

Seven Arts Entertainment Inc.  
Form 10-Q  
September 15, 2014

**U.S. SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended December 31, 2013

**OR**

**TRANSITION REPORT UNDER SECTION 13 OF 15(d) OF THE EXCHANGE ACT OF 1934**

Commission File Number **001-34250**

**SEVEN ARTS ENTERTAINMENT INC.**

(Exact name of small business issuer as specified in its charter)

**Nevada**                                **45-3138068**  
(State or other jurisdiction of    (IRS Employer

incorporation or organization) Identification No.)

**8721 Sunset Boulevard Suite 209**

**Los Angeles, CA 90069**

(Address of principal executive offices)

**(323) 372-3080**

(Issuer's telephone number)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 Web site, 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

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

Large Accredited Filer  Accelerated 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 Exchange Act). Yes  No

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As of September 12, 2014, there were 162,784,252 shares of Common Stock of the issuer outstanding.

**SEVEN ARTS ENTERTAINMENT, INC.**

**FORM 10-Q**

**DECEMBER 31, 2013**

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**Seven Arts Entertainment, Inc.****Consolidated Balance Sheets**

|   | December<br>31,<br>2013<br>(Unaudited) | June 30,<br>2013     |
|---|--|----------------------|
| <b><u>ASSETS</u></b>  |  |                      |
| <b>CURRENT ASSETS:</b>  |  |                      |
| Cash and cash equivalents   | \$ 13,432                              | \$ 4,884             |
| Accounts receivable, net of allowance for doubtful accounts of \$40,000 and \$40,000                              | 24,252                                 | 110,043              |
| Due from related parties  | 187,783                                | 205,787              |
| Fee income receivable from related parties, net of allowance of \$1,180,000                                       | 1,180,000                              | 2,055,000            |
| Other receivables and prepayments   | 206,992                                | 455,019              |
| Total Current Assets  | 1,612,459                              | 2,830,732            |
| Film costs, less accumulated amortization of \$14,063,827 and \$13,877,171  | 8,355,192                              | 8,368,686            |
| Music assets, less amortization of \$414,509 and \$408,205  | 240,000                                | 296,795              |
| Building Improvements, less amortization of \$247,244 and \$164,526   | 6,716,915                              | 4,102,525            |
| Property and equipment, net of accumulated depreciation of \$132,908 and \$129,084                                | 2,134                                  | 7,459                |
| <b>TOTAL ASSETS</b>   | <b>\$ 16,926,700</b>                   | <b>\$ 15,606,196</b> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |  |                      |
| <b>CURRENT LIABILITIES:</b>   |  |                      |
| Accounts payable  | 1,008,616                              | 1,824,140            |
| Accrued liabilities   | 1,706,465                              | 2,486,514            |
| Due to related parties  | 1,504,326                              | 1,681,701            |
| Participation and residuals   | 96,819                                 | 96,819               |
| Convertible debt  | 3,942,118                              | 4,073,901            |
| Mortgage and construction loans   | 7,823,797                              | 3,743,286            |
| Film & production loans   | 7,284,576                              | 7,814,412            |
| Deferred income   | 980,580                                | 954,265              |
| Total Current Liabilities   | 24,347,297                             | 22,675,039           |
| <b>TOTAL LIABILITIES</b>  | <b>\$ 24,347,297</b>                   | <b>\$ 22,675,039</b> |
| <b>STOCKHOLDERS' EQUITY</b>   |  |                      |
| Convertible redeemable Series A preferred stock at \$10 par value, 125,125 and 125,125 authorized and outstanding | \$ 1,251,250                           | \$ 1,251,250         |
|   | 5,525,454                              | 5,525,458            |

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|   |              |              |
|---|--------------|--------------|
| Convertible redeemable Series B preferred stock at \$100 par value, 200,000 authorized, 43,850 and 48,850 outstanding |              |              |
| Common stock; \$0.01 par value; 249,000,000 authorized, 2,116,687 and 23,162 issued and outstanding                   | 6,315,090    | 2,578,521    |
| Additional paid in capital  | 19,143,697   | 22,072,882   |
| Shares held as collateral   | (455,246 )   | (455,246 )   |
| Other Comprehensive income  | (13,555 )    | (13,555 )    |
| Accumulated deficit   | (38,669,666) | (38,154,995) |
| Warrants to be distributed  | 480,371      | 480,371      |
| Total Seven Arts Entertainment Inc. equity  | (6,422,605 ) | (6,715,314 ) |
| Non-controlling interest  | 997,992      | 353,530      |
| Total Shareholders' equity  | (7,420,597 ) | (7,068,843 ) |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY  | \$16,926,700 | \$15,606,195 |

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

**Seven Arts Entertainment, Inc.****Consolidated Statements of Operations and Comprehensive Loss**

|  | 3 Months Ended<br>December 31,<br>2013 |                | 6 Months Ended<br>December 31,<br>2013 |                |
|--|--|----------------|--|----------------|
|  | 2012                                   | 2012           | 2012                                   | 2012           |
|  | Unaudited                              | Unaudited      | Unaudited                              | Unaudited      |
| Revenue:   |  |                |  |                |
| Film revenue   | \$ (9,729 )                            | \$ 164,719     | \$ 87,267                              | \$ 394,112     |
| Music revenue  | -                                      | 6,450          | 14,974                                 | 696,240        |
| Fee Related Revenue - related party                              | -                                      | -              | -                                      | -              |
| Post production revenue  | 22,687                                 | 11,628         | 26,452                                 | 18,078         |
| Total revenue  | 12,958                                 | 182,797        | 128,693                                | 1,108,430      |
| Cost of revenue:   |  |                |  |                |
| Amortization of film costs and music assets                      | 94,699                                 | 94,886         | 195,146                                | 580,901        |
| Impairment of film costs and music assets                        | 50,491                                 | -              | 50,491                                 | -              |
| Other cost of revenue  | 20,037                                 | 129,351        | 21,563                                 | 249,658        |
| Cost of revenue  | 165,227                                | 224,237        | 267,200                                | 830,559        |
| Gross profit (loss)  | (152,269 )                             | (41,440 )      | (138,507 )                             | 277,871        |
| Operating expenses:  |  |                |  |                |
| Amortization of leasehold improvements                           | 41,359                                 | 42,848         | 82,718                                 | 80,775         |
| General and administrative expenses                              | 674,429                                | 781,667        | 1,200,900                              | 1,451,615      |
| Bad debt expense   | -                                      | -              | -                                      | -              |
| Total operating expenses   | 715,788                                | 824,515        | 1,283,618                              | 1,532,390      |
| Income/(Loss) from operations                                    | (868,057 )                             | (865,954 )     | (1,422,125 )                           | (1,254,518)    |
| Non-operating income(expense)                                    |  |                |  |                |
| Other income   |  | (6,451 )       | -                                      | -              |
| Gain/(Loss) on De-Consolidation of SAFE                          | 1,988,428                              |                | 1,988,428                              |                |
| Interest expenses  | (1,838,904)                            | (927,488 )     | (2,904,642)                            | (1,902,997)    |
| Realization of Tax Credits                                       | 1,180,000                              | -              | 1,180,000                              |                |
| Total non-operating income (expense)                             | 1,329,524                              | (933,939 )     | 263,786                                | (1,902,997)    |
| Income/(Loss) before taxes                                       | 461,467                                | (1,799,893)    | (1,158,339)                            | (3,157,515)    |
| Provision for income tax   | -                                      |                | (800 )                                 |                |
| Net Income/(loss)  | 461,467                                | (1,799,893)    | (1,159,139)                            | (3,157,515)    |
| Less: Net loss attributable to non-controlling interests         | (469,422 )                             | (89,293 )      | (644,462 )                             | (172,097 )     |
| Net income/(loss) attributable to Seven Arts Entertainment, Inc. | \$ 930,888                             | \$ (1,710,601) | \$ (514,677 )                          | \$ (2,985,418) |
| Comprehensive loss:  |  |                |  |                |

