



HOLTHOUSE
CARLIN &
VAN TRIGT_{LLP}

**PARADOX ENTERTAINMENT, INC.
AND SUBSIDIARIES**
CONSOLIDATED FINANCIAL STATEMENTS
AND
INDEPENDENT ACCOUNTANT'S REVIEW REPORT
DECEMBER 31, 2014

**PARADOX ENTERTAINMENT, INC.
AND SUBSIDIARIES**
CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2014

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Independent Accountant's Review Report

To the Board of Directors of
Paradox Entertainment, Inc.:

We have reviewed the accompanying consolidated balance sheet of Paradox Entertainment, Inc. and its subsidiaries (collectively, the "Company") as of December 31, 2014, and the related consolidated statements of operations, stockholder's deficit and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's financial data and making inquiries of company management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the consolidated financial statements as a whole. Accordingly, we do not express such an opinion.

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the consolidated financial statements.

Our responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require us to perform procedures to obtain limited assurance that there are no material modifications that should be made to the consolidated financial statements. We believe that the results of our procedures provide a reasonable basis for our report.

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

Holthouse Carlin & Van Trigt LLP

Long Beach, California
April 14, 2015

PARADOX ENTERTAINMENT, INC.
AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
DECEMBER 31, 2014
(SEE INDEPENDENT ACCOUNTANT'S REVIEW REPORT)

ASSETS

Current assets:		
Cash and cash equivalents	\$	62,555
Accounts receivable		1,509,719
Deferred income taxes		509,154
Total current assets		<u>2,081,428</u>
Deferred financing costs, net		272,143
Capitalized film development costs, net		10,697,759
Property and equipment, net		16,100
Intangible assets, net		7,088,740
Other assets		7,970
Total assets	\$	<u><u>20,164,140</u></u>

LIABILITIES AND STOCKHOLDER'S DEFICIT

Current liabilities:		
Accounts payable	\$	214,535
Accrued expenses		3,302,193
Deferred revenue		4,852,046
Current portion of notes payable		6,410,786
Total current liabilities		<u>14,779,560</u>
Notes payable to related party		9,225,825
Notes payable, net of current portion		1,515,708
Deferred income taxes		1,207,567
Total liabilities		<u>26,728,660</u>
Commitments and contingencies		
Stockholder's deficit:		
Series A preferred stock, \$0.001 par value. 1,000,000 shares authorized; 176,000 shares issued and outstanding		176
Common stock, \$0.001 par value. 1,000,000 shares authorized; 104,400 shares issued and outstanding		104
Additional paid-in capital		1,761,182
Accumulated deficit		(8,325,982)
Total stockholder's deficit		<u>(6,564,520)</u>
Total liabilities and stockholder's deficit	\$	<u><u>20,164,140</u></u>

See accompanying notes to consolidated financial statements.

**PARADOX ENTERTAINMENT, INC.
AND SUBSIDIARIES**
CONSOLIDATED STATEMENT OF OPERATIONS
FOR THE YEAR ENDED DECEMBER 31, 2014
(SEE INDEPENDENT ACCOUNTANT'S REVIEW REPORT)

Net revenues	\$ 2,606,657
Cost of revenues	<u>2,697,958</u>
Gross loss	<u>(91,301)</u>
Operating expenses:	
Selling, general and administrative expenses	1,042,356
Depreciation and amortization expense	<u>216,920</u>
Total operating expenses	<u>1,259,276</u>
Loss from operations	(1,350,577)
Other income (expense):	
Interest expense, net	(254,173)
Other income	<u>700</u>
Total other expense, net	<u>(253,473)</u>
Loss before provision for income taxes	(1,604,050)
Provision for income taxes	<u>88,294</u>
Net loss	<u><u>\$ (1,692,344)</u></u>

See accompanying notes to consolidated financial statements.

**PARADOX ENTERTAINMENT, INC.
AND SUBSIDIARIES**

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDER'S DEFICIT
FOR THE YEAR ENDED DECEMBER 31, 2014
(SEE INDEPENDENT ACCOUNTANT'S REVIEW REPORT)

	<u>Series A Preferred Stock</u>		<u>Common Stock</u>		<u>Additional Paid-in Capital</u>	<u>Accumulated Deficit</u>	<u>Total Stockholder's Deficit</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>			
Balance at December 31, 2013	176,000	\$ 176	104,400	\$ 104	\$ 1,761,182	\$ (6,633,638)	\$ (4,872,176)
Net loss	-	-	-	-	-	(1,692,344)	(1,692,344)
Balance at December 31, 2014	<u>176,000</u>	<u>\$ 176</u>	<u>104,400</u>	<u>\$ 104</u>	<u>\$ 1,761,182</u>	<u>\$ (8,325,982)</u>	<u>\$ (6,564,520)</u>

See accompanying notes to consolidated financial statements.

