Debt and Interest  | -                | 4,489,721                      |
| Changes in assets and liabilities:  |                  |                                |
| (Increase) Decrease in Accounts Receivable  | 359              | 239,856                        |
| Decrease in Due from Related Parties  | 42,204           | 609,436                        |
| Increase in Fee Income Receivable from Related Party                                      | -                | (3,235,000 )                   |
| (Increase)Decrease in Other Receivables and Prepayments                                   | (13,573 )        | 771,050                        |
| (Increase) in Film Costs  | (1,051,378 )     | (1,934,871 )                   |
| (Increase) in Music Assets  | (606,770 )       | (1,324,158 )                   |
| Increase (Decrease) in Accounts Payable   | 1,546,377        | (1,417,293 )                   |
| Increase(Decrease) in Accrued Liabilities   | 460,274          | 186,957                        |
| Increase in Due to Related Parties  | (30,433 )        | 1,060,905                      |
| Increase in Accrued Interest included in notes payable                                    | 4,043,129        | 2,939,546                      |
| Increase in Deferred Income   | 105,185          | 1,060,905                      |
| (Decrease) in VAT Payable   | -                | (1,477,584 )                   |
| Increase (Decrease) in Provision for Earn Out   | (50,000 )        | 50,000                         |
| Net Cash Used in Operating Activities   | (547,938 )       | 56,699                         |
| <b>CASH FLOWS PROVIDED BY (USED FOR) INVESTING ACTIVITIES :</b>                           |                  |                                |
| Building Improvements   | (466,068 )       | (4,551,270 )                   |

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|  |              |              |
|--|--------------|--------------|
| Net Cash Used in Investing Activities                          | (466,068 )   | (4,551,270 ) |
| <b>CASH FLOWS PROVIDED BY (USED FOR) FINANCING ACTIVITIES:</b> |              |              |
| Proceeds from Borrowings                                       | 1,838,162    | 3,991,047    |
| Cash Payments on Debt  | (1,239,930 ) | (1,313,337 ) |
| Issuance of Preferred Stock for Cash                           | -            | 1,251,250    |
| Issuance of Common Stock for Cash                              | 300,000      | 500,000      |
| Warrant dividend declared                                      | -            | -            |
| Net Increase in Equity From Asset Transfer                     | -            | 177,484      |
| Shares as collateral for legal settlement                      |              |              |
| Net Cash Provided by (Used for) Financing Activities           | 898,232      | 4,606,444    |
| NET INCREASE (DECREASE) IN CASH                                | (115,774 )   | 111,873      |
| CASH AT BEGINNING OF PERIOD                                    | 120,658      | 8,785        |
| CASH AT END OF PERIOD  | \$4,884      | \$120,658    |
| <b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>                     |              |              |
| Assumption of Debt   | -            | 3,001,270    |
| Shares of common stock issued for services                     | 1,288,945    | 640,527      |
| Shares of common stock issued in exchange for accounts payable | 875,214      | -            |
| Shares of common stock issued as collateral                    | 455,246      | -            |
| Shares of common stock pledged in connection with debt         | 70,000       | -            |
| Shares of common stock issued in payment of debt and interest  | 3,373,134    | 9,163,636    |
| Conversion of Preferred Shares Series B to common stock        | 1,001,819    | -            |

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

**Seven Arts Entertainment, Inc.**

**(Formerly Seven Arts Pictures, Plc.)**

**Notes to Consolidated Financial Statements**

**June 30, 2013 and 2012**

**NOTE 1 – NATURE OF ACTIVITIES AND SIGNIFICANT ACCOUNTING POLICIES**

Nature of Activities, History and Organization:

Seven Arts Entertainment, Inc. (herein referred to as “the Company”, “Seven Arts” or “SAE,”), a Nevada Corporation, is the continuation of the business of Seven Arts Pictures Plc. (“PLC”), which was founded in 2002 as an independent motion picture production and distribution company engaged in the development, acquisition, financing, production, and licensing of theatrical motion pictures for exhibition in domestic (i.e., the United States and Canada) and foreign theatrical markets, and for subsequent worldwide release in other forms of media, including home video and pay and free television. The Company currently owns interests in 33 completed motion pictures, subject in certain instances to the prior financial interests of other parties. As discussed herein, in late February 2012, the Company formed Seven Arts Music, Inc. (“SAM”) and acquired 52 completed sound recordings of the recording artist DMX from David Michery (“Michery”) with the rights to additional albums and acquired 100% of the stock of Big Jake Music (“BJM”). As a result, the Company is also in the business of producing and distributing recorded music. On June 30, 2012 Seven Arts Filmed Entertainment LLC (“SAFELA”) was transferred to the Company. SAFELA, which is now 60% owned by the Company, has a 30 year lease to operate a film production and post-production facility at 807 Esplanade in New Orleans, Louisiana. The post production facility commenced operations on August 12, 2012. On Aug 14, 2012 Seven Arts Filmed Entertainment Louisiana LLC (“SAFELA”), commenced operation of Seven Arts Post at the Company’s production facility located at 807 Esplanade Ave., New Orleans, Louisiana.

On June 11, 2010, SAE, was formed and became a wholly owned subsidiary of PLC. As of June 11, 2010, the Company entered into an Asset Transfer Agreement, as amended on January 27, 2011 and again on August 31, 2011, to transfer certain assets with a cost basis from PLC to SAE, in exchange for assumption by SAE of certain indebtedness and for one share of common stock of SAE for each ordinary share of PLC which have been distributed to shareholders. Additionally, 571 shares (2,000,000 shares as adjusted for the 1:70 and 1:50 reverse stock splits discussed herein) of SAE were issued to PLC in order to satisfy any remaining obligations. This transfer was approved by the PLC shareholders at an Extraordinary General Meeting on June 11, 2010. The purpose of this transfer was to eliminate our status as a foreign private issuer and to assume compliance with all obligations of a domestic issuer under all applicable state and Federal securities laws. Our intention in executing this transaction was to redomicile our business with no change in the economic interests of our shareholders. Subsequent to the transfer SAE became is a United States issuer and commenced regular quarterly reporting from the first quarter ended September 30, 2011.

On August 31, 2011, NASDAQ approved the substitution of one share of SAE, Inc. stock for the Company's NASDAQ listing, effective at the opening of trading on September 1, 2011. On that date, each of the Company's ordinary shares were exchanged for one share of common stock of SAE, and commenced trading on NASDAQ as the successor to the Company's NASDAQ listing. This transaction was approved by the Company's shareholders at the Company's Extraordinary General Meeting on June 11, 2010. On August 31, 2012, the Company announced a 1:70 reverse stock split, which was effective immediately. All share references herein have been adjusted to reflect this split.

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On November 8, 2011, the Company's listing predecessor, PLC, was placed into involuntary creditors' liquidation under English law (See Note 13 – Commitments and Contingencies). Certain indebtedness of PLC remained with PLC and will be subject to administration or payment in those administration proceedings. In accordance with the asset transfer agreement, PLC has been issued 571 shares of common stock of SAE in order to satisfy these obligations.

On February 23, 2012, the Company formed Seven Arts Music, Inc. ("SAM") and acquired 52 completed sound recordings of the recording artist DMX from David Michery ("Mr. Michery") with the rights to additional albums and acquired 100% of the stock of Big Jake Music ("BJM"). As a result, the Company is also in the business of producing and distributing recorded music.

In connection with the acquisition of the music assets of Michery, the Company issued 100,000 shares of our Series B convertible preferred stock, par value \$100 convertible at approximately \$1.10 per share) to Michery and his assigns. 50,000 shares of the Company's Series B convertible preferred stock were held in escrow and to be released to Michery and his assigns only if two DMX albums and two Bone Thugs-N-Harmony albums generate an aggregate of net earnings before interest and taxes of \$5,000,000 during the next five fiscal years.

During the quarter ended December 31, 2012, Mr. Michery converted and sold 38,000 of the 50,000 shares of Series B that he and his assigns held. The Company and Mr. Michery have agreed the remaining 50,000 shares of Series B in escrow will be disposed of by release of 20,000 shares of the Series B convertible preferred stock to Mr. Michery in full satisfaction of any claims he may have against the Company and the balance of the 30,000 shares of Series B will be cancelled. The release of the 20,000 shares has been recognized as services in the accompanying financial statements. As of June 30, 2013, Mr. Michery or his assigns hold 32,000 shares of Series B convertible preferred stock.

In connection with the acquisition of the stock of BJM, the Company issued 80,000 shares of the Company's Series B convertible preferred stock, par value \$100 convertible at approximately \$1.10 per share) to Jake Shapiro and his assigns with 70,000 of these shares held in escrow to be released to Shapiro and his assigns only if certain specific terms are met: 40,000 shares were subject to proving valuation and usage of certain advertising credits and 30,000 shares were subject to an earnout over a two year period.

The Company entered into a settlement agreement with Mr. Shapiro on February 27, 2013 and all shares of Series B preferred stock held in escrow for him and persons associated with him have been cancelled, with Mr. Shapiro and his assigns still holding 10,000 shares of Series B convertible preferred stock as of March 31, 2013. The name and the website of Big Jake Music were also reassigned to Mr. Shapiro as part of the settlement agreement.

Seven Arts Pictures Louisiana LLC, (“SAPLA”), a related party of the Company, entered into a Credit Agreement with Advantage Capital Community Development Fund LLC dated October 11, 2007, for the acquisition and improvement of the production and post-production facility located at 807 Esplanade Avenue in New Orleans, Louisiana (“807 Esplanade”) for aggregate principal advances of up to \$3,700,000. This agreement was guaranteed by the Company’s predecessor. Approximately \$3,700,000 plus interest has been drawn under the terms of this Credit Agreement, as of June 30, 2012. The Company has now assumed the liability for \$1,000,000 of this amount plus a contingent sum of \$750,000 (contingent on receipt of at least \$5,000,000 in cash proceeds from the tax credits to be earned by SAPLA) due to an agreement with the now mortgagor Palm Finance. A construction loan of \$1,850,000 previously guaranteed by the Company has now also been assumed by the Company. The Company through SAFELA, has a 30 year lease on the property 807 Esplanade to operate a film production and post-production facility.

On January 1, 2012, Seven Arts Film Entertainment Limited (“SAFE”) sold all of its film assets to SAE for assumption of indebtedness. SAFE ceased operations on May 31, 2013 on closing of its office in London, England. The Company plans to file for creditors voluntary liquidation of SAFE in England. The asset transfer agreement had no impact on the Company’s consolidated financial statements.

## Capital Structure:

SAE's authorized capital is 250,000,000 shares of capital stock. SAE has authorized the following classes of stock:

249,000,000 of common stock, \$.01 par value per share. As of June 30, 2013, there are 46,323,297 shares of common stock outstanding. Each outstanding share of common stock entitles the holder thereof to one vote per share on matters submitted to a vote of stockholders.

125,125 shares of Series A Preferred Stock with a \$10.00 stated value per share. All of such authorized shares were issued to one shareholder in November 2011. These shares have a conversion price to common stock of \$10.50 per share.

200,000 shares Series B Preferred Stock with a \$100.00 stated value per share. As of June 30, 2013, there are 43,580 shares outstanding. The per share conversion price for the Series B Preferred Stock is \$1.10 per share.

On September 14, 2012 the Company's common stock began trading on the OTC Market's OTCQB marketplace. The Company's common shares trade under the Company's symbol "SAPX." The Company is applying to trade on the highest OTC marketplace, OTCQX, but is trading on the OTCQB tier until the Company is eligible to trade on the OTCQX.

Trading of the Company's common stock on The NASDAQ Capital Market was suspended at the opening of business on September 14, 2012, due to the fact that the Company did not meet the \$1 minimum bid price stock listing requirement of NASDAQ for ten trading days prior to September 20, 2012, the expiration date on the Company's six-month extension to meet this listing requirement.

On September 14, 2012, the Company's common stock began trading on the OTC Market's OTCQB marketplace. The Company's common stock is quoted under the symbol "SAPX." The Company is applying to trade on the highest OTC marketplace, OTCQX, but is quoted on the OTCQB tier until the Company is eligible to be quoted on the OTCQX.

On January 28, 2013, at a shareholders' meeting, an increase in the number of authorized shares of the Company's shares to 250,000,000 was approved, with 1,000,000 designated for preferred shares, and 249,000,000 as common shares.

The Board of Directors was also authorized to increase the number of shares of the Company's common stock issuable in the Company's 2012 Stock Incentive Plan from 71,429 to 15,000,000.

Seven Arts also, subject to appropriate and required regulatory filings and approvals, declared a warrant dividend to those persons beneficially owning its common stock as of the close of the markets on August 31, 2012. For every ten pre-reverse split shares of common stock held as of such date and time, the holders thereof are entitled to receive one warrant as a dividend. Until its expiration date, each warrant, once distributed following such approvals, will be exercisable for the purchase of one share of the Company's post-reverse split common stock at a price equivalent to today's post-reverse split closing bid price. The warrants will expire on the earlier of (i) the date that the holder disposes of the common stock in respect of which the warrant dividend was declared, if such disposition occurs on or before the close of the markets on October 31, 2012, or (ii) 5:00 p.m., PST, on June 30, 2014. Seven Arts does not expect that a secondary market will develop for such warrants.

#### Reverse Stock-Splits:

On May 2, 2013 and August 31, 2012, the Company effected one-for-fifty and one-for-seventy reverse stock splits, respectively, collectively referred to as the Stock Splits. Unless otherwise noted, all impacted amounts included in the consolidated financial statements and notes thereto have been retroactively adjusted for the Stock Splits. Unless otherwise noted, impacted amounts include shares of common stock authorized and outstanding, share issuances and cancellations, shares underlying preferred stock, convertible notes, warrants and stock options, shares reserved, conversion prices of convertible securities, exercise prices of warrants and options, and loss per share.

Audited Financial Statements:

The accompanying audited consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules of the Securities and Exchange Commission. These financial statements are audited and, in the opinion of management, include all adjustments necessary to present fairly the balance sheet, statement of operations, statement of stockholders' equity and statement of cash flows for the periods presented in accordance with accounting principles generally accepted in the United States.

Basis of Presentation:

The accompanying consolidated financial statements include the accounts of Seven Arts Entertainment, Inc. ("SAE"), and its subsidiaries:

- Seven Arts Filmed Entertainment, Limited ("SAFE, Ltd.") (100% owned)
- Seven Arts Music, Inc. ("SAM") (100% owned) and
- Big Jake Music, Inc. ("BJM") (100% owned)
- Seven Arts Filmed Entertainment Louisiana LLC ("SAFELA") (As of June 30, 2012) (60% owned by SAE, 40% owned by Palm Finance)

The Company consolidates its subsidiaries in accordance with Accounting Standards Codification ("ASC") 810, "*Business Combinations*", and specifically ASC 810-10-15-8 which states, "The usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule, ownership by one reporting entity, directly or indirectly, or over 50% of the outstanding voting shares of another entity is a condition pointing toward consolidation." The Company does not have any variable interest or special purpose entities. The Company presents Palm Finance's 40% share of SAFELA's profit or loss as a noncontrolling interest.

The Company prepares its financial statements on the accrual basis of accounting and in accordance with Generally Accepted Accounting Principles of the United States of America ("US GAAP"). All material intercompany balances and transactions are eliminated. Management believes that all adjustments necessary for a fair presentation of the results of the years ended June 30, 2032 and 2012 have been made.

### Going Concern

The accompanying consolidated financial statements are prepared under a going concern basis in accordance with US generally accepted accounting principles ("GAAP") which contemplates the realization of assets and discharge of liabilities and commitments in the normal course of business. For the year ended June 30, 2013, the Company recorded a loss from operations of \$18,232,123 and utilized cash in operations of \$2,436,484. As of June 30, 2013, the Company had a working capital deficit of approximately \$19,844,000.

These factors, among others, raise substantial doubt about the Company's ability to continue as a going concern. The Company's ability to continue as a going concern is dependent upon its ability to return to profitability or to develop additional sources of financing or capital. The Company's financial statements do not include any adjustments that might result from the outcome of these uncertainties.