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|  |            |               |              |               |
|--|------------|---------------|--------------|---------------|
| Net loss   | 461,467    | (1,799,893)   | (1,159,139)  | (3,157,515)   |
| Other Comprehensive income/(loss)  | -          | -             | -            | -             |
| Comprehensive income/(loss)  | 461,467    | (1,799,893)   | (1,159,139)  | (3,157,515)   |
| Less: Comprehensive loss attributable to non-controlling interests         | (469,422 ) | (89,293 )     | (644,462 )   | (172,097 )    |
| Comprehensive Income/(loss) attributable to Seven Arts Entertainment, Inc. | \$930,888  | \$(1,710,601) | \$(514,677 ) | \$(2,985,418) |
| Weighted average shares of common stock outstanding:                       |            |               |              |               |
| Basic  | 537,545    | 25            | 308,464      | 177           |
| Diluted  | 537,545    | 25            | 308,464      | 177           |
| Basic profit/ (loss) per share   | \$1.73     | \$(68,608.06) | \$(1.67 )    | \$(16,899.97) |
| Diluted profit/ (loss) per share   | \$1.73     | \$(68,608.06) | \$(1.67 )    | \$(16,899.97) |

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



**Seven Arts Entertainment Inc.****Consolidated Statements of Cash Flows**

|  | <b>6 months<br/>ended<br/>December 31,<br/>2013</b> | <b>6 months<br/>ended<br/>December 31,<br/>2012</b> |
|--|---|---|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |   |   |
| Net Loss   | \$ (1,159,139 )                                     | \$ (3,157,515 )                                     |
| <b>Adjustments to reconcile net loss to net cash provided by (used in) operating activities:</b> |   |   |
| Depreciation   | 5,325   | 5,693   |
| Amortization of Film Costs and Music Assets  | 195,146   | 580,901   |
| Impairment of film and music costs   | 50,491  | -   |
| Amortization of Building improvements  | 82,718  | 80,775  |
| Provision for Returns  | -   | 231,405   |
| Stock issued for services  | 31,979  | 100,500   |
| Bad debt expense   | (1,180,000 )  | -   |
| <b>Changes in assets and liabilities:</b>  |   |   |
| (Increase) Decrease in Accounts Receivable   | 45,791  | (224,419 )  |
| Decrease in Due from Related Parties   | 18,004  | 19,791  |
| Increase in Fee Income Receivable from Related Party   | -   | -   |
| (Increase) Decrease in Other Receivables and Prepayments   | 288,027   | (784,723 )  |
| (Increase)Decrease in Film Costs   | 139,117   | (629,150 )  |
| (Increase) in Music Assets   | -   | (593,054 )  |
| Increase (Decrease) in Accounts Payable  | (781,749 )  | 401,111   |
| Increase(Decrease) in Accrued Liabilities  | (916,799 )  | 68,930  |
| Increase in Due to Related Parties   | 25,625  | 887,445   |
| Increase in Accrued Interest included in notes payable   | 2,905,949   | 1,459,834   |
| Increase(Decrease) in Deferred Income  | 26,315  | 74,100  |
| Net Cash Used in Operating Activities  | \$ (223,200 )                                       | \$ (1,478,376 )                                     |
| <b>CASH FLOWS PROVIDED BY (USED FOR) INVESTING ACTIVITIES:</b>                                   |   |   |
| Building Improvements  | -   | (375,420 )  |
| Net Cash Used in Investing Activities  | -   | (375,420 )  |
| <b>CASH FLOWS PROVIDED BY (USED FOR) FINANCING ACTIVITIES:</b>                                   |   |   |
| Proceeds from Borrowings   | 231,750   | 1,737,407   |
| Issuance of Common Stock for Cash  | -   | 300,000   |
| Common and Preferred Stock to be issued  | -   | (107,793 )  |
| Shares as collateral for legal settlement  | -   | (180,000 )  |
| Net Cash Provided by (Used for) Financing Activities   | 231,750   | 1,749,614   |

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|                                 |           |            |
|---------------------------------|-----------|------------|
| NET INCREASE (DECREASE) IN CASH | 8,550     | (104,182 ) |
| CASH AT BEGINNING OF PERIOD     | 4,884     | 120,658    |
| CASH AT END OF PERIOD           | \$ 13,434 | \$ 16,476  |

**Supplemental disclosure of cash flow information:**

|                   |   |   |
|-------------------|---|---|
| Interest paid     | - | - |
| Income taxes paid | - | - |

**Supplemental disclosure of non-cash investing and financing activities:**

|   |            |              |
|---|------------|--------------|
| Shares of common stock issued in satisfaction of debt   | \$ 339,250 | \$ 4,297,520 |
| Stock issued for services   | 31,979     | 100,500      |
| Conversion of Preferred Shares Series B to common stock   | -          | 1,001,818    |
| Application of SAPLA tax credit to Fee Income Receivable, related party and Film Production Loan balances | 2,055,000  | -            |
| Series A Preferred Stock modification   | 203,000    | -            |

**Seven Arts Entertainment, Inc.**

**Notes to Consolidated Financial Statements**

**December 31, 2013**

**(Unaudited)**

**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.

On November 8, 2011, the Company's listing predecessor, PLC, was placed into involuntary creditors' liquidation under English law (See Note 9 – 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 2 million (pre-split)/29 post-split shares of common stock of SAE in order to satisfy these obligations.

In late February 2012, the Company formed Seven Arts Music, Inc. (“SAM”) and acquired 52 completed sound recordings of the recording artist DMX with the rights to additional albums and acquired 100% of the stock of Big Jake Music (“BJM”). The music segment has not grown as the Company expected it to, and sales of the acquired sound recordings were not as estimated. The Company has recognized total impairments on this segment of \$4,775,000 since acquisition. Therefore, the Company is rethinking the music segment, and is presently not acquiring any new artists, or producing new recordings, and is only exploiting the already released recordings. The Company has determined their entry into the music business did not succeed to the level expected, as evidenced by the impairments recognized in the music segment, and will no longer invest capital in this activity to actively pursue new artists or recordings. The Company will continue to release recordings from their previously acquired material and exploit their released recordings.

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 July 1, 2012.

On October 1, 2013, the Company formed a new subsidiary in England and Wales, Cinevisions (UK) LTD, whose purpose mainly is to process salary for the two remaining UK based staff and collect European based revenue on behalf of the company.

On October 9, 2013 the Company’s subsidiary, Seven Arts Filmed Entertainment Limited (SAFE), entered into Creditors’ Voluntary Liquidation under English law. The Company had previously acquired certain assets of SAFE on January 3, 2012 for assumption of certain debt. All assets and liabilities of SAFE have been removed from the Company’s financial statements effective October 9, 2013.

The Company’s common stock is trading on the OTC Market’s OTCQB marketplace and is quoted under the symbol “SAPX.”

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

-

An "emerging growth company" is defined in the Securities Exchange Act of 1934 as an issuer that had total annual gross revenues of less than \$1 billion during its most recently completed fiscal year. An issuer that is an emerging growth company as of the first day of that fiscal year shall continue to be deemed an emerging growth company until the earliest of: i) the last day of the fiscal year of the issuer during which it had total annual gross revenues of \$1 billion or more, ii) the last day of the fiscal year of the issuer following the fifth anniversary of the date of the first sale of common equity securities of the issuer pursuant to an effective registration statement under the Securities Act of 1933, iii) the date on which such issuer has during the previous 3-year period, issued more than \$1 billion in non-convertible debt, or iv) the date on which such issuer is deemed to be a “large accelerated filer.”

The Company qualifies as an “emerging growth company” under the 2012 JOBS Act. Section 107 of the JOBS Act provides that an emerging growth company can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. As an emerging growth company, the Company can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. The Company may elect to take advantage of the benefits of this extended transition period in the future.

**Reverse Stock-Splits:**

On February 12, 2014, October 31, 2013, May 2, 2013 and August 31, 2012, the Company effected one –for-one hundred, one-for-twenty, 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.