PARADOX ENTERTAINMENT, INC.
AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2014
(SEE INDEPENDENT ACCOUNTANT'S REVIEW REPORT)

Cash flows from operating activities:	
Net loss	\$ (1,692,344)
Adjustments to reconcile net loss to net cash provided by operating activities:	
Amortization of film development costs	1,950,256
Impairment of film development costs	461,347
Depreciation and amortization	216,920
Deferred income taxes	88,294
Changes in operating assets and liabilities:	
Accounts receivable	(1,505,648)
Deferred financing costs	772,664
Capitalized film development costs	(2,916,316)
Other assets	22,000
Accounts payable	34,976
Accrued expenses	265,745
Deferred revenue	4,403,768
Net cash provided by operating activities	<u>2,101,662</u>
Cash flows from financing activities:	
Proceeds from notes payable, net of deferred financing costs	2,248,799
Repayments on notes payable	(4,713,422)
Proceeds from notes payable to related party	201,250
Net cash used in financing activities	<u>(2,263,373)</u>
Net decrease in cash and cash equivalents	(161,711)
Cash and cash equivalents, beginning of year	<u>224,266</u>
Cash and cash equivalents, end of year	<u>\$ 62,555</u>
Supplemental disclosure for cash flow information:	
Cash paid during the year for:	
Interest	\$ <u>987,791</u>
Income taxes	\$ <u>8,100</u>
Non-cash operating and financing activities:	
Notes payable included in capitalized film development costs	<u>\$ 300,000</u>

See accompanying notes to consolidated financial statements.

**PARADOX ENTERTAINMENT, INC.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2014
(SEE INDEPENDENT ACCOUNTANT'S REVIEW REPORT)

NOTE 1. ORGANIZATION

Paradox Entertainment, Inc. (the "Company") was incorporated in September 2002 in the state of Delaware. The Company develops and licenses brands, including the stories and characters of Robert E. Howard, Conan, Kull, Bran Mak Morn, Solomon Kane, and Mutant Chronicles. The property portfolio consists of approximately 1,000 stories and characters. Industries exploiting the Company's property portfolio include film, TV, book, comics, video game, internet/mobile/wireless, toys, apparel, etc. The Company also finances and produces its own film productions.

The Company's sole stockholder is Paradox Entertainment AB ("PEAB"), whose stock is listed on the NASDAQ OMX-controlled First North Premier exchange in Stockholm, Sweden.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation and Basis of Presentation

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("US GAAP") and include the accounts of the Company and its wholly owned subsidiaries Conan Properties International, Inc., a Delaware corporation ("CPI"); Mutant Chronicles International, Inc., a Delaware corporation ("MCI"); Robert E. Howard Properties, Inc., a Delaware corporation ("REH"); Solomon Kane, Inc., a Delaware corporation ("SKI"); Kull Productions, Inc., a Delaware corporation ("KPI"); Paradox Studios, Inc., a Delaware corporation ("PSI"); FWF Productions, LLC, a Delaware limited liability company; Mocom Productions I, LLC, a Delaware limited liability company ("MPI"); Rogue Warrior, LLC, a Delaware limited liability company; and Reclaim, LLC, a Delaware limited liability company. All significant intercompany balances and transactions have been eliminated upon consolidation.

Use of Estimates

The preparation of the Company's consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of certain assets and liabilities and the disclosure of certain commitments and contingencies at the date of the consolidated financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Estimates have been prepared on the basis of the most current and best available information; however, actual results could differ from those estimates.

PARADOX ENTERTAINMENT, INC.
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NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenue Recognition

The Company recognizes revenue from licensing of intellectual property and executive production services in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 605, *Revenue Recognition*, where revenue is recognized when all of the following conditions are met:

- Persuasive evidence of a licensing agreement with a customer exists.
- The characters are made available to the customer.
- The license period of the arrangement has begun and the customer can begin its exploitation, exhibition, or sale.
- The arrangement fee is fixed or determinable.
- Collection of the arrangement fee is reasonably assured.

In addition, the Company participates in the production and development of various filmed entertainment projects. The Company recognizes revenue related to these projects using the Individual-Film-Forecast-Computation method as defined in FASB ASC Topic 926 *Entertainment – Films* ("ASC 926"). Under this revenue recognition method, revenue is not recognized for a film unless the film is available for exploitation. Fees received for films before they are available for exploitation are deferred.

Cash and Cash Equivalents

The Company considers money market accounts and other highly liquid investments with original maturities of three months or less to be cash equivalents.