Historically, the Company's main source of cash was through the exploitation of its films, sales of equity and debt financing. However, the Company has not released or distributed a new film since July 2012. The Company's next film, Schism, is expected to be released in March, 2014, and the Company also intends to release the next DMX album in early 2014 and the Thugs Bones N Harmony album in December 2013. Additionally, management has begun to implement cost reductions including reducing the size of its' staff and size of its UK office and expects to be able to continue to obtain additional financing. No assurance can be given that the financing will be available or, if available, that it will be on terms that are satisfactory to the Company.

### Use of Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. The most significant estimates made by management in the preparation of the financial statements relate to ultimate revenue and costs of its films which are used in the amortization and impairment of film costs, estimates for allowances and income taxes. Accordingly, actual results could differ from those estimates.

### **Emerging Growth Company Critical Accounting Policy Disclosure:**

The JOBS Act contains provisions that relax certain requirements for "emerging growth companies" for which we qualify. For as long as we are an emerging growth company, which may be for up to five years after the first sale of

our common equity securities pursuant to an effective registration statement under the Securities Act., unlike other public companies, we will not be required to: (i) comply with any new or revised financial accounting standards applicable to public companies until such standards are also applicable to private companies under Section 102(b)(1) of the JOBS Act; (ii) provide an auditor's attestation report on management's assessment of the effectiveness of our system of internal control over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act; (iii) comply with any new requirements adopted by the PCAOB requiring mandatory audit firm rotation or a supplement to the auditor's report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer; or (iv) comply with any new audit rules adopted by the PCAOB after April 5, 2012 unless the SEC determines otherwise.

Under the JOBS Act, emerging growth companies can delay adopting new or revised accounting standards that have different effective dates for public and private companies until such time as those standards apply to private companies. We currently intend to take advantage of such extended transition period. Since we are not required to comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for other public companies, our financial statements may not be comparable to the financial statements of companies that comply with public company effective dates.

Significant Accounting Policies:

The Company's management selects accounting principles generally accepted in the United States of America and adopts methods for their application. The application of accounting principles requires the estimating, matching and timing of revenue and expense. It is also necessary for management to determine, measure and allocate resources and obligations within the financial process according to those principles. The accounting policies used conform to generally accepted accounting principles which have been consistently applied in the preparation of these financial statements.

Revenue Recognition:

FILMS

The Company recognizes revenue from the sale (minimum guarantee or non-refundable advances) or licensing arrangement (royalty agreements) of a film in accordance with ASC 605-15 "*Revenue Recognition*". Revenue will be recognized only when all of the following criteria have been met:

- a) Persuasive evidence of a sale or licensing arrangement with a customer exists.  
The film is complete and, in accordance with the terms of the arrangement, has been delivered or is available for
- b) immediate and unconditional delivery. (i.e. the "notice of delivery" ("NOD") has been sent and there is a master negative available for the customer).
- c) The license period of the arrangement has begun and the customer can begin its exploitation, exhibition, or sale.
- d) The arrangement fee is fixed or determinable.
- e) Collection of the arrangement fee is reasonably assured.

A written agreement with clients (purchase order, letter, contract, etc.), indicating the film name, territory and period is required for the recognition of revenue. Revenue is recognized when the performance criteria in the contracts have been met. The customer generally confirms agreement by their signature on the contract.

Minimum guarantee revenue (i.e., non-refundable advances) is recognized as and when the film is available for delivery to the respective territories. Cash deposits received on the signing of the contracts are recorded as deferred revenue until the film is available for delivery (as described above) at which point the deferred revenue is recognized as revenue. The Company does not recognize any revenues relating to minimum guarantee on any motion picture or related amortization expense on that picture until United States theatrical release if it has agreed with the licensees that



delivery or payment of minimum guarantee will be delayed for any material period of time to permit such a theatrical release.

Royalty revenue, which equates to an agreed share of gross receipts of films, is recognized as income as and when the Company is notified of the amounts by the customers through their royalty reports. Revenue is recorded net of any sales or value added taxes charged to customers.

### MUSIC

Revenue, which equates to an agreed share of gross receipts, is recognized as income when the Company is notified of the amounts by the distribution agent through their distribution reports.

Revenue is recorded:

- a) net of any sales or value added taxes charged to customers
- b) net of discounts agreed with customers
- c) net of returns provision agreed with the distributor and
- d) grossed up for the distribution fee charged by the distribution agent.

Revenue from digital distribution will be reported by the various digital platforms such as iTunes in their periodic reports and posted as received.

#### FILM TAX CREDITS

Many countries make tax credits available to encourage film production in the territory. Seven Arts benefits from tax credits in:

- a) The UK and several other European territories for their European productions
- b) Canada for their Canadian productions
- c) Louisiana for their US productions
- d) Tax preferred financing deals

These tax credits may be treated as a reduction in the capitalized costs of the film assets they are financing or as producer fees to us if the tax credits are earned and owned by a company in the Group and paid to us as overhead or producer fees.

#### Fee Income Receivable from Related Party

Revenue in the form of fee income is due to the Company from a related party, SAPLA (owned by the wife of Peter Hoffman, the Company's former CEO) for developer, advisory and financial services provided by the Company as concerns infrastructure and historic rehabilitation tax credits earned by SAPLA. In accordance with an intercompany agreement between SAE and SAPLA, the cash proceeds from the disposition of the tax credits earned by SAPLA are due to SAE. The Company has recognized the fair value of the services as revenue with any excess received as a capital contribution by the related party.

#### Foreign Currency Transactions and Comprehensive Income:

The Company's functional currency, as well as that of all the Company's subsidiaries, is the US Dollar. The functional currency of the Company's predecessor, was the Pound Sterling ("GPB"), and some transactions which are generated in the United Kingdom are denominated in GBP.

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Assets and liabilities generated in a currency other than the functional currency are translated at exchange rates as of the balance sheet date. Revenues and expenses are translated at average rates in effect for the periods presented. The cumulative translation adjustment is included in the accumulated other comprehensive gain (loss) within shareholders' equity. Foreign currency transaction gains and losses arising from exchange rate fluctuations on transactions denominated in a currency other than the functional currency are included in the consolidated results of operations. The Company no longer has any operations generated in a currency other than the functional currency and therefore there is no resulting other comprehensive income/loss.

The Company records transaction gains and losses in the consolidated statements of operations related to the recurring measurement and settlement of such transactions.

To date, the Company has not hedged any transactional currency exposure but will keep such exposures under review and where appropriate may enter into such transactions in future.

#### Income Taxes:

The Company has adopted ASC 740-10 "*Income Taxes*", which requires the use of the liability method in the computation of income tax expense and the current and deferred income taxes payable.

#### Cash and Cash Equivalents:

Cash and cash equivalents includes cash in banks with original maturities of three months or less and are stated at cost which approximates market value, which in the opinion of management, are subject to an insignificant risk of loss in value. The cash and cash equivalents of the Company consisted of cash balances held on deposit with banks, including various accounts denominated in US Dollars, Pounds Sterling and Euros.

#### Accounts Receivable:

Accounts Receivable are carried at their face amount, less an allowance for doubtful accounts. On a periodic basis, the Company evaluates accounts receivable and establishes an allowance for doubtful accounts based on a combination of specific customer circumstances and credit conditions, and on a history of write offs and collections. The Company's

policy is generally not to charge interest on trade receivables after the invoice becomes past due. A receivable is considered past due if payments have not been received within agreed upon invoice terms. Write offs are recorded at a time when a customer receivable is deemed uncollectible. The Company's allowance for doubtful accounts was \$131,062 and \$171,062 at June 30, 2013 and June 30, 2012, respectively. Substantially all of the trade receivables in the consolidated financial statements are pledged as security for borrowings by the Company.

#### Due To/Due From Related Parties

In September 2004, the Company's predecessor entered into an agreement with SAP under which SAP provided the services of Mr. Peter Hoffman for the amount of his contracted salary and the Los Angeles office and staff of SAP Inc. to the Company's predecessor at cost. Pursuant to two inter Company agreements, SAP also from time-to-time owned limited liability companies in the United States which distributed the Company's motion pictures for a fee, with all profits ensuing to the benefit of the Company. These companies also provided other services to the Company at no fee other than Mr. Hoffman's salary and the direct third-party costs of SAP's Los Angeles office, all of which were reflected in the Company's financial statements. Portions of Mr. Hoffman's salary have not been paid to him and have been reflected as Due To Related Party. As of June 30, 2013 and 2012, \$1,665,762 and \$1,698,578 (Restated), respectively, was owed to Mr. Hoffman for unpaid salary and unreimbursed expenses, as well as repayment of cash he advanced the Company or its predecessors.

These other services may include accounting services, audits of distribution statements, collection of accounts receivable, supervision of production of motion pictures and similar day-to-day aspects of the Company's business. SAP assigned to the Company any proceeds arising from services performed by SAP on its behalf. SAP was granted the power and authority to enter into agreements on the Company's behalf. These agreements were terminated from December 31, 2011.

SAP directly or through related various Louisiana limited liability companies have, from time-to-time, made non-interest bearing advances to the Company or its subsidiaries or have received advances back from the Company, and have paid expenses on each other's behalf.

Other Receivables and Prepayments:

The Company has entered into contracts for investor relations and consulting services to assist in future fundraising activities. A portion of these services were prepaid with shares of common stock that vested immediately and will be amortized over the period the services are to be provided. Additionally, the Company had approximately \$200,000 in revenue to be received from digital platforms on the film, The Pool Boys, which has been earned but not received as of June 30, 2012. The Company also has prepaid some legal costs, which will be released when services are performed, or related transaction is completed. As of June 30, 2013 substantially all of the balance represents prepaid legal fees.

Film Costs:

Film costs include the unamortized costs of completed films which have been produced by the Company or for which the Company has acquired distribution rights, libraries acquired as part of acquisitions of companies and films in progress and in development. For films produced by the Company, capitalized costs include all direct production and financing costs, capitalized interest and production overhead.

Costs of acquiring and producing films are amortized using the individual-film-forecast method, whereby these costs are amortized and participations and residuals costs are accrued in the proportion that current year's revenue bears to management's estimate of ultimate revenue at the beginning of the current year expected to be recognized from the exploitation, exhibition or sale of the films. The majority of a film's costs (approximately 80% or more) are generally amortized within three years of the picture's initial release.

Ultimate revenue includes estimates over a period not to exceed ten years following the date of initial release. Film costs are stated at the lower of amortized cost or estimated fair value. Individual film costs are reviewed on a title-by-title basis, when an event or change in circumstances indicates that the fair value of a film is less than its unamortized cost. The fair value of the film is determined using management's future revenue and cost estimates and a discounted cash flow approach. Impairment is recorded in the amount by which the unamortized costs exceed the estimated fair value of the film. Estimates of future revenue involve measurement uncertainty, and therefore it is possible that reductions in the carrying value of investment in films may be required as a consequence of changes in management's future revenue estimates.

Films are included in the general "library" category when initial release dates are at least three years prior to the acquisition date.

Films in progress include the accumulated costs of productions which have not yet been completed. Films in development include costs of acquiring film rights to books, stage plays or original screenplays and costs to adapt such projects. Such costs are capitalized and, upon commencement of production, are transferred to production costs. Projects in development are written off at the earlier of the date they are determined not to be recoverable or when abandoned.

All Exploitation Costs (comprising of direct costs, including marketing, advertising, publicity, promotion, and other distribution expenses) incurred in connection with the distribution of a film ) are expensed as incurred in accordance with ASC 720- 926- 25-3 .

The Company begins to accrue participation costs after a film is released when it is probable that such costs will become payable. Participation costs are accrued using the individual-film-forecast method, which accrues participation costs in the same ratio that current period actual revenue bears to the estimated remaining unrecognized ultimate revenue as of the beginning of the current fiscal year.

#### Music Assets:

The initial material assets that were acquired comprise 52 completed sound recordings including two completed albums with “DMX”, up to two additional albums from “DMX” and up to five albums from “Bone Thugs-N-Harmony”.

Music assets include the unamortized costs of completed albums, singles and videos which have been produced by the Company or for which the Company has acquired distribution rights, libraries acquired as part of acquisitions and albums in progress and in development. For albums produced by the Company, capitalized costs include all direct production and financing costs, capitalized interest and production overhead.

Costs of acquiring and producing music assets will be amortized using the individual-album-forecast method, whereby these costs are amortized in the proportion that current year’s revenue bears to management’s estimate of ultimate revenue at the beginning of the current year expected to be recognized from the exploitation or sale of the music.

Building Improvements:

On June 30, 2012, the Company acquired SAFELA, which was previously a related party company. SAFELA has a 30 year lease on 807 Esplanade, New Orleans, Louisiana, which was constructed as a production and post-production facility. The Company has since assumed the liability for \$1,000,000 of these loans plus a contingent sum of \$750,000 (contingent on receipt of the tax credit revenue of at least \$5,000,000 in cash proceeds from the tax credits to be earned by SAPLA) due to an agreement with the now mortgagor Palm Finance. Additionally, a construction loan of \$1,850,000 previously guaranteed by the Company has now been assumed by the Company for the property at 807 Esplanade. The Company did not receive any consideration or benefit when they assumed the mortgage and construction loans, and have looked to the authoritative guidance on guarantees as a analogy. As the guidance on financial guarantees does not address which account would be set up as an offsetting entry when the liability is recognized at the inception of the guarantee, the Company has determined to call this asset balance created upon assumption of the debt "Building Improvements related to indebtedness" The Building Improvements will be amortized in a manner similar to leasehold improvements, over the life of the lease (30 years).

The post production facility commenced operations on July 1, 2012.

Property & Equipment:

Equipment is carried at the cost of acquisition or construction and depreciated over the estimated useful lives of the assets. Costs associated with repair and maintenance are expensed as incurred. Costs associated with improvements which extend the life, increase the capacity or improve the efficiency of our property and equipment are capitalized and depreciated over the remaining life of the related asset. Gains and losses on dispositions of equipment are reflected in operations. Depreciation and amortization are provided using the straight-line method over the estimated useful lives of the assets, which are 3 to 5 years.

Impairment of Long Lived Assets:

The Company evaluates, on a periodic basis, long-lived assets to be held and used for impairment in accordance with the reporting requirements of ASC 360-10, "Accounting for the Impairment or Disposal of Long-Lived Assets". The evaluation is based on certain impairment indicators, such as the nature of the assets, the future economic benefit of the assets, any historical or future profitability measurements, as well as other external market conditions or factors that may be present. If these impairment indicators are present or other factors exist that indicate that the carrying amount of the asset may not be recoverable, then an estimate of the discounted value of expected future operating cash flows is used to determine whether the asset is recoverable and the amount of any impairment is measured as the difference between the carrying amount of the asset and its estimated fair value. The fair value is estimated using valuation techniques such as market prices for similar assets or discounted future operating cash flows.



Deferred Income:

Any income received from customers before a film is delivered for release, (such as deposits on distribution contracts) is recorded as a liability called deferred income in case the film does not reach completion and the income has to be returned to customers.

Provision for earn-out for David Michery/Big Jake Music:

The Company's Asset Purchase Agreement with David Michery provided for 50,000 of the Company's \$100 stated, Convertible Redeemable Series B Preferred Shares, be held in Escrow until the Net EBIT (as defined in the agreement) from distribution of the DMX Albums and two albums embodying the performance of Bone Thugs-n-Harmony exceeds \$5,000,000, as confirmed by the Company's independent auditor. At the end of five years, should the Net EBIT be less than \$5,000,000, the shares will be released on a fractional basis, as defined in the agreement. As of the year ended June 30, 2012 the Company has determined the estimated fair value of the earnout to be \$0. The PS held in escrow were released or cancelled as of a settlement agreement with Mr. Michery in February 2013, described previously.