**Unaudited Financial Statements:**

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States (“GAAP”) for complete consolidated financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals, unless otherwise indicated) considered necessary for a fair presentation of the interim financial data have been included. Operating results for the three and six months ended December 31, 2013 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2014.

The consolidated balance sheet at June 30, 2013 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by generally accepted accounting principles in the United States for complete financial statements.

The Company has evaluated events that occurred subsequent to December 10, 2013 and through the date the financial statements were available to be issued. Management concluded that no additional subsequent events required disclosure in these financial statements other than those disclosed in these notes to these financial statements.

The accompanying unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2013, filed with the Securities and Exchange Commission (the “SEC”) on October 15, 2013.

**Significant Accounting Policies:**

**Basis of Presentation:**

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

• Seven Arts Music, Inc. (“SAM”) (100% owned)

• 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)

• Cinevisions (UK) LTD, (100% owned)

All material intercompany balances and transactions are eliminated. 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 non-controlling interest. As of December 31, 2013, SAFELA’s net loss was approximately \$1,618,000.

**Liquidity and Management's Plan:**

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 approximately \$18,190,000, and utilized cash in operations of \$548,000. As of June 30, 2013, the Company had a working capital deficit of approximately \$19,844,000. For the six months ended December 31, 2013 the Company recorded a loss from operations of approximately \$1,422,125, utilized cash in operations of approximately \$223,000 and had a working capital deficit of approximately \$22,735,000

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.

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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, *Fractured* (formerly known as *Schism*), is expected to be released in April, 2014, and the Company also intends to release the next DMX album in mid 2014. Additionally, management has begun to implement cost reductions including reducing the size of its' staff and size of its UK office, relocating the Los Angeles 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.

Recently Issued Accounting Pronouncements:

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

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. 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.

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.

Deconsolidation of Seven Arts Filmed Entertainment Limited (SAFE):

On October 9, 2013, Seven Arts Filmed Entertainment Limited (SAFE), a wholly owned subsidiary, entered into a Creditors' Voluntary Liquidation in the United Kingdom on the basis that it was in liquidation and that it had issued a winding up petition in April 2013. In accordance with Accounting Standards Codification (ASC) 810, when a subsidiary becomes subject to the control of a government, court, administrator, or regulator, deconsolidation of that subsidiary is generally required. We have therefore deconsolidated SAFE from our balance sheet as of October 9, 2013 and have eliminated the results of SAFE's operations from our results of operations beginning on that date.

SAFE had a net payable at October 9, 2013 that we expect will remain unchanged until liquidation proceedings have been finalized. Included in this net amount are receivables and payables we have determined are reportable as a net amount based on the fact the amounts are determinable, the balances are due to and from SAFE, and the amounts would remain legally enforceable.

Income Taxes:

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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 (deferred tax liability) or benefit (deferred tax asset). Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

The Company accounts for uncertain tax positions according to the provisions of ASC 740. ASC 740 contains a two-step approach for recognizing and measuring uncertain tax positions. Tax positions are evaluated for recognition by determining if the weight of available evidence indicates that it is probable that the position will be sustained on audit, including resolution of related appeals or litigation. Tax benefits are then measured as the largest amount which is more than 50% likely of being realized upon ultimate settlement. The Company considers many factors when evaluating and estimating tax positions and tax benefits, which may require periodic adjustments and which may not accurately anticipate actual outcomes. No material changes have occurred in the Company's tax positions taken as of December 31, 2013.

The Company has provided a valuation allowance against all existing and newly created deferred tax assets as of December 31, 2013, as it is more likely than not that its deferred tax assets are not currently realizable due to the net operating losses incurred by the Company.

As of December 31, 2013, the Company did not have any unrecognized tax benefits or open tax positions. The Company's practice is to recognize interest and/or penalties related to income tax matters in income tax expense. As of December 31, 2013 the Company had no accrued interest or penalties related to income taxes. The Company currently has no federal or state tax examinations in progress.

### 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 \$40,000 at both December 31, 2013 and June 30, 2013, 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 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 June and October 2013, 147,143 (post split) shares were issued in satisfaction of \$2,091,227 of this liability. These shares are being held as collateral against certain loans and will be returned to the Company, if not called as collateral, when the related loans are paid or converted.

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 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.

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.

#### 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 are 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. As of December 31, 2013, the Company was in default on the Forbearance Agreement governing this loan with Palm Finance, who has demanded an additional \$2.7 million plus interest. (see Note 7). This additional amount of the mortgage has been recognized in Building Improvements. 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.

Loss 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. 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 September 30, 2013 and 2012, due to the loss from continuing operations, as they would have an anti-dilutive effect on EPS.

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 is 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.

**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. The Company's three segments are the film distribution and production segment, the music segment and the pre-production facility.

The table below presents the financial information for the three reportable segments for the three months ended December 31, 2013 and 2012:

|                               | Three Months Ended<br>December 31, 2013 |                |                              |               |
|-------------------------------|---|----------------|------------------------------|---------------|
|                               | Film<br>(SAE)                           | Music<br>(SAM) | Post- Production<br>(SAFELA) | Total         |
| Revenue                       | \$ (9,729 )                             | \$ -           | \$ 22,687                    | \$ 12,958     |
| Cost of revenue               | \$ (95,199 )                            | \$ (65,491 )   | \$ (4,537 )                  | \$ (165,227 ) |
| Gross profit/(loss)           | (104,928)                               | (65,491)       | 18,150                       | (152,269)     |
| Operating expenses            | (563,873)                               | (14,108)       | (137,807)                    | (715,788)     |
| Profit/(Loss) from operations | \$ (668,801 )                           | \$ (79,599 )   | \$ (119,657 )                | \$ (868,057 ) |
| Total Operating Profit/(Loss) |   |                |                              | \$ (868,057)  |

  

|                 | Six Months Ended<br>December 31, 2013 |                |                              |               |
|-----------------|---------------------------------------|----------------|------------------------------|---------------|
|                 | Film<br>(SAE)                         | Music<br>(SAM) | Post- Production<br>(SAFELA) | Total         |
| Revenue         | \$ 87,267                             | \$ 14,974      | \$ 26,452                    | \$ 128,693    |
| Cost of revenue | \$ (191,868 )                         | \$ (71,795 )   | \$ (3,537 )                  | \$ (267,200 ) |

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|                               |               |             |            |               |
|-------------------------------|---------------|-------------|------------|---------------|
| Gross profit/(loss)           | (104,601 )    | (56,821 )   | 22,915     | (138,507 )    |
| Operating expenses            | (1,016,307)   | (14,108 )   | (253,203   | ) (1,283,618) |
| Profit/(Loss) from operations | \$(1,120,908) | \$(70,929 ) | \$(230,288 | ) (1,422,125) |
| Total Operating Profit/(Loss) |               |             |            | \$(1,422,125) |

Assets

|                        | December<br>31,<br>2013 | June 30,<br>2013 |
|------------------------|-------------------------|------------------|
| Film assets            | \$8,357,377             | \$8,368,686      |
| Music assets           | 240,000                 | 296,795          |
| Post-production assets | 6,716,915               | 4,102,525        |

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

Related Party due to/due from consists of:

As of December 30, 2013:

|               | SAE           | SAFE | SAFELA | CONSOLIDATED BALANCE |
|---------------|---------------|------|--------|----------------------|
| Due From:-    |               |      |        |                      |
| SAP LA LLC    | \$173,006     | \$-  | \$-    | \$173,006            |
| SAMT          | 13,000        | -    | -      | 13,000               |
| Peter Hoffman | -             | -    | 1,777  | 1,777                |
| Total         | 186,006       |      | 1,777  | 187,783              |
| Due to:-      |               |      |        |                      |
| Peter Hoffman | (1,504,326)   | -    | -      | (1,504,326)          |
| SAFE (UK)     | -             | -    | -      | -                    |
|               | \$(1,504,326) | \$-  | \$     | \$(1,504,326)        |

As of June 30, 2013:

|               | SAE       | SAFE | SAFELA   | CONSOLIDATED BALANCE |
|---------------|-----------|------|----------|----------------------|
| Due From:-    |           |      |          |                      |
| SAP LA LLC    | \$173,006 | \$-  | \$-      | \$173,006            |
| SAMT          | 13,000    | -    | -        | 13,000               |
| Peter Hoffman | -         | -    | 19,781   | 19,781               |
| Total         | \$186,006 |      | \$19,781 | \$205,787            |

Due to:-

|               |               |             |     |               |   |
|---------------|---------------|-------------|-----|---------------|---|
| Peter Hoffman | \$(1,272,112) | \$(393,650) | \$- | \$(1,665,762) | ) |
| SAFE (UK)     | (2,383 )      | (13,556 )   | -   | (15,939       | ) |
|               | \$(1,274,495) | \$(407,206) | \$- | \$(1,681,701  | ) |

**NOTE 4 – FEE INCOME RECEIVABLE FROM RELATED PARTY**

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 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 has 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 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, as of June 30, 2013 management had determined that the amount underlying the LFI credits should be reserved against, until such time as the Tax Credit Certification Letter is received by SAPLA.

Additionally, the State Historic Preservation Office (“SHPO”) had not issued their Part III approval as of June 30, 2011, 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 had 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 was \$1,180,000, which represented 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.

In late November 2013 the issues between SHPO and SAPLA were resolved, and on January 2, 2014 SAPLA received the Part III certification from SHPO. Subsequent to quarter end SAPLA has begun selling the tax credits to third parties, \$ \$1,197,500 to date, the proceeds of which have been collected and used to pay down the Palm Finance debt. Therefore, the Company has determined there is no further amounts of the receivable which are necessary to reserve, and has decreased the reserve accordingly, resulting in a credit to Bad Debt Expense of \$1,180,000 during the three and six months ended December 31, 2013.

During the three months ended December 31, 2013, the owner of Palm Finance used the Federal tax credits earned by SAPLA on his personal tax returns. The Company has reflected this usage by reducing the Receivable to Related Party with a corresponding reduction of the production loans.

**NOTE 5 – FILM COSTS**

Film costs as of December 31, 2013 and June 30, 2013 are as follows:

|   | December 31,<br>2013 | June 30,<br>2013 |
|---|----------------------|------------------|
| Released, net of accumulated amortization | \$ 3,129,145         | \$3,314,728      |
| Completed and not released                | —                    | —                |
| In production                             | 1,207,517            | 1,209,931        |
| In development                            | 4,018,529            | 3,844,027        |
|   | \$ 8,355,191         | \$8,368,686      |

Amortization of film costs was approximately \$94,700, \$188,843, \$94,885 and \$172,695, respectively, for the three and six months ended December 31, 2013 and 2012. The Company estimates that its amortization expense in the next year will be \$650,000.

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.

**NOTE 6 – MUSIC ASSETS**

Music assets as of December 31, 2013 and June 30, 2013 are as follows:

|   | December 31,<br>2013 | June 30,<br>2013 |
|---|----------------------|------------------|
| Music assets  | \$ 705,000           | 5,423,205        |
| Impairment recognized during the year               | (50,491 )            | 4,718,205        |
| Total music assets                                  | 654,509              | 705,000          |
| Less: Accumulated amortization                      | 414,509              | 408,205          |
| Total music assets, net of accumulated amortization | 240,000              | 296,795          |

For the three and six months ended December 31, 2013 and 2012, amortization of \$0 and \$6,304, and \$0 and \$408,205 has been recognized, respectively.

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. During December 2013 the Company released the Bones, Thugs N Harmony recording. The initial sales and future requested shipments were not as expected, and at this time the Company is estimating the net future cash flows will be approximately \$120,000. Based on these low sales, the Company also has lowered its estimated future cash flows on the DMX album to be released in mid 2014 to \$120,000 also. Therefore, the Company has concluded an impairment in the amount of \$56,795 was necessary for the six months ended December 31, 2013.

The Company has also decided that their music business is not performing as expected, evidenced by the impairments of \$4,775,000 since inception, and they will not at this time be expending any additional capital, nor pursuing new artists or agreements. The Company will continue to exploit their current recordings and releases.

**NOTE 7 – LOANS PAYABLE**

The Company has the following indebtedness as of December 31, 2013:

| Lender                                   | Balance      | Interest Rate    | Issuance Date | Maturity Date |
|--|--------------|------------------|---------------|---------------|
| Film and Production Loans:               |              |                  |               |               |
| Palm Finance Corporation                 | \$ 4,225,277 | 18               | % 5/7/2007    | 11/7/2008     |
| Palm Finance Corporation                 | 2,615,922    | 18               | % 12/17/2007  | 6/17/2009     |
| Palm Finance Corporation                 | 107,257      | 10               | % 7/30/2012   |               |
| Prodigy                                  | 331,695      | 10               | % 6/14/2013   | 10/31/2013    |
| 120db Film Finance LLC                   | 4,425        |                  |               | 8/25/2008     |
| Total Film and Production Loans          | \$7,284,576  |                  |               |               |
| Conversions:                             |              |                  |               |               |
| Trafalgar Capital                        | \$665,003    | 9                | % 10/15/2008  | 8/31/2009     |
| JMJ Financial                            | 434,564      | 10               | % 6/29/2012   | 10/27/2012    |
| GHP                                      | 137,573      | 18               | % 1/21/2011   | 4/30/2012     |
| Tonaquint, Inc.                          | 394,657      | 8                | % 08/22/2012  | 7/2/2013      |
| Beaufort Ventures PLC                    | 235,786      | 10               | % 07/31/2012  | 08/30/2012    |
| Beaufort Ventures PLC                    | 171,452      | 10               | % 07/26/2012  | 02/25/2013    |
| Runway Investments, LTD                  | 162,103      | 12               | % 11/1/2012   | 09/30/2012    |
| Sendero Capital Ltd                      | 308,027      | 12               | % 01/24/2012  | 9/30/2012     |
| Isaac Capital Group LLC                  | 36,852       | 12               | % 01/20/2012  | 06/30/2012    |
| Beaufort Ventures, PLC                   | 85,870       | 10               | % 07/19/2012  | 07/19/2012    |
| Beaufort Ventures, PLC                   | 57,247       | 10               | % 7/19/2012   | 07/19/2013    |
| Beaufort Ventures, PLC                   | 28,445       | 10               | % 08/14/2012  | 8/2/2013      |
| Beaufort Ventures, PLC                   | 83,433       | 12               | % 1/22/2013   | 7/22/2013     |
| CMS Capital                              | 41,508       | 12               | % 12/15/2011  | 06/30/2012    |
| Hanover Holdings LLC                     | 264,207      | 10               | % 02/23/2012  | 08/23/2012    |
| Beaufort Ventures PLC                    | 59,074       | 12               | % 06/26/2012  | 06/26/2013    |
| Agua Alta (Cold Fusion)                  | 118,180      | 12               | % 06/25/2012  | 06/25/2013    |
| Beaufort Ventures PLC                    | 1,120        | 12               | % 11/30/2012  | 11/30/2013    |
| Tripod Group, LLC                        | 65,770       | 12               | % 1/2/2012    | 1/2/2013      |
| Beaufort Ventures, PLC                   | 12,128       | 12               | % 6/4/2012    | 4/5/2013      |
| Old Capital Ltd                          | 278,515      | 12               | % 05/31/2012  | 05/30/2013    |
| WHC Capital, LLC                         | 51,055       | 10               | % 4/19/2013   | 5/31/2013     |
| Elegant Funding                          | 53,304       | 12               | % 4/30/2013   | 5/2/2013      |
| Firerock Global Opportunities Fund, L.P. | 1,799        | 5% (18% default) | 2/11/2013     | 7/15/2013     |