In connection with the acquisition of the stock of BJM, the Company issued 10,000 shares of the Company's Series B convertible preferred stock, par value \$100 convertible at approximately \$1.10 per share) to Jake Shapiro and his assigns and agreed to issue an additional 70,000 shares of Series B convertible preferred stock to Shapiro and his assigns if certain specific terms were met; 40,000 shares were subject to proving valuation and usage of certain advertising credits and 30,000 shares were subject to an earnout over a two year period. The 70,000 shares were held in escrow, until their cancellation in relation to a settlement with BJM, in February 2013, described previously.

As of June 30, 2012, the Company had determined the fair value of the earnout with regard until the proving of the media credits to be \$50,000, which the Board believed was the value of an equivalent public relations campaign.. Mr. Shapiro did have the right to seek an independent valuation. As the shares held in escrow against the valuation of the media credits were cancelled, as part of the settlement (Note 1) the earn-out has been derecognized on the accompanying financial statements.

Asset Transfer Agreement:

On June 11, 2010, Seven Arts Entertainment, Inc. (“SAE”), a Nevada Corporation, was formed and became a wholly owned subsidiary of Seven Arts Pictures Plc. As of June 11, 2010, the Company entered into an Asset Transfer Agreement, This was approved by the PLC shareholders at an Extraordinary General Meeting on that date, and was subsequently amended on January 27, 2011 and again on August 31, 2011, to transfer all of the assets with a cost basis from PLC to SAE, in exchange for assumption by SAE of certain indebtedness and for one share of common stock of SAE for each ordinary share of PLC which have been distributed to shareholders. Additionally, 28,571 shares of SAE were issued to PLC in order to satisfy any remaining obligations . The purpose of this transfer was to eliminate our status as a foreign private issuer and to assume compliance with all obligations of a domestic issuer under all applicable state and Federal securities laws. The Company’s intention in executing this transaction was to redomicile our business with no change in the economic interests of the Company’s shareholders. As the majority of the Company’s shareholders were domestic we felt they would be better served by the Company as a domestic issuer.

The assets and certain of the liabilities of SAP Plc. were transferred at net book value. All related party balances of PLC were left in the original company as were the shares in SAFE(UK) Ltd and Cinematic Finance Ltd. All disputed debts were left with the PLC. The “ consideration paid for the asset transfer was a one for one share exchange of PLC shares for shares of SAE Inc. and an issuance of a further 2,000,000 (pre-split) (28,571 post-split ) shares in SAE Inc. The issuance of the 2,000,000 shares was booked at the closing market price on August 31 2011, which was \$0.66/ share. The Board approved the issuance of the 2 million shares (pre-reverse split) to satisfy any remaining obligations in PLC, which approximated the amount of the liabilities left behind at the time of the issuance.

Although the transfer agreement amendment was executed on January 27, 2011, the PLC remained the parent company through August 31, 2011. until all procedures and approvals were in place with NASDAQ, DWAC and the transfer agent to finalize the one share of common stock of SAE for each ordinary share of PLC to be distributed to shareholders and trading of SAE to take over from PLC The fair value of the 2,000,000 shares was determined at the closing market price on August 31 2011, which was \$0.66/share.

Earnings Per Share:

Basic earnings (loss) per share are computed by dividing net income (loss) by the weighted average number of common shares outstanding for the period. Diluted earnings (loss) per share include the effects of any outstanding options, warrants and other potentially dilutive securities. For the periods presented, there were no potentially dilutive securities outstanding, therefore basic earnings per share equals diluted earnings per share. Basic and diluted earnings per share (“EPS”) are based on weighted-average common shares and exclude shares that would have an anti-dilutive effect. In accordance with ASC 260-10-45-19, the Company did not consider any potential common shares in the computation of diluted EPS as of June 30, 2013 and 2012, due to the loss from continuing operations, as they would

have an anti-dilutive effect on EPS.

Share Based Payments:

The Company accounts for share based payments using a fair value based method whereby compensation cost is measured at the grant date based on the value of the services received and is recognized over the service period. The Company uses the Black-Scholes pricing model to calculate the fair value of options and warrants issued. In calculating this fair value, there are certain assumptions used such as the expected life of the option, risk-free interest rate, dividend yield, volatility and forfeiture rate. The use of a different estimate for any one of these components could have a material impact on the amount of calculated compensation expense.

Segment Reporting:

The Company has three operating segments based on its major lines of businesses: a motion picture producer and distributor, music label, and post-production facility. Each operating segment derives its revenues from the sale of products or services, respectively and each is the responsibility of a group of senior management of the Company who has knowledge of product and service specific operational risks and opportunities. The Company's chief operating decision maker reviews and evaluates separate sets of financial information for decisions regarding resources allocation and performance assessments.

Fair Value Measurements:

ASC Topic 820, "*Fair Value Measurements and Disclosures*", defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and requires certain disclosures about fair value measurements. In general, fair value of financial instruments are based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and the Corporation's credit worthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time.

Derivative Instruments:

The Company's policy is to not use derivative or hedging financial instruments for trading or speculative purposes, except certain embedded derivatives derived from certain conversion features or reset provisions attached to the convertible debentures, as described in Note 9.

Reclassification:

Certain prior year balances were reclassified to conform with current year presentation.

Recently Issued Accounting Pronouncements:

In October 2012, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2012-07, "Entertainment - Films (Topic 926): Accounting for Fair Value Information That Arises after the Measurement date and Its Inclusion in the Impairment Analysis of Unamortized Film Costs." ASU No. 2012-07 eliminates the rebuttable presumption that the condition leading to the write-off of unamortized film costs existing after the balance sheet date also existed as of the balance sheet date. In addition, in performing the impairment test, an entity is no longer required to incorporate the effects of changes in estimates resulting from evidence arising subsequent to the balance sheet date if the information would not have been considered by market participants at the balance sheet date. This guidance was effective for the Company's impairment assessments performed on or after December 15, 2012.

The Company does not expect the adoption of and other recently issued accounting pronouncements to have a significant impact on the Company's results of operations, financial position or cash flow.

**NOTE 2 - SEGMENT INFORMATION**

In accordance with ASC 280 “*Segment Reporting*”, operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker, or decision-making group, in making decisions how to allocate resources and assess performance. Our chief decision maker, as defined under the FASB’s guidance, is a combination of the Chief Executive Officer and the Chief Financial Officer.

In the quarter ended March 31, 2012, the Company formed a new subsidiary, Seven Arts Music, and acquired music assets from David Michery and purchased the stock of Big Jake Music. This was a new line of business for the Company, and therefore, for the year ended June 30, 2012, the Company had two reportable operating segments.

The pre and post production facility run by the Company’s majority owned subsidiary, SAFLA, commenced operations in July 2012, and therefore for the year ended June 30, 2013 the Company has three reportable segments.

The tables below present the financial information for the reportable segments for the years ended June 30, 2013 and 2012:

|                      | <b>Film</b>    | <b>Music</b> | <b>Year<br/>ended<br/>June 30,<br/>2013<br/>Production<br/>facility</b> | <b>Total</b> |
|----------------------|----------------|--------------|---|--------------|
| Revenue              | \$841,956      | \$574,434    | \$106,417   | \$1,522,807  |
| Cost of Revenue      | (7,004,141 )   | (5,395,410)  | (22,160 )   | (12,421,711) |
| Gross profit/(loss)  | (6,162,185 )   | (4,820,975)  | (84,257 )   | (10,898,903) |
| Operating expenses   | (6,447,117 )   | (480,620 )   | (361,955 )  | (7,860,492 ) |
| Loss from operations | \$(12,609,302) | (5,301,595)  | (277,698 )  | (18,188,596) |

| <b>Year ended<br/>June 30, 2012<br/>(Restated)</b> | <b>Film</b> | <b>Music</b> | <b>Total</b> |
|--|-------------|--------------|--------------|
|--|-------------|--------------|--------------|

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|                      |                |             |                |
|----------------------|----------------|-------------|----------------|
| Revenue              | \$4,052,029    | \$5,977     | \$4,058,006    |
| Cost of revenue      | 14,350,858     | 39,031      | 14,389,889     |
| Gross profit/(loss)  | \$(10,364,937) | \$(33,054)  | \$(10,331,883) |
| Operating expenses   | 2,467,111      | ) 91,505    | 2,558,620      |
| Loss from operations | \$(12,765,944) | \$(124,559) | \$(12,890,503) |

Assets

|                        | June 30,<br>2013 | June 30,<br>2012<br>(Restated) |
|------------------------|------------------|--------------------------------|
| Film assets            | \$8,368,686      | \$14,612,609                   |
| Music assets           | 296,795          | 4,289,158                      |
| Post-production assets | 4,102,525        | 4,551,270                      |

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**NOTE 3 – RELATED PARTY DUE TO/DUE FROM**

Related Party Due/From at June 30, 2013 consisted of:

|               | SAE, Inc.   | SAFE      | SAFELA | Consolidated<br>Balance |
|---------------|-------------|-----------|--------|-------------------------|
| Due from:     |             |           |        |                         |
| SAMT          | 13,000      |           |        | 13,000                  |
| SAPLA         | 173,006     |           |        | 173,006                 |
| Peter Hoffman |             |           | 19,781 | 19,781                  |
| Total         | 186,006     |           |        | 205,787                 |
| Peter Hoffman | (1,272,112) | (393,650) |        | (1,665,762 )            |
| SAFE (UK)     | (2,383 )    | (13,556 ) |        | (15,939 )               |
|               | (1,274,495) | (407,206) |        | (1,603,367 )            |

| As of June 30, 2012 | SAE INC      | SAFE       | CONSOLIDATED<br>BALANCE<br>(Restated) |
|---------------------|--------------|------------|---------------------------------------|
| SAP Inc             | \$ 1,801,098 | \$(20,850) | \$ 1,780,248                          |
| SAPLA               | 336,290      | -          | 336,290                               |
| Peter Hoffman       | (1,679,617)  | (18,961)   | (1,698,578 )                          |
| SAFE (UK)           | -            | (13,556)   | (13,556 )                             |
|                     | \$457,771    | \$(53,367) | \$ 404,404                            |

SAP, Inc. has pledged an interest in its shares of the Company's stock to secure certain indebtedness for which SAP, Inc. and the Company are jointly liable such as the Apollo and Armadillo debts. The stock of SAP, Inc. (previously owned by Peter Hoffman) was transferred to the listing predecessor of SAE on September 1, 2011.

**SAP Inc. and Louisiana Companies:**

The Company's former Chief Executive Officer who is on a leave of absence, Peter Hoffman, controls several companies, including (prior to September 10, 2011) Seven Arts Pictures, Inc. ("SAP, Inc.") that are not part of the Company but from which it obtained or transferred distribution rights or other assets related to the business and which control production of the motion pictures. The agreements with Mr. Hoffman, and the companies controlled by him, provide that all revenues related to the Company's business payable to Mr. Hoffman or any of these related party companies is due to the Company, except Mr. Hoffman's salary, bonus and stock ownership. None of these affiliates are variable interest or special purpose entities.

Prior to January 1, 2012, pursuant to a related party agreement, SAP, Inc. held ownership of limited liability corporations in the United States, with all distribution rights and profits thereof being due to SAFE, Ltd. In addition, they have also provided other services for Seven Arts Pictures Plc. and SAFE, Ltd. and SAE, Inc. at no fee other than Mr. Hoffman's salary and the direct third party costs of the Los Angeles office, all of which are reflected in the financial statements of SAFE, Ltd. These other services include any reasonable requests of the management of the Company including accounting services, audits of distribution statements, collection of accounts receivable, supervision of production of motion pictures and similar day-to-day aspects of the Company's business. Effective January 1, 2012 no further such transactions were conducted.

As of June 30, 2013, the amount due from the related party, SAP, Inc, was determined to be uncollectible due to SAP, Inc. having been transferred to PLC, which is in liquidation proceedings. Therefore, \$1,868,547 was included in Bad Debt expense in the accompanying financial statements.



**Peter Hoffman:**

In September 2004, the Company's predecessor entered into an agreement with SAP under which SAP provided the services of Mr. Peter Hoffman for the amount of his contracted salary and the Los Angeles office and staff of SAP Inc. to the Company's predecessor at cost. Pursuant to two inter Company agreements, SAP also from time-to-time owned limited liability companies in the United States which distributed the Company's motion pictures for a fee, with all profits ensuing to the benefit of the Company. These companies also provided other services to the Company at no fee other than Mr. Hoffman's salary and the direct third-party costs of SAP's Los Angeles office, all of which were reflected in the Company's financial statements. Portions of Mr. Hoffman's salary have not been paid to him and have been reflected as Due To Related Party.

During the year ended June 30, 2013, 7,143 (25,000,000 pre-split) and 140,000 (7,000,000 pre-split) shares were issued in exchange for \$914,786, and \$1,190,000, respectively, of the Due to related party balance. The 7,143 shares have been pledged to JMJ Financial in connection with a \$500,000 convertible debenture, as collateral against repayment of the note. The 140,000 shares have been pledged to Tonaquint Inc, in connection with a total of \$590,000 in convertible debentures, under the terms of an amendment dated October 5, 2012, as collateral against repayment of the note. (Note 9) In the event of a default on either of the notes the holder may transfer and sell the pledged shares and apply the proceeds against the outstanding amounts on the notes. Per agreements between the Company and Mr. Hoffman in respect to the pledged shares, if the pledged shares are sold and applied to the note balance, or if the shares are not utilized by the pledges and returned to the Company, Mr. Hoffman's Due to related party balance as of the date of the agreements, will be reinstated. Due to the future obligation to in substance repurchase the shares and reinstate the Due to related party balance, the shares have been treated as if issued for no consideration, and a liability for \$2,104,786 was recognized included in the Due to related party balance for the obligation to reinstate the Due to balance.

**SAPLA Guarantee:**

Seven Arts Pictures Louisiana LLC, ("SAPLA") a related party of the Company, entered into a Credit Agreement with Advantage Capital Community Development Fund LLC dated October 11, 2007, for the acquisition and improvement of the production and post-production facility located at 807 Esplanade Avenue in New Orleans, Louisiana for aggregate principal advances of up to \$3,700,000. This agreement was guaranteed by the Company's predecessor. Approximately \$3,700,000 plus interest has been drawn under the terms of this Credit Agreement, as of June 30, 2012. The Company has since assumed the liability for \$1,000,000 of this amount plus a contingent sum of \$750,000 due to Advantage Capital (contingent on receipt of the tax credit revenue of at least \$5,000,000 in cash proceeds from the tax credits to be earned by SAPLA) due to an agreement with the now mortgagor Palm Finance.

A construction loan of \$1,850,000 previously guaranteed by the Company has now been assumed by the Company for the property at 807 Esplanade.

The Company did not receive any consideration or benefit when they assumed the mortgage and construction loans, and have looked to the authoritative guidance on guarantees as a analogy. As the guidance on financial guarantees does not address which account would be set up as an offsetting entry when the liability is recognized at the inception of the guarantee, the Company has determined to call this asset balance created upon assumption of the debt “Building Improvements related to indebtedness” The Building Improvements will be amortized in a manner similar to leasehold improvements, over the life of the lease (30 years).

**SAPLA Advances:**

On February 28, 2012, the Company took out a convertible loan of \$200,000 which was in turn loaned to SAPLA to cover outstanding interest payments which were due on the construction loan on 807 Esplanade previously guaranteed by the Company. Three additional convertible loans were taken out totaling \$600,000 during the year ended June 30, 2012 and then loaned to SAPLA to pay down the construction loan on the property at 807 Esplanade, as to not further delay the construction and opening of the facility. As of June 30, 2013, the convertible loan balance, after conversions, on the Company’s financial statements is approximately \$325,000.