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|                         |        |                      |              |           |
|-------------------------|--------|----------------------|--------------|-----------|
| Elegant Funding         | 17,623 | 18                   | % 5/6/2013   | 5/1/2014  |
| WHC Capital, LLC        | 28,668 | 21% (28%<br>default) | 4/19/2013    | 4/18/2014 |
| WHC Capital, LLC        | 22,578 | 21                   | % 5/20/2013  | 5/20/2014 |
| Tangiers Investors, LP  | 944    | 10                   | % 5/31/2013  | 5/31/2014 |
| Tangiers Investors, LP  | 19,255 | 10                   | % 6/10/2013  | 6/10/2013 |
| Isaac Capital Group LLC | 10,151 | 12                   | % 10/1/2013  | 4/1/2014  |
| Beaufort Ventures PLC   | 10,151 | 12                   | % 10/1/2013  | 4/1/2014  |
| Isaac Capital Group LLC | 85,078 | 12                   | % 10/21/2013 | 1/31/2014 |

\$3,942,118

Mortgage and Construction Loan:

|   |             |    |   |
|---|-------------|----|---|
| Palm Finance Corporation- mortgage and<br>construction loan | \$7,823,797 | 15 | % |
|---|-------------|----|---|

\$7,823,797

\*The Company does not agree with interest charged by Palm on the 2011 forgiven interest on these two film loans and believes the dispute will be resolved once the loans are repaid.

The loan balances include accrued interest of \$9,614,156 at December 31, 2013. Interest expense on all the loans for the three and six months ended December 31, 2013 and 2012 was \$1,909,860, \$557,732 and \$1,365,064, respectively.

On June 14, 2013, the Company guaranteed a debt agreement of Schism LLC for approximately \$216,000 to cover expenses connected to the film "Schism", (name later changed to "Fractured"). As the Company has unconditionally guaranteed the loan for Schism the debt is carried on the Company's books. The note was not finalized and funded until subsequent to year end, and therefore was not recognized in the loan balance outstanding until the quarter ended September 30, 2013. The note was later amended to an amount of approximately \$314,000. The note is due October 31, 2013 and bears interest at 10%, with no additional default rate. The Lender also is to receive 5% of adjusted gross receipts on the film after breakeven. The Lender has a security interest in the film, and until the debt is repaid is entitled to all revenue receipts on the film, including those paid to SAE. There was a loan arrangement fee in connection with the note, in the amount of 15% of the principle, or approximately \$63,000 after the amendment. This amount was immediately expensed based on the short term of the note agreement.

The Company negotiated a new convertible debenture on September 15, 2013 for \$25,000. The lender advanced the funding to the Company but has not agreed upon any terms nor executed a formal loan agreement with the Company. Therefore, this amount is included in accrued expenses, as not governed by a formal executed agreement.

On October 1, 2013, the Company entered into two \$10,000 convertible debentures with two separate parties, both notes with the same terms. The notes are due on April 1, 2014 and bear interest at 12% (default rate of 18%). The initial conversion rate is \$0.002, with the conversion rate eligible for a one time conversion reset to 60% of the trading value upon a reverse merger (the "reset conversion price"), which occurred on October 16, 2013. The conversion features have a reset provision upon the subsequent sale of equity at a lower price, which results in bifurcation and derivative accounting for the conversion features. Therefore, there is no beneficial conversion feature to be recognized upon the reset conversion price. Due to the short term of the note, as well as the low trading price of the Company's stock, it has been determined the fair value of the bifurcated derivative, as calculated by the Monte Carlo simulation model, is insignificant, and has not been recognized in the liabilities of the Company's financial position as of December 31, 2013.

On October 21, 2013, the Company entered into a second convertible debenture with one of the above parties, in the amount of \$200,000, due January 31, 2014. The note was issued with a \$25,000 discount, and bears interest at 12% (default rate of 18%). As of December 31, 2013 only \$75,000 of the note has been funded and recognized. A respective pro-rata amount of the discount was also recognized, and immediately expensed due to the short term of the note. The note is secured by the proceeds on the Fontana Distribution agreement, related to the released recordings of DMX and BTH (in all territories except for Germany, Austria and Switzerland). The initial conversion rate is \$0.04, with the conversion rate eligible for a one time conversion reset to 60% of the trading value upon a reverse merger (the "reset conversion price"), which occurred on October 16, 2013. The conversion features have a reset provision upon the subsequent sale of equity at a lower price, which results in bifurcation and derivative accounting for the conversion features. Therefore, there is no beneficial conversion feature to be recognized upon the reset conversion price. Due to the short term of the note, as well as the low trading price of the Company's stock, it has been determined the fair value of the bifurcated derivative, as calculated by the Monte Carlo simulation model, is insignificant, and has

not been recognized in the liabilities of the Company's financial position as of December 31, 2013.

On September 30, 2013 a note for \$30,888, related to amounts owing to the Company's legal firm, was assigned to another third party. The note had an original maturity date of October 31, 2013, and bears interest at a default rate of 18%. The transaction does not have any impact on the Company's financial statements, and was entered into for the new holder to qualify under Section 3(a)(9) of the Securities Act which allows for the underlying shares to be free traded.

The Company have evaluated their other convertible notes when issued for embedded derivative features and determined that no derivative liability is necessary to recognize. 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.

On December 5, 2013, the Company's subsidiary, SAFELA, entered into a Credit Line with Insurance Strategies Fund, LLC ("ISF") in which ISF has the right to loan amounts against individual pictures of their choice. The first picture to be funded is Fractured (formerly Schism) for \$150,000, at 10% interest, due June 5, 2014. The loan is secured by the film and all rights pertaining to the film. ISF also is entitled to participations of 100% of the gross receipts up to the amount funded, then is entitled to 50% of all net receipts. The loan does not have any conversion features, or other provisions containing embedded derivatives. As of December 31, 2013 \$50,000 has been funded, which is included in accrued expenses.

On December 2, 2013 the Company entered into an Advance and Assignment agreement with Lyric Financial, LLC, against future earnings on sales of BTH & DMX albums. For consideration of approximately \$77,260, less discount and other fees for net cash proceeds of \$65,000, the Company assigned 100% of their receipts under the Ingrooves/Fontana distribution agreement for six months, and then 50% of the receipts until advance repaid. Ingrooves holds the distribution rights on the DMX and BTH recordings in the territories Germany, Austria and Switzerland. If the advance is not recouped by September 2, 2014, the unpaid amount accrues interest at 2.5% per month until paid. As there is no set term of the advance, the discount is being amortized through September 2, 2014, as it is the understanding between Lyric and the Company that the royalties should be substantially collected before this date, and therefore has been determined by management to be the estimated termination date of the advance.

#### **NOTE 8 – EQUITY TRANSACTIONS**

On October 16, 2013 and February 12, 2014 the Company effected a 1-for-20 and 1-for-100 reverse split of its common stock. All share amounts in the accompanying financial statements have been restated to reflect this reverse stock split.

During the six month ended December 31, 2013, the Company issued 1,931,397 (post split) common shares upon conversion of notes totaling approximately \$552,000 under the original terms of the notes.

#### **Preferred Shares Series A:**

On July 31, 2013, Palm Finance sold 36,625 of their Preferred Shares Series A (“Series A”) to Susan Hoffman. On November 7, 2013, in connection with a sale of her shares to a third party, the Company agreed to modify the conversion price on these 36,625 Series A shares. Mr. Hoffman requested that the Company modify the conversion price to help Ms. Hoffman, and since this transaction did not benefit the Company in any way and therefore should not be treated as a expense incurred by the Company, Mr. Hoffman offered to bare the expense as a reduction of his “Due to” balance (Note X). The fair value of the modification was calculated following the guidance of ASC 718, *Stock Based Compensation*, as the difference between the fair value of the conversion feature immediately before and after the modification, using a Black Sholes Merton model. The fair value was determined to be \$203,000, which was recognized in Additional Paid in Capital as well as a reduction of the amounts owing to Mr. Hoffman.