**NOTE 4 – FEE INCOME RECEIVABLE FROM RELATED PARTY (RESTATED)**

SAPLA has filed for historical rehabilitation tax credits available from the United States (26%) and Louisiana (25%) on approximately \$9,500,000 of historical rehabilitation expenses paid in connection with the renovation of the building and property at 807 Esplanade Avenue in New Orleans, Louisiana (the “Property”) and reflected in a compilation of expenses by an independent accounting firm. SAPLA has filed the Part I application for historic rehabilitation credits and has received the Part II and Part III approvals from the United States Department of Parks with respect to the Property:

- SAPLA will allocate the Federal historic rehabilitation credits to investors in its lessee, 807 Esplanade Ave. MT LLC (“MT”), and receive cash or reduction in indebtedness as a result of such allocation.
- SAPLA will assign the Louisiana historic rehabilitation for cash.

SAPLA has also filed for Louisiana film infrastructure tax credits (40%) on all of its investment of approximately \$11,500,000 in connection with the Property to date, as reflected in an audit report of an independent accounting firm (which also includes audits of all rehabilitation expenses). SAPLA has approval from Louisiana that the Property is a certified state film infrastructure project and SAFELA, as lessee of MT, is now operating a production and post-production facility at the Property.

To date Louisiana has certified approximately \$6,500,000 of the \$11,500,000 film infrastructure expenditure filed for, the tax credits accruing on which SAPLA will assign for cash, with the remaining expenses remaining under consideration by the Louisiana Department of Economic Development (“LED”). SAPLA has received no objections to any of its film rehabilitation expenses from LED as reflected in the audit report submitted to LEDF on July 2, 2012. Under a published Opinion of the Attorney General of Louisiana, the Louisiana tax credits vest upon certification as a film infrastructure project which occurred in 2008. Revenue is not recognized until the required audit or compilation is complete and available to be submitted to the appropriate agency.

Under the terms of the related party agreement between SAPLA and SAE Inc. proceeds received from the disposition of the tax credits earned by SAPLA on the building are due to SAE to reduce the notes payable to Palm Finance and as fees for services provided by the Company. SAPLA is due to receive approximately \$9,447,544 from disposition of Louisiana and Federal historic rehabilitation and film infrastructure tax credits for the restoration and the establishment of a post-production facility at 807 Esplanade.

SAPLA will pay the proceeds from disposition of such tax credits to SAE Inc. as fee income. The Company provided “developer” services as concerns oversight of the rehabilitation work carried out on the facility, as well as advisory services in connection with the obtaining of the tax credits, and financial services related to the loans and mortgage. The Company has concluded the services evidence an earning process, in the providing of a service, and as such have recognized revenue in relation to the fair value of the services provided. The fair value of \$3,235,000 was determined based on the amounts stated as “qualified expenses” and determined to be reasonable and industry standard in the required audit of cost report expenditures performed on the project by an independent accountant. Any excess over the fair value of the services received by the Company from SAPLA will be recognized as a contribution to capital.

As of December 31, 2012, the current director of LED has toured 807 Esplanade and seemed satisfied with his review. He requested the building get a permanent business license and to confirm that the equipment in the building is permanent. The permanent business license was obtained on April 1 and the permanency of the equipment was confirmed by that date as well.

As of June 30, 2013, the Louisiana Department of Economic Development has not issued a Tax Credit Certification Letter as pertains to the LFI credits, and on June 23, 2013 SAPLA received a letter from the Louisiana Economic Development (“LED”) office that they could “not proceed further with any consideration to approve” the tax credits until SAPLA proves they have the correct occupational license from the city. SAPLA does have the appropriate license and

is currently appealing this notification. In light of these subsequent occurrences, management has determined that the amount underlying the LFI credits should be reserved against as of June 30, 2013, until such time as the Tax Credit Certification Letter is received by SAPLA.

Additionally, the State Historic Preservation Office (“SHPO”) has not yet issued their Part III approval, confirming what amount of the tax credits they are approving. In October 2012 the SHPO sent SAPLA some questions on their expenditures, which were answered by the independent auditor who performed the required audit of the cost expenditures, but there has been no further correspondence since. SAPLA is pursuing the issue with SHPO to force them to state the amount of tax credits they are approving, based on a recent law in Louisiana which says SHPO must state which line item they are disallowing. Therefore, the Company has also determined to reserve against the amount of the proceeds representing the LHR credits, until such time as SAPLA resolves the issue with SHPO and receives a Part III approval.

The total reserve recognized as of June 30, 2013 for the fee income from related party is \$1,180,000, which represents the cash proceeds underlying the LFI and LHR tax credits in excess of the \$3,235,000 recognized as revenue, and reduces the receivable amount to the amount the Company has determined to be known to be collectible, the amount of the cash proceeds underlying the Federal tax credits.

#### **NOTE 5 – FILM COSTS**

Film costs as of June 30, 2013 and June 30, 2012 are as follows:

|   | <b>June 30,<br/>2013</b> | <b>June 30,<br/>2012</b> |
|---|--------------------------|--------------------------|
| Released, net of accumulated amortization | \$3,314,728              | \$7,365,186              |
| Completed and not released                | —                        | —                        |
| In production                             | 1,209,931                | 6,286,587                |
| In development                            | 3,844,027                | 960,835                  |
|   | <b>\$8,368,686</b>       | <b>\$14,612,608</b>      |

Amortization of film costs was \$2,044,272 and \$3,996,576 for the years ended June 30, 2013 and 2012. The Company estimates that its amortization expense in the next year will be \$1,275,000.

The Company reviews capitalized film costs for impairment whenever events or changes in circumstances indicate that the carrying amounts of such assets may not be recoverable or at least once per year. Determination of recoverability is based on an estimate of future cash flows resulting from the use of the asset, and its eventual disposition. Measurement of an impairment loss for the assets is based on the fair value of the asset as estimated using a discounted cash flow model. As a result of the impairment evaluation the Company recognized an impairment of

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\$2,054,171 and \$9,494,247 (Restated) in the years ended June 30, 2013 and 2012, respectively, based on reduced ultimate revenue estimations.

All Exploitation Costs (comprising of direct costs, including marketing, advertising, publicity, promotion, and other distribution expenses) incurred in connection with the distribution of a film) are expensed as incurred in accordance with ASC 720-926-25-3.

No participations have been recorded as the Company does not believe anything will be due in the next 12 months.

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**NOTE 6 – MUSIC ASSETS**

Music assets are as follows:

|   | <b>June 30,<br/>2013</b> | <b>June 30,<br/>2012<br/>(Restated)</b> |
|---|--------------------------|---|
| Music assets  | 5,423,205                | \$6,324,158                             |
| Intangible Assets – music assets                    | -                        | 1,000,000                               |
|   | 5,423,205                | 7,324,158                               |
| <br>Impairment recognized during the year           | <br>4,718,205            | <br>3,035,000                           |
| <br>Total music assets                              | <br>705,000              | <br>4,289,158                           |
| Less: Accumulated amortization                      | 408,205                  | -                                       |
| Total music assets, net of accumulated amortization | 296,795                  | \$4,289,158                             |

There were two separate transactions in which SAE acquired the “music assets”. One was an Asset Purchase Agreement with David Michery, which was accounted for as an asset purchase. In this transaction SAE acquired the music assets comprised of masters recordings. The other was the BJM acquisition, in which SAE acquired the stock of BJM, which was accounted for as a business combination

The initial material assets that were acquired from David Michery comprise 52 completed sound recordings including two completed albums with “DMX”, up to two additional albums from “DMX” and up to five albums from “Bone Thugs-N-Harmony”. The music assets were initially recorded at the fair value of the preferred stock issued, less the amount of preferred stock held in escrow, which was \$5,000,000.

The BJM transaction qualified as an acquisition of a business, as defined in ASC 805-10-55-2, as the Company, the acquirer, gained control of BJM by issuing Series B Preferred Stock as consideration. BJM falls under the definition of a business, as set forth in ASC 805-10-55-4 through 7, as although BJM was not operational, they had inputs, in the form of intangible assets, including access to artists and customers and distribution channels and were pursuing a plan to produce outputs (the recordings and CDs or digital downloads). .

At the time of acquisition the only assets were the intangibles, and certain media credits, which could not be precisely valued. BJM’s common shares were not publically traded, and therefore, were also difficult to value. In accordance with ASC ASC 505-50-30-6 which gives guidance on how to measure the equity issued in a non-monetary exchange,

as the value of the Company's Series B Preferred Stock was determined as the most readily determinable, the consideration was calculated as the fair value of the Series B Preferred Stock, which was determined to be \$1,000,000. Per the guidelines for acquisition accounting, as the only asset was the intangible assets, which could not be clearly and separately identified in a cost effective manner,, the \$1,000,000 consideration was allocated to the fair value of "Intangible Assets - music assets".

The contracts with DMX and BTH allow for royalties varying from 12% to 20%, based on sales and other varying terms, be paid to the artists after initial advances are recouped by the Company. The Company does not anticipate that any additional royalties will be due after recoupment.

The Company capitalized \$606,774 and \$1,324,158 in music costs during the years ended June 30, 2013 and 2012, respectively, representing costs incurred in the production of the current DMX album and related videos.. The Company will begin to amortize the music assets once the related records are released, over the estimated life of the recorded performance using a method that reasonably relates the amount to the net revenue expected to be realized.

The \$408,205 was the amortization charge based on sales of the DMX “Undisputed” album compared to current forecast sales for the assets acquired.

The Company reviews capitalized music assets for impairment whenever events or changes in circumstances indicate that the carrying amounts of such assets may not be recoverable or at least once per year. Determination of recoverability is based on an estimate of future cash flows resulting from the use of the asset, and its eventual disposition. Measurement of an impairment loss for the assets is based on the fair value of the asset as estimated using a discounted cash flow model. As of June 30, 2013 and June 30, 2012, the Company recognized impairment losses of \$ 4,718,205 and \$3,035,000 (restated), respectively. The first of the DMX albums, “Undisputed”, was released in September 2012, and sales were below expectations. Management analyzed the realizability based on future use of the music assets and adjusted their estimations of sales on the albums to be released based on the remaining masters, which include one additional album for DMX and one album for Bone Thugs-N-Harmony, to reflect the actual sales and profit recognized on Undisputed. The impairment in the year ended June 30, 2012 was determined as the difference between the original consideration and the expected sales on the albums to be released from the masters acquired, and additionally included all of the intangibles, which were determined to have no future use.

#### **NOTE 7 – BUILDING IMPROVEMENTS**

On June 30, 2012, the Company acquired SAFELA, which was previously a related party company. SAFELA has a 30 year lease on 807 Esplanade, New Orleans, Louisiana, which was constructed as a production and post-production facility. The Company has since assumed the liability for \$1,000,000 of these loans plus a contingent sum of \$750,000 (contingent on receipt of the tax credit revenue of at least \$5,000,000 in cash proceeds from the tax credits to be earned by SAPLA) due to an agreement with the now mortgagor Palm Finance. Additionally, a construction loan of \$1,850,000 previously guaranteed by the Company has now been assumed by the Company for the property at 807 Esplanade.

The Company did not receive any consideration or benefit when they assumed the mortgage and construction loans, and have looked to the authoritative guidance on guarantees as an analogy. As the guidance on financial guarantees does not address which account would be set up as an offsetting entry when the liability is recognized at the inception of the guarantee, the Company has determined to call this asset balance created upon assumption of the debt “Building Improvements related to indebtedness”. The Building Improvements will be amortized in a manner similar to leasehold improvements, over the life of the lease (30 years). The post production facility commenced operations on July 1, 2012, and the Company began amortization of the building improvements on July 1, 2013. Amortization expense for the year ended June 30, 2013 was \$164,526.

#### **NOTE 8 – INCOME TAXES**



Deferred tax assets and liabilities result from temporary differences in the recognition of income and expense for tax and financial reporting purposes. Significant components of the Company's deferred tax assets and liabilities are as follows at June 30:.

|                     | 2013         | 2012        |
|---------------------|--------------|-------------|
| Deferred tax assets |              |             |
| NOL carryforwards   | \$11,413,000 | \$3,792,000 |
| Valuation allowance | (11,413,000) | (3,792,000) |
| Net                 | \$-          | \$-         |

A valuation allowance has been recorded against the realizability of the net deferred tax asset such that no value is recorded for the asset in the accompanying financial statements. The valuation allowance increased \$7,621,000 between the year ended June 30, 2012 and 2013.

The Company has net operating loss carryforwards available for federal and state tax purposes of approximately \$33,569,000, at June 30, 2013, which expire in varying amounts through 2032.

For the years ended June 30, 2013 and 2012, a reconciliation of the statutory rate and effective rate for the provisions for income taxes consists of the following:

|                     | Percentage |         |
|---------------------|------------|---------|
|                     | 2013       | 2012    |
| Tax statutory rate  | (34.0)%    | (34.0)% |
| Valuation allowance | 34.0       | 34.0    |
| Effective rate      | 0.0 %      | 0.0 %   |

**NOTE 9 – LOANS**

Indebtedness as of June 30, 2013 consists of:

| Lender                     | Balance     | Interest Rate | Issuance Date | Maturity Date |   |
|----------------------------|-------------|---------------|---------------|---------------|---|
| Film and Production Loans: |             |               |               |               |   |
| Palm Finance Corporation   | \$5,479,777 | 18 %          |               |               | Forebearance agreement /workout agreement number 6  |
| Palm Finance Corporation   | 2,221,572   | 18 %          |               |               | Forebearance agreement /workout agreement number 6  |
| Palm Finance Corporation   | 113,064     | 10 %          | 7/30/2012     |               | Due on demand or on settlement of the Content litigation  |
|                            | \$7,814,412 |               |               |               |   |
| Conversions:               |             |               |               |               |   |
| Trafalgar Capital          | \$585,729   | 9 %           | 10/15/2008    | 8/31/2009     | Conversion price is Market price  |
| JMJ Financial              | 438,373     | 10 %          | 6/29/2012     | 10/27/2012    | Conversion is only on default and is the lower of \$0.04 or 80% of the average of market price as defined in agreement  |
| GHP                        | 137,573     | 18 %          | 1/21/2011     | 4/30/2012     | Conversion price is Market price  |
| Tonaquint                  | 447,975     | 8 %           | 8/22/12       | 7/2/13        | The conversion price shall be the fixed conversion price of \$0.04 subject to standard anti-dilution provisions   |
| Beaufort Ventures PLC      | 240,132     | 10 %          | 7/31/2012     | 8/30/12       | Conversion price is 6 of market price as defined in agreement   |
| Beaufort Ventures PLC      | 163,932     | 10 %          | 7/26/12       | 2/25/13       | Conversion price is 65% of market price as defined in agreement   |
| Runway Investments, LTD    | 154,582     | 12 %          | 11/1/12       | 9/30/12       | The conversion price will be the lower of the fixed conversion price of \$0.20 or the variable conversion price which is equal to 75% of the market price as defined in the agreement |
| Sendero Capital Ltd        | 292,986     | 12 %          | 1/24/12       | 9/30/12       | The conversion price will be the lower of the fixed conversion price of \$0.20 or the variable conversion price which is equal to 75% of the market price as defined in the agreement |
| Isaac Capital Group LLC    | 148,825     | 12 %          | 1/20/12       | 6/30/12       | The conversion price shall be the fixed conversion price of \$0.15 subject to standard anti-dilution provisions   |

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|                         |         |    |   |            |            |   |
|-------------------------|---------|----|---|------------|------------|---|
| Beaufort Ventures, PLC  | 82,110  | 10 | % | 7/19/12    | 7/19/12    | Conversion price is 65% of market price as defined in agreement   |
| Beaufort Ventures, PLC  | 54,740  | 10 | % | 7/19/12    | 7/19/13    | Conversion price is 65% of market price as defined in agreement   |
| Beaufort Ventures, PLC  | 27,192  | 10 | % | 8/14/12    | 2/8/13     | Fixed conversion price of \$0.02. If at any time after maturity date the share price in any 10 day trading period is trading at below \$0.03/share there will be a one time reset to 70% of the average of the VWAP during 10 such trading days |
| Beaufort Ventures, PLC  | 78,921  | 12 | % | 1/22/13    | 7/22/13    | The conversion price shall be the fixed conversion price of \$0.15 subject to standard anti-dilution provisions, and reset upon default, as defined in agreement  |
| CMS Capital             | 39,503  | 12 | % | 12/15/2011 | 6/30/12    | The conversion price shall be the fixed conversion price of \$0.15 subject to standard anti-dilution provisions, and reset upon default, as defined in agreement  |
| Hanover Holdings LLC    | 280,581 | 10 | % | 2/23/12    | 4/23/13    | The conversion price shall be the fixed conversion price of \$0.20 subject to standard anti-dilution provisions   |
| Beaufort Ventures PLC   | 56,066  | 12 | % | 6/26/12    | 6/26/13    | Conversion price is 65% of market price as defined in agreement   |
| Agua Alta (Cold Fusion) | 112,164 | 12 | % | 6/25/12    | 6/25/13    | Conversion price is 65% of market price as defined in agreement   |
| Beaufort Ventures PLC   | 12,015  | 12 | % | 11/30/2011 | 11/30/2013 | Conversion price will be 75% of the closing price of the previous day to conversion   |
| Tripod Group, LLC       | 108,685 | 12 | % | 1/2/12     | 1/2/13     | The conversion price will be the lower of the fixed conversion price of \$0.235 or 75% of the average of VWA, as defined in agreement   |
| Beaufort Ventures, PLC  | 48,009  | 12 | % | 6/4/12     | 6/10/12    | Conversion price is 65% of market price as defined in agreement   |
| Old Capital Ltd         | 277,166 | 12 | % | 5/31/12    | 11/30/2012 | Conversion price is 65% of market price as defined in agreement   |
| WHC Capital             | 79,097  | 10 | % | 5/20/13    | 5/20/14    | The Conversion Price shall be equal to sixty five percent (65%) of the average price of the three (3) lowest closing prices during the ten (10) trading days prior to date of such conversion,  |
| Firerock                | 81,335  | 5  | % | 12/8/12    | 7/15/13    | The Conversion Price shall be the lower of \$0.02 and sixty percent (60%) of the closing price of the day immediately prior to the Holder's exercise of his conversion rights   |
| Elegant Funding         | 17,975  | 18 | % | 6/5/13     | 1/5/14     | Conversion price shall be 70% of the lowest closing bid ptive during the 10 trading days prior to conversion  |
| Firerock                | 719     | 12 | % | 7/31/12    | 6/14/13    | Conversion price shall be the lesser of \$0.06 or 60% Of the lowest trade price in the 25 days prior to conversion  |
| WHC Capital             | 26,036  | 21 | % | 4/19/13    | 4/18/14    | Conversion Price shall be equal to 75% of the average price of the 3 lowest closing prices  |

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|  |             |    |   |            |   |   |
|--|-------------|----|---|------------|---|---|
|  |             |    |   |            | during the 10 trading days prior to date of such conversion |   |
| WHC Capital  | 20,472      | 21 | % | 5/20/13    | 5/20/14   | Conversion Price shall be equal to 65% of the average market price as defined in the agreement  |
| Tangiers   | 40,630      | 10 | % | 10/15/2012 | 10/15/2014  | Fixed conversion price of \$0.0119. If at any time after maturity date the share price in any 10 day trading period is trading at below \$0.0117/share there will be a one time reset to 70% of the average of the VWAP during 10 such trading days |
| Tangiers   | 20,382      | 10 | % | 5/31/13    | 5/31/14   | Conversion price is 70% Of the 10 day trading VWAP before conversion.   |
|  | \$4,073,901 |    |   |            |   |   |
| Mortgage and Construction Loan Palm Finance Corporation-mortgage and construction loan | \$3,743,286 | 15 | % |            |   | Forebearance agreement /workout agreement number 6  |
|  | \$3,743,286 |    |   |            |   |   |

Indebtedness as of June 30, 2012 consists of:

Lender

Film and Production Loans

|                             |             |            |   |                        |
|-----------------------------|-------------|------------|---|------------------------|
| Palm Finance *              | \$4,324,431 | 18         | % | Forebearance agreement |
| Palm Finance                | 82,354      | 18         | % | Forebearance agreement |
| Palm Finance *              | 1,538,218   | 18         | % | Forebearance agreement |
| 120db Film Finance LLC      | 4,425       | Non stated |   | Due on demand          |
| Cold Fusion Media Group LLC | 175,000     | 10         | % | Due on demand          |
|                             | \$6,124,428 |            |   |                        |

|                         |           | Original<br>agreed<br>Conversion<br>rate | Issue<br>Date | Maturity<br>Date | Variable<br>Terms                                    |
|-------------------------|-----------|--|---------------|------------------|--|
| Convertibles            |           |  |               |                  |  |
| Trafalgar Capital       | 531,986   |  |               | Due on<br>demand |  |
| TCA                     | 62,149    |  | 3/31/2011     | 9/30/2011        |  |
| GHP                     | 137,573   |  |               |                  |  |
| JMJ Financial           | 500,137   |  | 6/30/2012     | 10/27/2012       |  |
| Hanover Holding         | \$160,479 | \$ 0.10                                  | 19/10/2011    | 18/05/2012       | Price will reset if not converted<br>within 8 months |
| Hanover Holding         | \$65,821  | \$ 0.10                                  | 16/11/2011    | 16/02/2012       | Lower of fixed and variable<br>conversion price      |
| Beauvoir Capital Ltd    | \$110,899 | \$ 0.20                                  | 22/11/2011    | 31/03/2012       |  |
| FireRock                | \$28,784  | \$ 0.25                                  | 12/12/2011    | 12/06/2012       | Lower of fixed and variable<br>conversion price      |
| Aegis – Tripod          | \$35,504  | \$ 0.27                                  | 15/12/2011    | 30/06/2012       | Price will reset if not converted<br>within 8 months |
| Aegis – CMS             | \$35,503  | \$ 0.27                                  | 15/12/2011    | 30/06/2012       | Price will reset if not converted<br>within 8 months |
| Aegis - Rachel          | \$35,503  | \$ 0.27                                  | 15/12/2011    | 30/06/2012       | Price will reset if not converted<br>within 8 months |
| Runway                  | \$200,682 | \$ 0.20                                  | 11/01/2012    | 30/09/2012       | Lower of fixed and variable<br>conversion price      |
| Tripod                  | \$52,729  | \$ 0.24                                  | 16/01/2012    | 30/06/2012       | Lower of fixed and variable<br>conversion price      |
| Isaac Loan              | \$263,315 | \$ 0.03                                  | 20/01/2012    | 30/06/2012       | Lower of fixed and variable<br>conversion price      |
| Sendero                 | \$262,986 | \$ 0.20                                  | 24/01/2012    | 30/09/2012       | Lower of fixed and variable<br>conversion price      |
| Tripod - \$150k         | \$125,918 | \$ 0.24                                  | 01/02/2012    | 01/02/2013       | Lower of fixed and variable<br>conversion price      |
| Briskin \$100k          | \$104,866 | \$ 0.23                                  | 03/02/2012    | 03/02/2013       | One time conversion price reset                      |
| Hanover                 | \$420,053 | \$ 0.10                                  | 23/02/2012    | 23/08/2012       | Lower of fixed and variable<br>conversion price      |
| Briskin - \$50k         | \$52,500  | \$ 0.09                                  | 04/04/2012    | 10/10/2012       | One time conversion price reset                      |
| Briskin - \$40k         | \$41,667  | \$ 0.09                                  | 13/04/2012    | 22/10/2012       | One time conversion price reset                      |
| Briskin - \$60k         | \$62,500  | \$ 0.09                                  | 17/04/2012    | 22/10/2012       | One time conversion price reset                      |
| Briskin - \$45k         | \$46,350  | \$ 0.07                                  | 14/05/2012    | 22/10/2012       | One time conversion price reset                      |
| Firerock - \$62,500     | \$62,654  |  | 21/06/2012    | 21/12/2012       | Lower of fixed and variable<br>conversion price      |
| Agua Alta (Cold Fusion) | \$100,163 | ****                                     | 25/06/2012    | 25/06/2013       | 35% discount from previous day's<br>closing price    |
| Beaufort                | \$50,066  | ****                                     | 26/06/2012    | 26/06/2013       | 35% discount from previous day's<br>closing price    |

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|                                      |             |      |            |            |  |
|--------------------------------------|-------------|------|------------|------------|--|
| Beaufort - \$100k (807 Esplanade)    | \$ 102,794  | **** | 06/04/2012 | 05/04/2013 | 35% discount from previous day's closing price |
| Beaufort - \$250k (807 Esplanade)    | \$256,411   | **** | 13/04/2012 | 12/04/2013 | 35% discount from previous day's closing price |
| Old Capital - \$250k (807 Esplanade) | \$252,466   | **** | 31/05/2012 | 30/05/2013 | 35% discount from previous day's closing price |
|                                      | \$4,162,458 |      |            |            |  |

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Mortgage and construction:

Palm Finance - mortgage and construction loan \$3,001,271 15% Forebearance agreement

\*The Company does not agree with \$957,696 of interest charged by Palm on these two film loans and believes the dispute will be resolved once the loans are repaid.

The loan amounts at June 30, 2013 and 2012 include accrued interest of approximately \$4,227,000 and \$2,940,000 respectively.

Palm Agreement

The Company entered into two senior financing loan and security agreements with Palm to finance the production costs of The Pool Boys, Autopsy and Nine Miles Down dated May 7, 2007 and December 17, 2007. These loans are secured by the revenues to be collected from these motion pictures. The revenues so far collected have been insufficient to repay the majority of these loans, primarily as result of management's decision to delay the release of these films.

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In July, 2011 we entered into an amended financing agreement with Palm in to refinance the existing indebtedness secured by our production and post-production facility in New Orleans, Louisiana under which Palm has acquired the existing credit facility of \$3,700,000 plus accrued interest of our affiliate SAPLA for \$1,000,000 of this amount plus a contingent sum of \$750,000 (contingent on receipt of at least \$5,000,000 in cash proceeds from the tax credits to be earned by SAPLA) and advanced an additional \$1,800,000 to complete renovation and construction of this facility. Palm's advance and interest at the rate of 15% per annum are due and payable within five years and are secured by the property at 807 Esplanade Avenue in New Orleans and Louisiana film infrastructure and historical rehabilitation credits, as well as Federal historical rehabilitation credits associated with the Property. Under this arrangement the group guaranteed the debt on the post production facility and Palm forgave a total of \$4,458,624 of principal and interest on the two production loans as well as reduced the liability on the New Orleans production facility by \$1,950,000 in exchange for the group guaranteeing the production facility debt. The reduction in principal and interest has been recognized in the year ended June 30, 2012 as Other Income (restated). Palm's advance and interest at the rate of 15% per annum are due and payable within five years and are secured by the property at 807 Esplanade Avenue in New Orleans and Louisiana film infrastructure and historical rehabilitation credits, as well as Federal historical rehabilitation credits associated with the Property and cross guaranteed the Company, its affiliates and CEO, Peter Hoffman.

In June, 2012 as detailed in Note 7, the Esplanade debt was assumed by SAFELA in connection with a 30 year lease on the facility. SAFELA was in turn acquired by the Company.

### Trafalgar

SAP Plc. Borrowed £1,000,000 (\$1,651,000 ) convertible debenture from Trafalgar Capital Special Investment Fund ("Trafalgar") that came due on June 30, 2009. We were unable to repay the debenture and as a result, we defaulted on a payment of £1,000,000 plus interest to Trafalgar Capital Special Investment Fund in June 2009.

On September 2, 2009 the Group repaid Trafalgar \$1,000,000 as a partial payment against this loan, with the remaining balance subject to repayment in cash or convertible to the shares of common stock of the Group at the conversion terms as agreed between Trafalgar and the Group. On June 22, 2010 an amended agreement was entered into with Trafalgar for an extension of the due date of the convertible debentures to December 31, 2010, and the Group agreed to issue 971 shares of common stock to settle a portion of the debt. Trafalgar agreed to reduce the loan amount from the proceeds it received from selling the shares of common stock. Subsequent to June 30, 2010, a further amended agreement was entered into with Trafalgar for an extension of the due date of the convertible debentures to March 31, 2011, and the Group agreed to issue 1,214 shares of common stock to settle a portion of the debt. Trafalgar agreed to reduce the loan amount from the proceeds it received from selling the 1,214 shares of common stock. There have been no subsequent extensions and the loan remains past due. Interest is being accrued accordingly.



Tonaquint

On August 22, 2012, the Company entered into a purchase agreement for several convertible debentures (or “notes”) with Tonaquint, Inc. (“Tonaquint”), in the principal amounts of \$310,000, \$255,000 and \$125,000. The first convertible debenture under the agreement was issued on August 22, 2012 for \$310,000, less a discount of \$60,000 and \$10,000 in expenses. On October 5, 2012, due to a delisting default, an amendment was entered into which called for one of the additional convertible debentures to be issued in the principle amount of \$155,000 (less a \$25,000 discount and \$5,000 in fees) and the second in the principal amount of \$125,000, to be issued in the future. The debt discounts have been immediately expensed, based upon the short term nature of the notes, and the insignificance of the amount as compared to the total Convertible Debenture amount and to interest expense over the term of the note.

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The convertible debentures are convertible at \$0.20, which is above the market value of the Company's common stock on issuance date, so there is no beneficial element recognized. As a condition of the amendment the outstanding balance of the first note was increased to \$412,990 (to be reduced by \$50,000 if the note is paid on its maturity date). The notes are payable on certain instalment dates, to be satisfied by conversion of the instalment amount, or cash, at the option of the Company (provided no equity failure conditions, as defined in the agreement, exist, in which cash the instalment payment must be in cash.) As part of the amendment, Tonaquint entered into a Pledge Agreement with Peter Hoffman, for 140,000 post split/7,000,000 pre split shares of the Company's common stock as collateral against repayment of the note. In the event of a default on the notes the holder may transfer and sell the pledged shares and apply the proceeds against the outstanding amounts on the notes. (Note 3)

### Convertible Debentures

The Company has evaluated the convertible notes for embedded derivative features and has determined that no derivative liability exists.

Convertible debts are all convertible to common stock on maturity at the option of the lender. They all bear interest at varying rates and convert at different times and at fixed or variable conversion prices according to the contract.

Substantially all of the convertible debentures issued in the year ended June 30, 2013 were in exchange for existing loans or other debt of the Company, under assignment agreements between the original noteholder and the new noteholder. The exchanges were evaluated for any gains or losses to be recognized upon extinguishment of the original debt, and it was determined there were no gains or losses to be recognized.

The Company has evaluated their convertible notes for embedded derivative features and has determined that no derivative liability is necessary to recognize, as the varying conversion price is based on the trading value of the Company's stock, which is considered indexed to one's own stock, and therefore is fixed. Convertible debts are all convertible to common stock at the option of the holder. They all bear interest at varying rates and convert at different times and conversion prices according to the contract. The conversion features were evaluated for any beneficial aspect and determined that no beneficial conversion feature is necessary to recognize.

### NOTE 10 – EQUITY TRANSACTIONS

Fourth Quarter ended June 30, 2013 :

Between April 1, 2013 and June 30, 2013 the Company issued 37,130,383 shares of the Company's common stock upon conversion of \$468,099 of notes payable, under the original conversion terms of the convertible debentures.

The Company also issued 5,059,530 shares for services provided, with a fair value of \$120,776, valued at the trading price of \$XXX on the issuance date.