#### **NOTE 9 – COMMITMENTS AND CONTINGENCIES**

With the exception of items, as noted below, there has been no significant changes to this litigation this period.

### **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. The Company, representing its listing predecessor, are actively in discussions with the liquidator to negotiate the settlement with the creditors. The Company believes the maximum contingent liability is \$750,000 of the Company's Series C Preferred Stock.

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 tradable. This contingent liability, if any, is the same as set forth in the previous paragraph.

### **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. The Company has settled this contingent claim for no payment, and therefore there is no further contingent liability based on this matter. 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. Management believes this contingent liability will not exceed \$1,000,000 in value of the Company’s common stock.

### **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 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 the judgment was offered on appeal to the Ninth Circuit No. 11-56759, on November 6, 2013.

## **Jonesfilm**

Seven Arts Pictures plc ("PLC"), the Company's listing predecessor, its then-subsiidiary 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.

## **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 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 was affirmed on appeal to the New York Court of Appeals. Arrowhead has since filed on July 18, 2014 in New York Supreme Court claiming the Company is a "successor" of PLC or SAFE and liable for the summary judgment. The Company named this action to Federal District Court for the Southern District of New York on August 14, 2014 and is filing a motion to dismiss for lack of personal jurisdiction. 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 liquidation proceedings of SAFE under the law of the United Kingdom. The maximum contingent liability for this claim is approximately \$2,500,000.

**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 19th 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 SAPL A, the proceeds of which have been assigned to the Company.

### **Parallel Action**

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.

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 \$1 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. The Company believes the maximum contingent liability for this claim is \$750,000 of the Company’s Series C Preferred Stock.

### **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 and completed interviews with three officers of PLC to discuss whether those officers were involved in the arrangements for subscription of shares in the relevant companies. 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.

### **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 an indefinite leave of absence, 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 was to 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 was also to 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. During the six months ended December 31, 2013 Mr Vallardita has been issued 30,000 shares (post split) for a corresponding reduction in the accrual of approximately \$22,000, for a remaining balance of \$18,000 to be issued.

### **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.

On March 1, 2014 the Company entered into a two year lease for new office space at 8721 W Sunset Blvd in West Hollywood, commencing April 1, 2014 and ending March 31, 2016 with a monthly payment of \$2,184. The move was a result of the previous landlord requesting the space the Company occupied for another existing tenant at the premises.

**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 December 31, 2013 and December 31, 2012, is as follows:

|   | December 31,<br>2013 | December 31,<br>2012 |
|---|----------------------|----------------------|
| Balance at July 1,  | \$ 353,530           | \$ -                 |
| Non-controlling interest’s proportionate share of Net loss for the six months | 644,462              | 172,097              |
| Non-controlling interest at December 31,                                      | \$ 997,992           | \$ 172,097           |

**NOTE 13 – SUBSEQUENT EVENTS**

**Subsequent stock issuances:**

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The Company issued the following shares of common stock subsequent to December 31, 2013:

Between January 1, 2014 and September 12, 2014, the Company issued 178,446,999 common shares at an average price of \$0.002041 per share. The total number of shares outstanding on September 12, 2014 was 180,564,252.

|             |  |
|-------------|--|
| 149,611,179 | Common shares were issued upon conversion of debt totaled \$303,454.14 converted at an average conversion price of \$0.002028 per share.                             |
| 28,835,820  | Common shares were issued for consulting services with a fair value of \$60,692.50, at \$0.002105 per share, determined at the market price on the date of issuance. |
| 178,446,999 |  |



**Notes Payable:**

On January 21, 2014 the Company assumed the legal costs incurred by related parties with regard to the SHO tax credits and Jonesfilm litigation. The debts were assigned to a third party through 2 convertible debt purchase agreements, and promissory notes were issued with the dates of the original debts: July 1, 2013 and July 10, 2013 both with a maturity date of June 23, 2014 and bearing interest at 18%. The conversion price is the lesser of \$0.0006 or 40% of the last sale price for the Common Stock on the Trading Day immediately preceding the date the conversion notice was transmitted to the Company.

**Reverse Stock-Splits:**

On February 12, 2014 the Company effected one –for-one hundred reverse stock split. Unless otherwise noted, all impacted amounts included in the consolidated financial statements and notes thereto have been retroactively adjusted for the Stock Splits.

**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 2012 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 included 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. This agreement still has not been finalized and executed, but is in operation per terms agreed upon in December 2012.

**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.

**Palm Workout Agreement:**

The Company has entered into and executed a Workout Agreement with Palm on August 29, 2014. The principal terms of this Agreement include the following:

1. Forgiveness of all indebtedness of the Company to Palm.
2. All film rights of the Company have been transferred to SAFELA, owned 60% by the Company and 40% by Palm.
3. Palm will be entitled to 60% of future film revenue from certain designated motion pictures and may obtain an assignment of all these film rights from SAFELA under certain conditions.
4. The Company and SAPLA have assigned to Palm all these rights in the Property and the historic rehabilitation and film infrastructure tax credits related to the Property.

## Acquisitions:

Sanwire Transaction/Change of Control.

The “Company” and Sanwire Corporation (OTC:SNWR) (“Sanwire”) announced on July 18, 2014 the execution of a definitive Stock Purchase Agreement (“the “Agreement”) under which Seven Arts will acquire Sanwire’s two subsidiaries; Oklahoma-based Aeronetworks LLC (“Aeronetworks”) and Nevada-based iTerra Technologies Inc. (“iTerra”).

Aeronetworks ([www.aeronetworks.net](http://www.aeronetworks.net)) provides advanced communications and broadband services to rural communities and Native American tribes with focus on public safety, education and healthcare sectors. Aeronetworks is a pioneer in delivering 4G/LTE, TV White Space, and advanced wireless technologies. Aeronetworks’ revenue for year ended Dec 31, 2013 was approximately \$462,400 (unaudited), and the first four months of 2014 was approximately \$251,000 (unaudited).

iTerra ([www.ipterra.net](http://www.ipterra.net)) is a designer, developer, manufacturer and marketer of a real-time 2-way wireless and/or wireline communications, and mine-safety solution for the global mining and industrial industry. iPMine, iTerra’s flagship product, allows mine operators to communicate (voice, text, and video), track, locate, identify, and monitor miners and equipment. iTerra is pre-revenue.

Pursuant to the Agreement, Seven Arts has acquired all the capital stock of iTerra and all the membership interests in Aeronetworks from Sanwire in return for the Company’s Series D Preferred Stock converting into approximately 40% of the Company’s common stock and assumption of approximately \$2,905,000.00 in convertible notes. Aero and iTerra will operate as wholly owned subsidiaries of Seven Arts.

The transaction set forth in the Agreement was closed on August 22, 2014. As a result, the Board of Directors (except Mr. Hickox) resigned and appointed Mr. Rick Bjorklund as CEO and a member of the Board and Mr. Bob Riggs. Robert La Salle was appointed as Chief Financial Officer. All the members of the Board and other officers of the Company resigned effective August 22, 2014. The closing of the transaction set forth in the Agreement was subject to the execution of the Palm Workout Agreement which occurred on August 29, 2014.

## Officers and Directors

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Post acquisition and pursuant to the Agreement, the Company's officers will be (a) Aeronetworks' Rick Bjorklund as Chief Executive Officer, and (b) Robert La Salle as Chief Financial Officer. The Company's directors will be (a) Rick Bjorklund (director and chairman), (b) Bob Riggs (independent), and (c) Anthony Hickox (independent).