Third Quarter ended March 31, 2013: (all figures quoted reflect the 1:50 reverse split on May 2, 2013)

Between January 1, 2013 and March 31, 2013, the Company issued 3,552,522 common shares at an average price of \$0.40 per share.

|           |  |
|-----------|--|
| 2,450,293 | common shares were issued in satisfaction of film and production debt totaling \$844,707 converted at an average conversion price of \$0.34 per share.                 |
| 612,350   | common shares were issued in satisfaction of various expenses totaling \$173,075 converted at an average conversion price of \$0.28 per share.                         |
| 145,588   | common shares of S-8 common stock were issued for consulting services totaling \$134,994 at \$0.93 per share   |
| 20,000    | common shares were issued at \$0.25 per share upon conversion of \$5,000 in partial settlement of a music contract   |
| 324,292   | shares were issued as collateral in settlement of an outstanding judgment related to Nine Miles Down UK Ltd at \$0.85 per share in satisfaction of a debt of \$275,246 |
| 3,552,522 | Total shares issued in the quarter   |

The shares issued as collateral arose out of a suit brought against Nine Miles Down UK Ltd, the original entity under which the film 9 Miles Down was being produced, as well as Seven Arts, among others. The suit put the entity into liquidation, and rather than delay the production of the film, or harm the chain of title on the film, Seven Arts determined to settle the case. As part of the settlement the Company is to pay £25,000 over a specified period of time, with restricted shares equal to the amount issued as collateral. Additionally the settlement called for £150,000 restricted shares to be issued as collateral against the liquidation proceeds in favour of the creditors. The restricted shares shall be released to cover any shortfall not realized upon liquidation. As the Company has determined that it is unlikely for the liquidation to realize significant proceeds, it is considered to be probable that the shares will be released to cover the shortfall. Therefore, as of March 31, 2013, the Company has recognized the fair value of the shares held as collateral, or \$275,246, as well as the shares already released, as film costs.

Second Quarter Ended December 31, 2012:

Between October 1, 2012 and December 31, 2012, the Company issued 506,797 common shares at an average price of \$5.73 per share.

|         |   |
|---------|---|
| 153,777 | common shares were issued in satisfaction of film debt totalling \$403,809, with an average conversion price of \$2.63 per share.   |
| 140,000 | common shares were issued to Peter Hoffman, based on a market share price of \$8.50 per share in exchange for debt of \$1,190,000. As the shares will be in substance repurchased and the debt reinstated at a point in the future, the shares were accounted for as if issued for no consideration (Note 3). |
| 69,091  | common shares were issued at \$14.50 per share upon conversion of 38,000 Series B preferred shares  |
| 60,564  | common shares were issued in satisfaction of various convertible loans totalling \$133,537 at an average conversion price of \$2.20 per share.  |
| 35,456  | common shares were issued at \$1.20 per share in satisfaction of \$42,723 of 807 Esplanade loans  |
| 34,075  | common shares were issued at \$0.92 per share in satisfaction of \$31,232 of expenses   |
| 7,833   | S-8 common shares were issued for consulting services totalling \$82,500 at \$10.53 per share   |
| 6,000   | common shares were issued to David Furth, a director, at a price of \$3.00 per share  |
| 506,796 | Total shares issued in the quarter  |

Warrants and Options

On December 17, 2012, the Company declared a warrant dividend to those persons beneficially owning its common stock as of the close of the markets on August 31, 2012. For every ten pre-reverse split shares of common stock held as of such date and time, the holders thereof will be entitled to receive one warrant as a dividend, exercisable at \$1.50 per post-reverse split share (a "Warrant Share"), which expire on June 30, 2014. The warrants fair value was determined using the Black Scholes Merton Model. The fair value of \$480,371 has been recognized on the accompanying financial statement in Accumulated Deficit and Warrant Dividend to be distributed.

First Quarter Ended September 30, 2012:

On August 31, 2011, NASDAQ approved the substitution of one share of SAE stock for the Company's NASDAQ listing, effective at the opening of trading on September 1, 2011. On that date, each of the Company's ordinary shares were exchanged for one share of common stock of SAE, and commenced trading on NASDAQ as the successor to the Company's NASDAQ listing. This transaction was approved by the Company's shareholders at the Company's Extraordinary General Meeting on June 11, 2010.

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During the three months ended September 30, 2012, Company issued 48,534 shares at an average price of \$56.58 per share in satisfaction of \$2,446,219 of outstanding loans payable and accrued interest and 171 shares for \$300,000 cash.

|        |  |
|--------|--|
| 5,161  | common shares were issued in partial payment of the Palm debt to the value of \$133,500 at an average conversion price of \$25.87 per share.             |
| 21,161 | common shares were issued in satisfaction of the Schism debt of \$646,374 at an average conversion price of \$30.55 per share                            |
| 9,654  | common shares were issued in satisfaction of various convertible loans totaling \$586,114 converted at an average conversion price of \$60.71 per share. |
| 1,814  | common shares were issued for expenses totalling \$179,800 for the music company at \$99.12 per share  |
| 894    | S-8 common shares were issued for consulting services totalling \$54,200 at \$60.63 per share  |
| 4,883  | common shares were issued for general expenses totalling \$357,232 provided under the 3a9 authority at \$73.16 per share.                                |
| 1,514  | common shares were issued to lenders as fees for loan arrangements of \$159,000 at \$105.02 per share  |
| 1,714  | common shares were issued as collateral for a loan totalling \$180,000 at \$105.02 per share   |
| 171    | common shares were issued for \$300,000 cash at \$1,754.39 per share   |
| 1,612  | common shares were issued to cover 807 Esplanade construction fees totalling \$150,000 at \$93.05 per share  |
| -44    | adjustment for reverse split shares  |
| 48,534 | Total shares issued in the quarter   |

Fourth Quarter Ended June 30, 2012:

Between April 1, 2012 and June 30, 2012, the Company issued 1,140,343 shares at an average price of \$4.81 per share. The total number of shares outstanding on June 30, 2012 was 1,739,900

|         |   |
|---------|---|
| 111,143 | common shares were issued in part payment of the Palm debt to the value of \$430,000 at an average conversion price of \$3.87/share .         |
| 174,240 | common shares were issued in satisfaction of the Blue Rider debt of \$980,000 at an average conversion price of \$5.62/share                  |
| 160,556 | common shares were issued in satisfaction of the Cold Fusion debt of \$725,000 was converted at an average conversion price of \$4.52/ share. |
| 40,118  | common shares were issued against the <u>Pool Boys</u> tax credit loan of \$100,000 at an average conversion price of \$2.49/share.           |
| 16,071  | common shares were issued for cash, for the music company at \$6.22/share   |
| 69,908  | common shares were issued for consulting services totalling \$513,321 provided under the S-8 authority at \$7.34/share                        |
| 156,158 | common shares were issued as general loans totalling \$494,152 at \$3.16/share  |
| 357,143 | common shares were issued to Peter Hoffman in satisfaction of a debt of \$877,824 at \$2.46/share   |
| 55,006  | common shares were issued to cover 807 Esplanade construction fees totalling \$200,000 at \$3.64/share  |

1,140,343

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Third Quarter Ended March 31, 2012:

Between January 1, 2012 and March 31, 2012, the Company issued 276,411 shares at an average price of \$13.30 per share.

|         |  |
|---------|--|
| 96,425  | common shares were issued in satisfaction of the \$943,580 of newly converted film debt at an average conversion price of approximately \$9.80/share .   |
| 65,237  | common shares were issued in satisfaction of \$929,596 of overhead at an average conversion price of \$14.00/share   |
| 49,889  | common shares were issued on the conversion of old notes including the final conversion of the Runway convertible notes, total debt of \$516,568 was converted at an average conversion price of \$10.50/ share. |
| 43,928  | common shares were issued in satisfaction of \$698,736 of film loans previously converted at an average conversion price of \$16.10/share.   |
| 17,143  | common shares were issued as restricted stock for cash, to Blue Rider at \$0.50/share  |
| 3,789   | common restricted shares were issued for consulting services provided under the S-8 authority at \$19.60/share   |
| 276,411 |  |

Second Quarter Ended December 31, 2011:

Between October 1, 2011 and December 31, 2011 the Company issued 163,868 shares:

|         |   |
|---------|---|
| 66,272  | common shares were issued in satisfaction of the \$612,336 of convertible debt shares at an average conversion price of \$9.10/share .                                  |
| 40,734  | common shares were issued on the conversion of the Agua Alta, Sendero and Isaac convertible notes totalling \$427,706 at an average conversion price of \$10.50/ share. |
| 49,863  | common shares were issued in satisfaction of \$906,000 of corporate loans at an average conversion price of \$18.20/share.  |
| 5,714   | common shares were issued as restricted stock for cash, \$250,000 to Fletcher and \$150,000 to Goldstrand at \$70.00/share  |
| 1,071   | common restricted shares were issued for investor relations services at \$25.20/share   |
| 214     | common restricted shares were issued to a director in lieu of compensation at \$35.00/share   |
| 163,868 |   |

First Quarter Ended September 30, 2011:



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During the three months ending September 30, 2011, Company issued 92,805 shares in satisfaction of \$3,188,028 of outstanding loans payable and accrued interest, consisting of \$225,000 of convertible notes payable and \$2,963,028 of film and production loans. The conversions were done at contractual share prices ranging from \$.20 to \$2.00 per share (pre-reverse split, equal to \$14.00 to \$140.00 post-split).

In July 2011, the Company also issued 143 shares for investor relations services valued at approximately \$10,000.

As of September 30, 2011, \$1,986,722 of stock was fully paid but still to be issued, consisting of \$1,251,250 of Series A preferred stock and \$735,472 of debt that was being converted to equity.

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Warrants and Options:

During the year ended June 30, 2012, the Company issued 1,429 options to the seven members of the board of directors. These options have a five year term and a strike price equal to the closing price of the Company's stock at the date of issue. Each director was issued 5,714 options with a strike price of \$30.80 on October 14, 2011 and 714 options with a strike price of \$27.30 on December 6, 2011. Half of the options vested on December 31, 2011 and the remaining half vested on December 31, 2012.

During the quarter ended June 30, 2012, the Company issued 28,571 options to David Michery in conjunction with his employment agreement with the Company. These options have a strike price of \$12.60 and vest and shall be exercisable in equal monthly instalments over the term of his employment agreement, which is February 22, 2012 through December 31, 2016. The Company measures compensation expense related to stock options with the Black Scholes option pricing model, and recognizes expense over the vesting period. The employment agreement was terminated as part of the settlement agreement with Mr. Michery.

During the quarter ended June 30, 2012, the Company has agreed to issue 714 options per year to Jake Shapiro in conjunction with his employment agreement with the Company. These options have a strike price equal to the closing price of the Company's stock at the date of issue, with the exception of the first year, which the strike price was set at \$55.30 per share. The Company measures compensation expense related to stock options with the Black Scholes option pricing model, and recognizes expense over the vesting period. The employment agreement was terminated as part of the settlement agreement in May 29, 2013, with Big Jake Music.

On June 29, 2012, 119,048 warrants were issued to JMJ Financial. These options have a strike price of \$2.10

No warrants or options have been exercised through June 30, 2013.

**Convertible Preferred Stock**

125,125 shares of Series A Cumulative Convertible \$10.00 Preferred Stock with a dividend rate of 8% (payable quarterly) were issued in November 2011. The conversion price into common stock of the Company is \$10.50/share.

180,000 Series B convertible preferred stock, \$100.00 par value, were issued to acquire music assets for the Company (Note XX). 120,000 of these shares were in escrow and shown on the balance sheet as a reduction in equity as of June 30, 2012. The per-share conversion price for the Series B Preferred Stock is \$1.10.

The Preferred Shares include piggyback registration rights. There are no damages or penalties for failure to file or maintain a registration statement.

During the year ended June 30, 2013 38,000 of the Series B convertible preferred shares were converted into common shares and 100,000 shares were cancelled in connection with settlement agreements.

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**NOTE 11 – NON-CONTROLLING INTEREST**

The Company's subsidiary SAFELA is owned 60 % by the Company and 40% by another party. Accordingly, the subsidiary is included in the consolidated financial position and results of operations of the Company, with recognition of the non-controlling interest separately in the Statement of Operations and from the equity of the Company's shareholders on the balance sheet.

The activity of the non-controlling interest as of June 30, 2013 is as follows:

|   |           |
|---|-----------|
| Initial balance recognized at July 1, 2012  | \$-       |
| Non-controlling interest's proportionate share of Net loss for the year ended June 30, 2013 | 353,530   |
| Non-controlling interest at June 30, 2013   | \$353,530 |

**NOTE 12 – COMMITMENTS AND CONTINGENCIES**

**Creditors Liquidation of SAP Plc.**

The Company's listing predecessor Seven Arts Pictures Plc. ('PLC') was placed by the English Companies Court into compulsory liquidation on November 8, 2011. The Company's CEO, Mr. Peter Hoffman, as a director of PLC had sought an administration order but this request was denied by the Courts as a result of inter alia the opposition of Parallel Pictures LLC ('Parallel'). PLC's principal creditors have appointed a liquidator for the orderly winding up of its remaining assets not transferred to the Company pursuant to the Asset Transfer Agreement, effective January 27, 2011.

Based on discussions with the liquidator, our management believes this liquidation proceeding will have no material effect on the cost, business or market value of common stock.

**Further Share Issue to SAE Inc.**

On June 11, 2010, Seven Arts Entertainment, Inc. (“SAE”), a Nevada Corporation, was formed and became a 100% owned subsidiary of Seven Arts Pictures Plc. As of June 11, 2010, the Company entered into an Asset Transfer Agreement, as amended on January 27, 2011 and again on August 31, 2011, to transfer all of the assets with a cost basis from PLC to SAE, in exchange for assumption by SAE of certain indebtedness and for one share of common stock of SAE for each ordinary share of PLC which have been distributed to shareholders. Additionally, 2,000,000 shares of SAE were issued to PLC in order to satisfy any remaining obligations. SAE Inc. may issue more shares of its common stock to resolve any claim made on the liquidation of PLC. The 2,000,000 pre-split shares were originally booked on January 27, 2012 at the market price on the day the SEC approved the transaction i.e. \$3.94/share. Management now believe the shares should be booked at the August 31, 2012 market price of \$0.66/share which is the date from which the shares in SAE were tradeable.

#### 807 Esplanade Guarantee

Seven Arts Pictures Louisiana LLC, a related party and/or an affiliate of the Company, entered into a Credit Agreement with Advantage Capital Community Development Fund LLC dated October 11, 2007, for the acquisition and improvement of the production and post-production facility located at 807 Esplanade Avenue in New Orleans, Louisiana (“807 Esplanade”) for aggregate principal advances of up to \$3,700,000. This agreement was guaranteed by the Company’s predecessor. Approximately \$3,700,000 plus interest has been drawn under the terms of this Credit Agreement, as of June 30, 2012. The Company has now assumed the liability for \$1,000,000 of this amount due to an agreement with the now mortgagor Palm Finance. A construction loan of \$1,850,000 previously guaranteed by the Company has now been assumed by the Company. The Company has a 30 year lease on the property to operate a production and post-production facility.

As part of the assumption of the mortgage and construction loans regarding 807 Esplanade, the Company has agreed to pay an additional \$750,000 in connection with the loan, contingent on the receipt of at least \$5,000,000 in cash proceeds from the tax credits earned by SAPLA. As the Company has determined it is not probable at this point that the \$5,000,000 will be achieved, they have not recognized the \$750,000 in the accompanying financial statements.

### Armadillo

The Company has guaranteed a \$1,000,000 note plus interest due to Armadillo by the Employee Benefit Trust of the Company's listing predecessor resulting from the purchase of Seven Arts preferred stock from Armadillo.

### Fireworks Litigation

The Company obtained summary judgment on February 10, 2011 in an action in Ontario Superior Court, Canada, against CanWest Entertainment and two of its affiliates ("CanWest") confirming the Company's ownership of five motion pictures Rules of Engagement, An American Rhapsody, Who Is Cletis Tout, Onegin, and The Believer, (the "Copyrights"), CineVisions v. Fireworks International, No. 03-CV-247553 CM2. The Company has filed on September 7, 2011, an action in the High Court of England and Wales on September 7, 2011 against Content Media Corporation ("Content") and Paramount Picture Corp. ("Paramount") to recover the Copyrights and substantial damages for the use of the copyrighted works after their purported acquisition from CanWest. Seven Arts Filmed Entertainment v. Content Media Corp. No. HC11CO3046. The Company may incur up to \$200,000 in legal expenses to pursue this claim but expects to recover those fees from Content. The Company's motion for summary judgment against Content in the United Kingdom was denied demurred on March 18, 2013, but the dismissal did not consider the merits of the Company's claims, only that Content was not bound by the Canadian judgment. The Company has also filed on May 27, 2011 an action in United States District Court in Los Angeles, California against Paramount Pictures for infringement of the Copyrights. Seven Arts Filmed Entertainment v. Paramount Pictures Corp. No. CV 11-04603. This action was dismissed on October 3, 2012 by the District Court based on a claimed application of the statute of limitation and we have appealed to the Ninth Circuit No. 11-56759, the argument on which was heard on August 28, 2013.