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **FORWARD-LOOKING STATEMENTS**

Certain statements in this document might constitute "forward-looking statements". Some, but not all, forward-looking statements can be identified by the use of words such as "anticipate," "believe," "plan," "estimate," "expect," and "intend," statements that an action or event "may," "might," "could," "should," or "will" be taken or occur, or other similar expressions. Although the Company has attempted to identify important factors that could cause actual results to differ materially from expected results, such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company, or other future events, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following risks: the need for additional financing; uncertainties and risks related to carrying on business in foreign countries; risks associated with third party infringement of copyrights and other intellectual property, especially the unauthorized duplication of motion picture DVDs and unauthorized distribution of motion pictures through the world wide web; risks associated with the lack of enforcement of applicable copyright and intellectual property laws, especially in foreign countries; risks associated with changing copyright and applicable intellectual property laws, especially in foreign countries; risks associated with changing distribution models for motion pictures, especially on the world wide web; risks associated with restrictions of motion picture content, especially in foreign countries; reliance on key personnel; the potential for conflicts of interest among certain officer, directors or promoters of the Company; the absence of dividends; currency fluctuations; competition; dilution; the volatility of the Company's ordinary share price and volume; and tax consequences to United States shareholders. Except as required by law, the Company undertakes no obligation to revise any forward-looking statements because of new information, future events or otherwise.

### **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.

### **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.

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

#### Music Company

The Company incorporated Seven Arts Music Inc. (“SAM”) in the State of Nevada on February 23, 2012, as a wholly owned subsidiary of the Company, although set-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 the first album for Bone Thugs-N-Harmony delivered in December 2013. The Company has decided that their music business is not performing as expected, evidenced by the impairments of \$4,775,000 since inception, and they will not at this time be expending any additional capital, nor pursuing new artists or agreements. The Company will continue to exploit their current recordings and releases.

### 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 pot-production facility at 807 Esplanade Avenue in New Orleans, Louisiana (“807 Esplanade”). The facility commenced operations on July 1, 2012, and several theatrical motion picture and television productions have done production work at the property since then.

### Company Outlook

The principal factors that affected our results of operations in the past have been the number of motion pictures delivered in a fiscal period, the distribution rights of motion pictures produced by others acquired in a fiscal period, the choice of motion pictures produced or acquired by us, management’s and talents' execution of the screenplay and production plan for each picture, the distribution and market reactions to the motion pictures once completed, management's ability to obtain financing and to re-negotiate financing on beneficial terms, the performance of our third-party distributors and our ability to take advantage of tax-incentivized financing. These factors, when applicable to the fiscal period, will continue to be, in our opinion, the principal factors affecting future results of operation and our future financial condition. In the current period we have not released any motion pictures, nor acquired any new distribution rights, but are actively working on development of several projects. 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. 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. This accounted for the majority of our revenue in the periods presented.

## **RESULTS OF OPERATIONS**



**Results of Operations for the Six Months Ended December 31, 2013 and 2012**

We generated a net loss (after non-controlling interest) of \$514,677 for the six months ended December 31, 2013, as compared to \$2,985,418 for the six months ended December 31, 2012. A major component of this decrease in loss is the Company's recognition of a gain of \$1,988,428 on the de-consolidation of its subsidiary SAFE. A discussion of the other key components of our statements of operations and material fluctuations for the six months ended December 31, 2013 and 2012 is provided below.

Revenue

A) Film revenue totaled \$87,267 for the six months ended December 31, 2013, as compared to \$394,112 for the six months ended December 31, 2012, a decrease of \$276,845, or 70%, primarily due to the factors discussed below:

The 2013 Revenue consisted primarily of license and royalty fees received from several markets, both domestic and international, on several titles. These include \$18,800 for "Nine Miles Down", \$20,589 for "Drunkboat", \$22,992 for "Shooting Gallery", \$12,961 for "I'll Sleep When I'm Dead", and amounts under \$10,000 on 5 other titles. This revenue was offset by credits issued of \$approximately \$45,000 on 4 titles, which resulted in a negative film revenue.

The majority of 2012 sales came from accrued sales for the US release of "Drunkboat", releasing "Ninth Cloud" from Deferred Income to Sales and on-going royalty income received for "Pool Boys", "Knife Edge", "Night of the Demons" and "Nine Miles Down".

B) Music revenues for the six months ended December 31, 2013 totaled \$14,974, which related to the DMX recording released in 2012. No amounts of revenue had yet been received on the December 2013 release of the BTH recording. Revenues for the six months ended December 31, 2012 totaled \$689,790, all from the newly released DMX recording.

C) Revenue from the post production facility operations for the six months ended December 31, 2013 totaled \$26,452, compared to \$18,078 for the six months ended December 31, 2012, an increase of \$11,059, or 46%, primarily due to rental income received for the facility.

Cost of Sales

Cost of revenue was \$ 267,200 for the six months ended December 31, 2013 as compared to \$ 830,559 for the comparable period in 2012, a decrease of \$563,359, or 68 % as a result of:

A) The 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 proportion to what the current year's revenue bears to management's estimates of ultimate revenue expected to be recognized from the exploitation or sale of the films. The decrease in amortization for the six months ended December 31, 2013 as compared to 2012 are a result of the reduced revenue, and later stage life of the titles. No new films were released in the six months ended December 31, 2013.

An amortization charge of \$188,842 was made in the six months ended December 31, 2013 which was spread over four titles, "Nine Miles Down", "Pool Hall Prophets", "Knife Edge" and "A Broken Life" in line with revenue forecasts.

The equivalent charge during the six months ended December 31 2012 was \$580,901 mainly related to the release of "The Pool Boys" and "Knife Edge".

B) The music company assets have also been amortized in proportion to that the current year's revenue bears to management's estimates of ultimate revenue expected to be recognized from the exploitation or sale of the album. \$6,304 was amortized for the six months ended December 31, 2013, based on the low revenue recognized this period. Amortization of \$408,205 was recognized in the six months ended December 31, 2012, reflecting the release of the DMX recording. An impairment of \$50,491 was taken in the six months ended December 31, 2013 as the Company is recognizing the decreased value of the assets due to poor sales to date and continued expected underperformance.

C) The building improvements related to the post-production facility are being written off to costs of sales over the 30 year period of the lease, and the write-off was \$82,718 for the six months ended December 31, 2013, which is consistent with the \$80,775 for the six months ended December 31, 2012.

Other cost of revenue in the six months ended December 31, 2013 totaled \$21,563 as compared to \$249,658 in the same six months in 2012. Other cost of revenue for the six months ended December 31, 2013 mainly consisted of commission fees for distribution of the film "Nine Miles Down" and social media marketing costs related to the release of the music company Bones Thug & Harmony album. Other cost of revenue for the comparable period in 2012 arose mainly from distribution fees incurred by the music company from Fontana.

Administration Expenses

General and administrative expenses decreased by \$250,717, or 17 % from \$ 1,451,615 for the three months ended December 31, 2012 to \$1,200,898 for the six months ended December 31, 2013. The decrease was primarily attributable to the reduction of staff and our former CEO taking a leave of absence without pay.

Other Expense

Interest expense in the six months ended December 31, 2013 was \$2,904,612 compared to \$1,902,997 in the same period in 2012. The 2013 interest expense includes \$1,380,867 related to SAFELA for the mortgage and construction loan, of which \$899,361 is attributable to the accrued interest now recognized on the \$2.7million default portion of the mortgage.

Interest on movie and production loans was \$1,216,998 during the six months ended December 31, 2013 as compared to \$1,118,778 for the six months ended December 31, 2012.

On January 2, 2014 SAPLA received the Part III certification from SHPO, and subsequent to quarter end SAPLA has begun selling the tax credits to third parties. Therefore, the Company has determined there is no further amounts of the receivable which are necessary to reserve, and has decreased the reserve accordingly, resulting in a Realization of Tax Credits of \$1,180,000 during the three and six months ended December 31, 2013. (see Note 4)

### Income Tax

No tax expense was recognized in either period.

### **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.

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 approximately \$18,190,000, and utilized cash in operations of \$548,000. As of June 30, 2013, the Company had a working capital deficit of approximately \$19,844,000. For the six months ended December 31, 2013 the Company recorded a loss from operations of approximately \$1,284,000, utilized cash in operations of approximately \$223,000 and had a working capital deficit of approximately \$22,735,000.