### Jonesfilm

Seven Arts Pictures plc ("PLC"), the Company's listing predecessor, its then-subsiary Seven Arts Filmed Entertainment Limited ("SAFE") and Seven Arts Pictures Inc. ("SAP"), were the subject of an arbitration award of attorney fees totaling approximately \$ 246,000, with interest and charges, both of which were reduced to judgment in favor of Jonesfilm ("JF") in a judgment dated June 19, 2007 entered by United States District Court in Los Angeles, California ("Judgment"). This amount is included in Accrued Liabilities on the accompanying financial statements. JF

asserts that the Company is liable as the “successor in interest” to PLC, which the Company denies. JF has sought to enforce the Judgment against SAFE, Mr. Hoffman and SAP in proceedings filed on July 28, 2009 in United States District Court in New Orleans, Louisiana, in Case Nos. 09-4814/4815. Thereafter, Jonesfilm filed claims purportedly against the separate property of Mr. Hoffman’s wife in Case Nos. 11-1994 and 12-0535. Mrs. Hoffman filed action against Jonesfilm to seek relief (from Jonesfilm’s actions against her and her separate property). All proceedings are still pending. Mr. Hoffman and SAFE have appealed to the Fifth Circuit (No. 11-311 24) an order of garnishment against Leeway and penalties and legal fees awarded in connection with that order of garnishment, which appeal was denied. The Company does not believe it owes any amounts over the amount already accrued above.

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Arrowhead Target Fund

Seven Arts Future Flow I (“SFF”), a limited liability company owned by SAP Inc., a company previously controlled by Mr. Hoffman, obtained financing from the Arrowhead Target Fund, Ltd. (“Arrowhead”) of approximately \$8,300,000 (the “Arrowhead Loan”). SFF secured the Arrowhead Loan with liens on 12 motion pictures. The Company’s only liability is to repay the Arrowhead Loan from the proceeds of the film assets pledged against the Arrowhead Loan. The Company is not required to repay the Arrowhead Loan from any of its other assets or revenues. SAE’s subsidiary, SAFE, Ltd. was the collateral agent of the film assets.

The Arrowhead Loan became due in February 2009 and SFF has not paid the outstanding principle and interest due thereon. Arrowhead has the right to foreclose on the pledged film assets, but has not done so at the present time. SFF has received a default notice to this effect and as a result Arrowhead is now collecting directly all sums receivable by the Company with respect to these motion pictures, and has appointed a new servicing agent for these motion pictures with the result that the Company no longer controls the licensing of these motion pictures. Failure to repay or refinance the Arrowhead Loan could result in a material disposition of assets through the loss of the Company’s rights to the twelve motion pictures and related loss of revenues in amounts that are difficult to predict.

Arrowhead filed an action on September 22, 2010 in New York Supreme Court, New York, New York, Arrowhead Target Fund v. Hoffman No. 657481/2010, which seeks recovery from the Company of the monies which the Company has retained under its interpretation of the relevant agreements with Arrowhead. In addition, Arrowhead makes substantial additional claims against the Company, Mr. Hoffman and SAP Inc. regarding claimed breaches of the terms of the operative agreements, including failure to properly account, failure to turn over materials, failure to remit monies collected, and similar matters. The claims against the Company for these breaches of warranties for damages are \$8,300,000 although Arrowhead states no basis for this amount.

The Company had moved to dismiss the action against all defendants other than Seven Arts Future Flows I LLC, which is not part of the Company. On August 9, 2011, the New York Supreme Court granted the Company’s motion and dismissed all defendants except Seven Arts Filmed Entertainment Limited in its capacity as a collateral agent, which is not a material element of Arrowhead claim. The Company continues to believe that Arrowhead’s claims against the Company are without substantial merit.

Arrowhead has purported to amend its claim against the Company and the other defendants. The Company has moved for dismissal of these claims on the same grounds. A former counsel for SAFE and Mr. Hoffman failed to appear at a hearing and the Court orally entered default against SAFE and Mr. Hoffman on October 7, 2013, both of whom will move to vacate the order for the motion to dismiss based on lack of personal jurisdiction on the merits. The Company continues to believe that Arrowhead’s claims against the Company are without substantial merit and will vigorously defend. The Company has accrued \$744,000 as a loss contingency on this matter.



Arrowhead has purported to amend its claim against the Company and the other defendants. The Company will seek dismissal of these claims on the same grounds. As of June 30, 2013, and through the date of this filing, there have been no further development. The Company continues to believe that Arrowhead's claims against the Company are without substantial merit and will vigorously defend. The Company has accrued \$744,000 as a loss contingency on this matter.

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Arrowhead Capital Partners – ACG Loan

PLC, SAP and SAFE, and several special purpose companies formed by SAP were named as defendants in an action by Arrowhead Capital Partners Ltd filed in the Supreme Court of New York County of New York State served on May 24, 2010, seeking to collect \$1,000,000 plus interest (the “ACG Loan”) due to Arrowhead Consulting Group LLC (“ACG”) as well as foreclosure on the collateral granted as part of the Cheyne Loan described above in Note 13 under “Production Loans”. Arrowhead Capital Finance v. Seven Arts Pictures, No. 601199/10. The ACG Loan is fully subordinated to repayment of the Cheyne Loan, which has not been repaid, and a subsidiary of the Company has been assigned all Cheyne’s rights under the subordination provision of the Cheyne Loan. ACG and the Company filed our motion for summary judgment which resulted in summary judgment in favor of ACG against SAFE, SAP and the special purpose companies. That summary judgment is on appeal to the New York Court of Appeals. As of June 30, 2013, and the date of this filing, there has been no decision in the appeal. The Company plans to vigorously defend this matter and cannot yet determine the probability of the outcome. The Company has not accrued a loss contingency on this matter and it is not a defendant in this action. Any claim against SAFE will be subject to the customary liquidation proceedings of SAFE under the law of the United Kingdom.

Investigation into Claim for Tax Credits (SAPLA)/ Possible Litigation Re: Tax Credits

The US Attorney in New Orleans is investigating claims for Louisiana film infrastructure tax credits including such tax credits to be claimed by Seven Arts Pictures Louisiana LLC (“SAPLA”) and has issued subpoenas for discovery of documents in the possession of the Company related to these tax credits. The Company has complied with that subpoena on March 15, 2012.

This investigation appears to include investigation as to whether certain expenses claimed by this affiliate were improper or fraudulent. All such claimed expenses were audited by independent auditors in Louisiana and reviewed by counsel. Management believes that this investigation will have no material adverse effect on the Company’s operations or the total tax credits to be received by the Company’s affiliates, but could result in charges against current or former employees of this affiliate based on prior audits, including Mr. Hoffman.

SAPLA, controlled by Mr. Hoffman’s wife, filed legal action in the 1<sup>st</sup> District Court in Baton Rouge, Louisiana in August, 2013 to require the Louisiana Department of Economic Development and State Historic Preservation Office to certify the tax credits due SAPLA, the proceeds of which have been assigned to the Company.

Parallel Action

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On June 28, 2011, Seven Arts Pictures Plc. (“PLC”) filed an action in the High Court of England against Parallel Media LLC (“Parallel”) to collect sums due to PLC with respect to acquisition of distribution rights in Russia to four motion pictures and to confirm Parallel’s obligations under both a signed and unsigned investment agreement with respect to the motion picture project Winter Queen. On the same day Parallel filed a petition to wind up and liquidate PLC in the Companies Courts of England based on its claim of repayment of \$1,000,000 of investment made by Parallel in Winter Queen. PLC is no longer part of the Company.

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On September 19, 2011, Parallel filed a new action against PLC and SAE in the Superior Court of California in Los Angeles, asserting the same claims as in the winding up petition and seeking to enjoin the proposed administration proceedings in England. Parallel Media v. Seven Arts Entertainment, No. SC114182. A request for a preliminary injunction was denied by the Superior Court. Parallel was permitted to pursue a claim in the Los Angeles Superior Court for alleging that the Asset Transfer Agreement dated July 1, 2011 between PLC and the Company (“ATA”) was not for fair consideration. Parallel’s motion for summary judgment has been denied. The Company believes that a favorable decision by the liquidator as discussed above will resolve this action in the Company’s favor. The Company has not accrued for a loss contingency in this matter. The potential loss to the Company could be between \$million and \$1.75 million.

The liquidator has been advised in a letter from its counsel dated October 10, 2013, that the Company may be obligated to reimburse the liquidator for additional shares of the Company’s common stock by reason of the reduction in the value of the Company’s common stock issued to PLC pursuant to the ATA, from July 1, 2010 to August 31, 2011. The Company had previously offered to the liquidator to make such an adjustment in the consideration paid pursuant to the ATA. The Company intends to negotiate an amicable resolution of this issue with the liquidator which counsel believes should resolve any claims by Parallel.

#### HMRC Investigation

On July 19, 2011 Officers of Her Majesty’s Revenue & Customs (“HMRC”) attended the offices of Seven Arts Pictures Plc. (the “Company”) in London. Documents were retained appertaining to arrangements involving the subscription for shares in a number of companies which had lost value, resulting in subscribers making claims to tax relief.

The Company’s participation in these transactions was limited to the Company’s predecessor’s transfer of rights to certain motion pictures to the investors in return for their investments in the production and release costs of those pictures and making available the provision of loans to fund a portion of those investments. The Company received no tax benefits from the transactions, which were made on arms-length terms. The Company believes that it is not a subject of the HMRC investigation.

In connection with the transactions, the Company did not make any representations or warranties to any party, including the investors, regarding any potential tax benefits related to the transactions. Prior to the closing of the transactions the investors obtained and made available to the Company, an opinion of prominent Queen’s counsel, specializing in United Kingdom tax laws, that the transactions were permitted and acceptable under the terms of the applicable United Kingdom revenue laws. The Company remains confident that the transactions were permitted and acceptable under the terms of the applicable United Kingdom revenue laws.

HMRC has requested interviews with three officers of PLC to discuss whether those officers were involved in the arrangements for subscription of shares in the relevant companies, the first of which with Ms. Elaine New, CFO, occurred in April 2012 and a second in May 2012. PLC is fully cooperating with the investigation. PLC believes there is no basis for any claim of responsibility of any of its officers or employees. Based on facts currently known by PLC, there is no need for it to record a contingent liability in its financial statements in connection with the investigation or the related transactions.

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**Commitments:**

**Employment agreements**

We have an employment agreement with Peter Hoffman pursuant to which he will act as our CEO until December 31, 2018. He has taken a leave of absence until December 31, 2013, and has waived his salary in that period. In connection with that employment agreement, we have granted Mr. Hoffman:

· the right to sole responsibility for creative and business decisions regarding motion pictures we develop and produce,

· a right of first refusal to produce remakes, sequels or prequels of motion pictures produced by Mr. Hoffman and acquired by us or any motion picture produced by us during his employment,

· an annual salary of \$500,000 per year plus bonuses, expenses and a signing option and

· a right upon termination without cause to a lump sum payment of approximately \$1,500,000, an assignment of all projects in development during the term of his employment and any amounts due upon such compensation as an excise tax.

We have an employment agreement with Kate Hoffman for a term ending on April 30, 2018, pursuant to which she will act as our COO at a salary of £100,000 per year plus bonuses and expenses. Ms. Hoffman's contract contains a "non-compete" clause pursuant to which she will be excluded from competing against us for 6 months following the date of her termination.

We have a consultant agreement with Candace Wernick pursuant to which she will act as chief financial officer for compensation of \$167,000 per year and expenses, as well as additional compensation for special projects. The contract automatically renews each July 15, unless advance notice is given.

**Appointment of new Chairman and President**

On April 2, 2013, we appointed Vince Vellardita as President and Chairman of the Board of Directors., pursuant to a three-year employment agreement dated April 1, 2013. Pursuant to the employment agreement, Mr. Vellardita will

receive an annual salary of \$200,000 payable on a monthly basis and a bonus of 10% of any net income realized by the Company or its subsidiaries for the music and movie license agreements to be entered into with him. Mr. Vellardita will also be entitled to reimbursement of all reasonable and customary expenses and other benefits that are generally available to the Company's employees. On August 29, 2013 Mr. Vallardita resigned from the Company and \$40,000 (to be satisfied in common stock of the Company) has been accrued in the accompanying financial statements as settlement of his employment contract.

### **Leases – 807**

The Company, through its subsidiary SAFELA, has a sublease on the property at 807 Esplanade, New Orleans, Louisiana, which houses the post-production facility. The sublease is with 808 Espanade Ave MT, LLC, and unrelated party, who leases the property through a master lease with SAPLA. The term of the lease is for 30 years, terminating on December 31, 2024, with annual rent of \$110,000.

### **Lease – West Hollywood**

The Company has entered into a lease for their West Hollywood office which commenced on January 1, 2011 and terminates on December 31, 2016, with a monthly base rent of approximately \$9,516. The Company has the option to extend the lease period for one five year period. The base rent shall increase annually by the Consumer Price Index, but in no case to be less than 3% or greater than 6%.

On February 1, 2012, the Company and landlord amended the lease to include additional space for a new total base rent of \$15,138, and extended the lease term through December 31, 2017. As of June 30, 2012 the Company has vacated the additional space, and the landlord has leased the space to new tenants. The Company and management are negotiating a settlement on the termination of the lease, for which \$75,000 has been included in accrued expenses.

**NOTE 13 – FAIR VALUE MEASUREMENTS**

Cash, accounts receivable, accounts payable and other accrued expenses and other current assets and liabilities are carried at amounts which reasonably approximate their fair values because of the relatively short maturity of those instruments.

ASC 820, “*Fair Value Measurements and Disclosures*”, establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820 are described as follows:

Level 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Company has the ability to access.

Level 2 - Inputs to the valuation methodology include:

quoted prices for similar assets or liabilities in active markets;  
quoted prices for identical or similar assets or liabilities in inactive markets;  
inputs other than quoted prices that are observable for the asset or liability;  
inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.



The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

The preceding method described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Company believes its valuation method is appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date. As of June 30, 2013 and June 30, 2012, all of the Company's financial assets and liabilities were considered current and due to the short maturity the carrying amounts are considered to approximate fair value.

#### **NOTE 14 – SUBSEQUENT EVENTS**

Subsequent stock issuances:

The Company issued the following shares of common stock subsequent to June 30, 2013:

Between July 1, 2013 and October 15, 2013, the Company issued 172,952,931 common shares at an average price of \$0.001962 per share. The total number of shares outstanding on October 15, 2013 was 219,276,228.

|             |  |
|-------------|--|
| 154,127,619 | common shares were issued in satisfaction of various convertible loans totalling \$ 309,250 converted at an average conversion price of \$0.002006/share.                                      |
| 18,825,312  | common shares were issued in satisfaction of various convertible loans related to construction loans totalling \$ 30,000 and was converted at an average conversion price of \$0.001594 share. |
| 172,952,931 |  |

Debt issuances:

On June 14, 2013, the Company entered into a debt agreement for approximately \$216,000 to cover expenses connected to its' film "Schism". The note was not finalized and funded until subsequent to year end, and therefore is not recognized in the loan balance outstanding as of June 30, 2013. The note is due October 31, 2013 and bears interest at 10%.

On September 15, 2013, the Company issued a convertible note for \$50,000, due March 15, 2014. The note is convertible at the lesser of \$0.003 or 65% of the closing price on the trading day prior to the holder's exercise of the note.