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, Fractured (Schism), is expected to be released in April, 2014, and the Company also intends to release the next DMX album in mid 2014 and the Thugs Bones N Harmony album was released in December 2013, so revenue, although lower than originally expected, will be received in 2014. Additionally, management has begun to implement cost reductions including reducing the size of its' staff and size of its Los Angeles and UK offices and expects to be able to continue to obtain additional financing. Additionally, as the SHPO tax credits have been certified and SAPLA has begun to sell them and receive cash proceeds, amounts are expected to be collected against the Receivable from related party (Note 4). 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.

### Short Term Liquidity

The Company has an accumulated deficit of \$38,670,000 as of December 31, 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, Fractured, in April 2014, which will see revenues generated during the next year. As noted above, the Company will also begin to receive collections on their Receivable from related party. In addition, the Company has scaled back on administrative expenses through the closing of our UK office and move of our Los Angeles office to a smaller location. The Company also hopes to 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 for the six months ended December 31, 2013 was approximately \$223,000. Accrued interest increase, amortization of film costs, music assets and amortization of building improvements, and an increase in accounts payable were the primary adjustments to the Net Loss of approximately \$1,159,139.

Investing Activities: There was no cash used in investing activities this period.

Financing Activities: Net cash provided by financing activities for the six months ended December 31, 2013 was \$232,000, arising from the proceeds from the new convertible debentures entered into this quarter.

### Capital Resources

As of December 10, 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.

Working capital deficit at December 31, 2013 was approximately \$22,735,000, which is increasing from our position as of June 30, 2013 of \$19,845,000, with the largest impact on the working capital deficit being the increase in accrued interest on the indebtedness, which is all classified as current liabilities.

Working capital is negative due to the fact that all the loans are classified as current even with longer-term workout agreements. The majority of the other loans are convertible to stock and it is expected the note holders will choose to convert and so will have little or no cash impact.

Additionally, the mortgage and construction loans on 807 Esplanade are current liabilities with corresponding leasehold improvements being recorded as non-current assets.

Stockholder's Deficit at December 31, 2013 was approximately \$7,421,000 increasing from \$7,070,000 as at June 30, 2013. The change was primarily due to the conversion of debt to equity through the issuance of common shares offset by the Net loss for the period.

Historically, we have successfully raised additional operating capital through private equity funding sources or loans from affiliates. However, no assurances can be given that we will be able to obtain sufficient working capital through the sale of common stock and/or borrowing or that the development and implementation of our business plan will generate sufficient future revenues to sustain on-going operations.

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

We have no off-balance sheet arrangements.

#### **ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Not applicable.

#### **ITEM 4: CONTROLS AND PROCEDURES**

## **Evaluation of Disclosure Controls and Procedures**

Under the supervision and participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures as such term is defined under Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Based upon this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that as of December 31, 2013, our disclosure controls and procedures were ineffective due to a material weakness existing in our internal controls over financial reporting (described below), which has not been fully remediated as of December 31, 2013.

A material weakness is a deficiency, or a combination of deficiencies, in Internal Control over Financial Reporting (“ICFR”), such that there is a reasonable possibility that a material misstatement of the Company’s annual or interim financial statements will not be prevented or detected on a timely basis. A material weakness would permit information required to be disclosed by the Company in the reports that it files or submits to not be recorded, processed, summarized and reported, within the time periods specified in the SEC rules and forms. Based upon an evaluation conducted for the period ended December 31, 2013, our Chief Executive and Chief Financial Officer have concluded that as of the end of the period covered by this report, we have identified the following material weakness of our internal control:

Lack of sufficient accounting staff which results in a lack of segregation of duties necessary for a good system of internal control and financial statement presentation, as well as information not being recognized into the accounting records in a timely manner.

## **Changes in Internal Control over Financial Reporting**

We have made significant changes in our internal control over financial reporting: We have employed a new controller knowledgeable in US GAAP and the entertainment industry, as well as a CFO, with experience as an assurance partner at a registered public accounting firm, with extensive knowledge of SEC reporting. All entries will now be booked at source in the LA office.



## PART II OTHER INFORMATION

### Item 1. Legal Proceedings.

There have been no significant changes other than as noted below, to this litigation this period, since our disclosure included in the Annual Report included in the Form 10K, filed on October 15, 2013.

#### Litigation

##### 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 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 their judgment was offered on appeal to the Ninth Circuit No, 11-56759, on November 6, 2013.

##### Jonesfilm

Seven Arts Pictures plc (“PLC”), the Company’s listing predecessor, its then-subsiidiary 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.

#### 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 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 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 19th 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

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.

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 \$1 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 and completed interviews with three officers of PLC to discuss whether those officers were involved in the arrangements for subscription of shares in the relevant companies. 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.

### **Item 1A. Risk Factors**

Not applicable.

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

None.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**Item 5. Other Information.**

Not applicable.

**ITEM 6 - EXHIBITS AND REPORTS ON FORM 8-K**

**Exhibit No. Description**

|           |  |
|-----------|--|
| 2.1       | Asset Acquisition Agreement dated as of July 1, 2010 between Seven Arts Entertainment Inc. and Seven Arts Pictures Plc (1)   |
| 2.1.1     | Amendment to Asset Transfer Agreement dated January 27, 2011 (2)   |
| 2.1.2     | Second amendment to Asset Transfer Agreement (2)   |
| 3.1.      | Articles of Incorporation of Seven Arts Entertainment Inc.(1)  |
| 3.1.1     | Amendment to Articles of Incorporation of Seven Arts Entertainment Inc. *  |
| 3.2.      | By-Laws of Seven Arts Entertainment Inc.(1)  |
| 3.2.1.    | Amended By-Laws of Seven Arts Entertainment Inc. (2)   |
| 3.3       | Certificate of designation of Series A preferred stock (2)   |
| 3.4       | Certificate of designation of Series B preferred stock (revised) (2)   |
| 3.4.1     | Amendment to the Certificate of Designation of Series B preferred stock (2)  |
| 4.1       | Specimen Common Stock Certificate (1)  |
| 10.1*     | Revised 2012 Stock Incentive Plan (3)  |
| 31.1**    | 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.                             |
| 32.1**    | 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 and Chief Financial Officer, pursuant to 18 United States Code Section 1350, as enacted by Section 906 of the Sarbanes-Oxley Act of 2002. |
| 99.1      | Departure of Directors or Certain Officers   |
| 99.1      | Announcement of reverse stock split effective October 16, 2013. (4)  |
| 101.INS** | XBRL Instance Document.  |
| 101.SCH** | XBRL Taxonomy Extension Schema Document.   |
| 101.CAL** | XBRL Taxonomy Extension Calculation Linkbase Document.   |
| 101.DEF** | XBRL Taxonomy Extension Definition Linkbase Document.  |
| 101.LAB** | XBRL Taxonomy Extension Label Linkbase Document.   |
| 101.PRE** | XBRL Taxonomy Extension Presentation Linkbase Document.  |

\* Indicates management contract or compensatory plan or arrangement.

\*\* Filed herewith.

\*\*\* Furnished herewith.

(1) Filed as an exhibit to Amendment No. 4 to Registration Statement on Form F-1 filed on September 27, 2010 and incorporated herein by reference.

(2) Filed as an exhibit to Registration Statement on Form S-3 filed on August 20, 2012 and incorporated herein by reference.

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- (3) Filed as an exhibit to Definitive Proxy Statement on Schedule 14A on January 17, 2013 and incorporated herein by reference.
- (4) Filed as an exhibit on Form 8-K on October 16, 2013 and incorporated herein by reference.



**SIGNATURES**

In accordance with the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

**SEVEN ARTS  
PICTURES, INC.**

Date: September 12, 2014 By: */s/ Rick Bjorklund*  
Rick Bjorklund, CEO

Date: September 12, 2014 By: */s/ Robert La Salle*  
Robert La Salle  
Chief Financial Officer