On October 1, 2013, the Company entered into three convertible notes, with two parties. One party acquired convertible notes in the amount of \$50,000 and \$10,000, the second party's note was in the amount of \$10,000. All three notes are due on April 1, 2014, and have the same conversion rate of \$0.002, with certain reset rights.

SAFE UK in liquidation:

On Wednesday, October 9, 2013, Seven Arts Filmed Entertainment Limited ("SAFE"), agreed to voluntary creditors liquidation under the terms of English law. One of SAFE's creditors, Content Media, is seeking to convert this proceeding into an involuntary creditors' liquidation and has filed a petition in the Company's Court, part of the High Court of London and Wales, No. \_\_\_\_\_. SAFE's agreement to voluntary creditors liquidation follows from the termination of its business by reason of the Asset Transfer Agreement between the Company and SAFE dated January 3, 2012 and the termination of SAFE's activities in the United Kingdom in May, 2013. SAFE's voluntary liquidation was supported by its and the Company's principal creditor, Palm Finance Inc., which controls more than 50% of the aggregate indebtedness of SAFE.

Sixteen19:

In October of 2012, SAFELA began negotiations with Sixteen19, a post production and digital production facility with offices in New York, Los Angeles and London, to run the operations of the production facility located at 807 Esplanade Avenue on New Orleans. As of this date the parties have not completed a formal agreement. It is not contemplated that there will be a new company formed for this joint venture, but rather a contracted partnership between SAFELA and Sixteen19. The name of the facility has been agreed to be French Quarter Film Center.

The basic terms of the agreement to run the facility were agreed in early December as follows: SAFELA and Sixteen19 agreed to joint operational control of the facility. For any business which utilized residential or office space at the facility, SAFELA will earn 80% of the gross revenue and pay Sixteen19 a 20% commission. For any business which was considered editorial or digital daily work, Sixteen19 will earn 80% of the gross revenue and pay SAFELA a 20% commission. There was an agreed set of "base rates" and any deviation below the agreed level of base rates for any new business will have to be mutually agreed by Kate Hoffman on behalf of SAFELA and Pete Conlin on behalf of Sixteen19. In addition, SAFELA agreed to pay 100% of the costs associated with the running of the building, including but not limited to all utilities, cleaning, gardening, sundry supplies and repairs to any damage to the facility that did not include technical issues. Sixteen19 agreed to pay 100% of the equipment and personnel costs associated with the editorial and digital daily business. In addition, SAFELA and Sixteen19 agreed to split the salary of a

facility manager 50/50.

During the year ended June 30, 2013 the joint venture did contract some work with CBS Sports which was purely editorial and digital daily work performed at the facility. As such, SAFELA is entitled to a twenty percent commission of the gross revenue paid by CBS Sports to Sixteen19.

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On August 29, 2013, Vince Vellardita resigned as Chairman and a Director and employee of Seven Arts Entertainment Inc., and its affiliates (the "Company"). Mr. Vellardita will be issued \$40,000 in newly issued common stock of SAE, with a restrictive legend under Rule 144. Mr Vellardita will appoint the Company as an agent to license of the television series "AJ Time Traveler" pursuant to a customary distribution agreement subject to good faith negotiation with standard industry parameters. The terms of the agency shall be two years with a commission of 25% to Mr Vellardita of actual collections, whenever such collections are made. Mr Vellardita shall have approval of any cost incurred by the Company above \$5,000 in relation to the licensing of "AJ Time Traveler".

Form S-1:

The Company is currently in the process of responding to SEC comments on the registration statement on Form S-1 which was filed with the SEC on January 22, 2013.

#### **NOTE 15 – Restatement of Previously Issued Financial Statements**

The Company is restating the consolidated financial statements for the years ended June 30, 2012 and 2011. The Company identified certain errors as follows:

The Company recognized \$4,489,721 for forgiveness of debt and interest for the year ended June 30, 2011 based on a verbal agreement with the lender. However, it was not until October of 2011 that all the other terms and issues of the Forbearance and Workout Agreement #6 ("Forbearance agreement") were memorialized in a formal agreement. Management originally concluded the verbal agreement and finalized agreement were sufficient evidential matter to support the determination that the forgiveness could be recognized during the year ended June 30, 2011. Management has revisited this conclusion and has instead determined, based on the executed formal agreements, to recognize the forgiveness as of the date the Forbearance Agreement was finalized, on October 28, 2011. Therefore, the gain on forgiveness of debt and interest has been restated to be recognized during the year ended June 30, 2012, instead of June 30, 2011.

During the year ended June 30, 2012, the Company had recognized \$6,459,247 as a one time "Change in estimate on impairment of film costs". The Company is reclassifying this amount to properly be included as a component of Cost of Revenue.

The Company recognized \$7,540,898 for "Fee related revenue – related party" in the year ended June 30, 2012. The amounts were clearly labeled and disclosed as between the Company and a related party, on both the face of the financial statements as well as in the footnote disclosures. Upon further reflection, management has determined a more appropriate treatment of the transaction would be to recognize as revenue an amount equal to the fair value for the services as if it had occurred between unrelated third parties. The fair value of \$3,235,000 was determined based on the amounts stated as "qualified expenses" and determined to be reasonable and industry standard in the required

audit of the cost report of infrastructure expenditures done performed by an independent accounting firm. Therefore, the “Fee related revenue – related party” has been restated during the year ended June 30, 2012, from \$7,540,898 to \$3,235,000..

During the year ended June 30, 2012 the Company revalued Series B Preferred Stock that had been issued in an acquisition for music assets, as an acquisition price adjustment during the measurement period. The “revalue” of the Series B Preferred Stock resulted in a journal entry that debited the Series B Preferred Stock and credited the Music Assets by \$4,400,684. Upon re-examination of the facts and accounting literature, management also has determined that the events on which the decision to remeasure the Series B Preferred Stock during the measurement period did not in fact reflect circumstances that existed at the acquisition date. Furthermore, as the Series B Preferred Stock was determined to be classified as permanent equity it should not have been remeasured after initial measurement. Therefore, the financial statements have been restated to reflect this correction of an error, resulting in an increase to both the Music Assets and Series B by \$4,400,684.

As a result of the increase to Music Assets as of June 30, 2012, the Company re-evaluated it’s impairment analysis for this date, which has resulted in the recognition of a \$3,035,000 impairment in the year ended June 30, 2012.

The Company entered into an agreement with Mr. Hoffman whereby he pledged 25,000,000 (pre-splits) shares to a certain noteholder as collateral against the debt. The shares pledged were newly issued to Mr. Hoffman, and under the Company’s original accounting treatment the Company charged the issuance of the shares against Mr. Hoffman’s Due to account. However, per further research of the transaction, if the pledged shares are sold and applied to the note balance, or if the shares are not utilized by the pledges and returned to the Company, Mr. Hoffman’s Due to related party balance as of the date of the agreements, will be reinstated. Due to the future obligation to in substance repurchase the shares and reinstate the Due to related party balance, it has been determined the shares should have been treated as if issued for no consideration, with only recognition of the number of shares issued at par, with an offset to APIC.

**Seven Arts Entertainment, Inc.****(Formerly Seven Arts Pictures, Plc)****Consolidated Statements of Operations****For the Year Ended June 30, 2012**

|  | Year Ended<br>June 30,<br>2012<br>(as originally<br>filed) | Foregiveness<br>of<br>Debt | Reclass<br>of "one-<br>time<br>revlauation<br>of<br>film costs" | Impairment<br>of<br>Music<br>Assets | Adjustment of<br>Revenue/AR<br>recognized from<br>SAPLA | June 30,<br>Restated |
|--|--|----------------------------|---|-------------------------------------|---|----------------------|
| Revenue:                                       |  |                            |   |                                     |   |                      |
| Film revenue                                   | 823,006  |                            |   |                                     |   | 823,006              |
| Fee income revenue - related party             | 7,540,898  |                            |   |                                     | (4,305,898 )  | 3,235,000            |
| Total revenue                                  | 8,363,904  |                            |   |                                     |   | 4,058,006            |
| <b>Cost of revenue</b>                         |  |                            |   |                                     |   |                      |
| Amortization of film costs                     | 3,996,577  |                            |   |                                     |   | 3,996,577            |
| Impairment of film and music costs             |  |                            | 6,459,247   | 3,035,000                           |   | 9,494,247            |
| Other cost of revenue                          | 899,065  |                            |   |                                     |   | 899,065              |
| Cost of revenue                                | 4,895,642  |                            |   |                                     |   | 14,389,889           |
| Gross profit                                   | 3,468,262  |                            |   |                                     |   | (10,331,883)         |
| Operating expenses:                            |  |                            |   |                                     |   |                      |
| General and administrative expense             | 2,251,139  |                            |   |                                     |   | 2,251,139            |
| Change in estimate on impairment of film costs | 6,459,247  |                            | (6,459,247)   |                                     |   | -                    |
| Bad debt expense                               | 307,481  |                            |   |                                     |   | 307,481              |
| Total operating expenses                       | 9,017,867  |                            |   |                                     |   | 2,558,620            |
| Income from operations                         | (5,549,605 )   |                            |   |                                     |   | (12,890,503)         |
| Non-operating income(expense)                  |  |                            |   |                                     |   |                      |
| Other income                                   | 31,100   | 4,458,621                  |   |                                     |   | 4,489,721            |
| Interest expense                               | (2,752,682 )   |                            |   |                                     |   | (2,752,682 )         |
| Interest income                                | -  |                            |   |                                     |   | -                    |
| Total non-operating income (expense)           | (2,721,582 )   |                            |   |                                     |   | 1,737,039            |
| Income/(loss) before taxes                     | (8,271,187 )   |                            |   |                                     |   | (11,153,464)         |

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|   |              |                      |
|---|--------------|----------------------|
| Change in debt derivative   | -            | -                    |
|   | (8,271,187 ) | (11,153,464)         |
| Provision for income tax (benefit)  | -            | -                    |
| Net income (loss)   | (8,271,187 ) | (11,153,464)         |
| Comprehensive income (loss):  |              |                      |
| Net income (loss)   | (8,271,187 ) | (11,153,464)         |
| Foreign exchange translation gain (loss)  | (13,555 )    | (13,555 )            |
| Comprehensive income (loss)   | (8,284,742 ) | (11,167,019)         |
|   | 4,458,621 -  | 3,035,000 -6,305,898 |
| Weighted average number of ordinary shares used in the profit (loss) per share calculation: |              |                      |
| Basic   | 453,057      | 453,057              |
| Diluted   | 453,057      | 453,057              |
| Basic profit/ (loss) per share  | (18.26 )     | (24.62 )             |
| Diluted profit/ (loss) per share  | (18.26 )     | (24.62 )             |

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**Seven Arts Entertainment, Inc.****(Formerly Seven Arts Pictures, Plc)****Consolidated Balance Sheets****A of June 30, 2012**

|   | June 30,<br>2012<br>(Audited) | 2011<br>restatement<br>of<br>Foregiveness<br>of<br>Debt/Interest | Foregiveness<br>of<br>Debt/Interest | Correct<br>"revaluation"<br>of<br>Series B<br>PS | Recognize<br>Impairment<br>Music<br>Assets after<br>restatement<br>of PS | Reversal of<br>Revenue/AR<br>recognized<br>from<br>SAPLA | Recognize<br>adjusted<br>revenue<br>from<br>SAPLA |
|---|-------------------------------|--|-------------------------------------|--|--|--|---|
| <b><u>ASSETS</u></b>  |                               |  |                                     |  |  |  |   |
| <b>CURRENT ASSETS:</b>  |                               |  |                                     |  |  |  |   |
| Cash and cash equivalents   | \$ 120,658                    |  |                                     |  |  |  |   |
| Accounts receivable, net of<br>allowance for doubtful<br>accounts of \$171,062 and<br>\$195,623 | 192,035                       |  |                                     |  |  |  |   |
| Due from related parties, net   | 2,116,538                     |  |                                     |  |  |  |   |
| Fee income receivable from<br>related parties   | 5,896,970                     |  |                                     |  |  | (5,896,970)  | 3,235,000   |
| Other receivables and<br>prepayments  | 849,845                       |  |                                     |  |  |  |   |
| Total Current Assets  | 9,176,047                     |  |                                     |  |  |  |   |
| Long term receivable from<br>related parties  | 1,643,928                     |  |                                     |  |  | (1,643,928)  |   |
| Film costs, less amortization<br>and impairment of<br>\$10,458,823 and \$2,843,734              | 14,612,608                    |  |                                     |  |  |  |   |
| Music assets  | 2,923,474                     |  |                                     | 4,400,684  | (3,035,000)  |  |   |
| Leasehold Improvements  | 4,551,270                     |  |                                     |  |  |  |   |
| Property and equipment, net<br>of accumulated depreciation<br>of \$111,232 and \$106,671        | 16,137                        |  |                                     |  |  |  |   |
| <b>TOTAL ASSETS</b>   | <b>\$32,923,463</b>           |  |                                     |  |  |  |   |
| <b>LIABILITIES AND<br/>SHAREHOLDERS'<br/>EQUITY</b>   |                               |  |                                     |  |  |  |   |



## CURRENT LIABILITIES:

|                             |               |           |             |             |
|-----------------------------|---------------|-----------|-------------|-------------|
| Accounts payable            | 1,152,977     |           |             |             |
| Accrued liabilities         | 2,758,845     |           |             |             |
| Due to related parties      | 1,060,906     |           |             |             |
| Shares to be issued         | 200,000       |           |             |             |
| Participation and residuals | 114,215       |           |             |             |
| Other loans                 | 7,163,730     | 4,458,621 | (4,458,621) |             |
| Film & production loans     | 6,124,428     |           |             |             |
| Deferred income             | 849,080       |           |             |             |
| VAT                         | -             |           |             |             |
| Provision for earn-out      | 50,000        |           |             |             |
| Total Current Liabilities   | 19,474,181    |           |             |             |
| TOTAL LIABILITIES           | \$ 19,474,181 |           |             |             |
|                             |               | 4,400,684 | (3,035,000) | (7,540,898) |
|                             |               |           |             | 3,235,000   |

## STOCKHOLDERS'

## EQUITY

|   |              |             |           |  |
|---|--------------|-------------|-----------|--|
| Convertible redeemable Series A preference shares at \$10 par value, 125125 authorised and outstanding        | \$ 1,251,250 |             |           |  |
| Convertible redeemable Series B preference shares at \$100 par value, 200,000 authorised, 180,000 outstanding | 4,762,952    |             | 4,400,684 |  |
| Convertible redeemable Series B shares held in escrow   | (3,163,636)  |             |           |  |
| Common stock ; \$0.01 par value, 35,992,964 authorised, 1,739,900 issued and outstanding                      | 17,399       |             |           |  |
| Common stock; £0.25 par value; 20,527,360 shares authorized; 37,759 issued and outstanding                    | -            |             |           |  |
| Deferred stock; £0.45 par value; 13,184,000 shares authorized; and 13,184,000 shares issued and outstanding   | -            |             |           |  |
| Deferred stock; £1.00 par value; 2,268,120 shares issued and outstanding                                      | -            |             |           |  |
| Additional paid in capital  | 18,866,060   |             |           |  |
| Convertible debentures  | -            |             |           |  |
| Receivable from EBT   | -            |             |           |  |
| Accumulated profit /(deficit)   | 0            | (4,458,621) |           |  |

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|  |              |             |           |             |             |             |           |
|--|--------------|-------------|-----------|-------------|-------------|-------------|-----------|
| Comprehensive income                             | (13,555 )    |             |           |             |             |             |           |
| Current Earnings                                 | (8,271,187 ) | 4,458,621   |           | (3,035,000) | (7,540,898) | 3,235,000   |           |
| Shareholders' equity                             | 13,449,283   |             |           |             |             |             |           |
| TOTAL LIABILITIES AND<br>SHAREHOLDERS'<br>EQUITY | \$32,923,463 |             |           |             |             |             |           |
|  |              | (4,458,621) | 4,458,621 | 4,400,684   | (3,035,000) | (7,540,898) | 3,235,000 |

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