Accounts Receivable

Accounts receivable are stated at amounts due from customers. As a general policy, the Company determines its allowance by considering a number of factors including the length of time accounts receivable are past due, the Company's previous loss history, the customer's current ability to pay its obligation to the Company, and the condition of the general economy and the industry as a whole. The Company writes off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts.

As of December 31, 2014, the Company believes the entire balance for its accounts receivable is fully collectible.

Financial Instruments and Concentration of Credit and Business Risk

FASB ASC Topic 825, *Financial Instruments*, requires disclosure of fair value information about financial instruments. The Company's financial instruments include cash and cash equivalents, accounts receivable, accounts payable, and certain other assets and liabilities. Financial instruments that potentially subject the Company to concentrations of credit and business risk consist of cash and cash equivalents and accounts receivable.

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NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial Instruments and Concentration of Credit and Business Risk (Continued)

The Company maintains cash balances that, at times, exceed amounts insured by the Federal Deposit Insurance Corporation. The Company has not experienced any losses in these accounts and believes it is not exposed to any significant credit risk.

The Company's accounts receivable, which are unsecured, expose the Company to credit risks such as collectability and business risks such as customer concentrations. The Company mitigates credit risk by investigating the creditworthiness of all customers prior to establishing relationships with them, performing periodic reviews of the credit activities of those customers during the course of the business relationships, regularly analyzing the collectability of accounts receivable, and recording allowances for doubtful accounts when these receivables become uncollectible.

Customer concentrations for the year ended December 31, 2014 consist of one significant customer that accounts for approximately \$1,950,000, or 75%, of the Company's total net revenues for the year ended December 31, 2014. Amounts outstanding from this significant customer represent approximately \$63,000 or 4% of total accounts receivable at December 31, 2014.

Deferred Financing Costs

Financing costs incurred in connection with obtaining long-term financing have been capitalized. These fees are amortized using the straight-line method, which approximates the effective interest method, over the term of the related financing. In accordance with FASB ASC Subtopic 835-20, *Interest – Capitalization of Interest*, the amortization of these costs for the year ended December 31, 2014 are included in capitalized film development costs until the film is available for exploitation; at which point these capitalized interest charges will be amortized using the film forecast method.

Capitalized Film Development Costs

The Company has capitalized certain expenses paid in connection to the development of films and manuscripts for sale to motion picture studios as well as in-house produced productions. The costs are classified as long-term assets in the accompanying consolidated balance sheet and are evaluated for impairment on an annual basis.

One aspect of the accounting for production costs, as well as related revenues, that impacts the Company and requires the exercise of judgment relates to the process of estimating ultimate revenues, which is important for two reasons.

First, while a film is being produced and the related costs are being capitalized, as well as at the time the film is released, it is necessary for management to estimate the ultimate revenues, less additional costs to be incurred (including exploitation costs), in order to determine whether the carrying value of a film has been impaired and, thus, requires an immediate write-off of unrecoverable film costs.

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NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Capitalized Film Development Costs (Continued)

Second, such an estimate is important in determining the amount of capitalized film costs recognized as amortization for a given film in a particular period. This cost recognition is based on the proportion of the film's revenues recognized for each period as compared to the film's estimated ultimate revenues. To the extent that ultimate revenues are adjusted, the resulting gross margin reported on the exploitation of that film in a period is also adjusted.

For capitalized production costs for films that are in process, management bases its estimate of ultimate revenues for each film on numerous factors, such as the historical performance of similar films, the anticipated rating of the film, and pre-release market research. Management updates such estimates based on information available on the progress of the film's production and, upon release, the actual results of each film. Changes in estimates of ultimate revenues from period to period affect the amount of production costs amortized in a given period and, therefore, could have an impact on the Company's consolidated financial results for that period.

Ultimate revenue estimates on a film-by-film basis are periodically reviewed by management and revised when warranted, based upon management's appraisal of current and future market conditions and expected performance. When estimates of total net revenues indicate that a film's capitalized production cost has a future undiscounted cash flow that is less than its unamortized cost, an impairment loss is recognized for the amount by which the unamortized cost exceeds the film's future undiscounted cash flow.

Property and Equipment

Property and equipment are stated at cost, net of accumulated depreciation and amortization. Depreciation and amortization of property and equipment is computed using the straight-line method over the estimated useful lives of the related assets from five to seven years for consolidated financial statement purposes. Amortization of leasehold improvements is computed using the straight-line method based upon the shorter of the original terms of the lease or the estimated useful life of the respective improvement.

Betterments, renewals and extraordinary repairs that materially extend the useful life of the asset are capitalized; other repairs and maintenance charges are expensed as incurred. The cost and related accumulated depreciation and amortization applicable to assets retired are removed from the accounts, and the gain or loss on disposition, if any, is recognized in the consolidated statement of operations for the period.

Intangible Assets

The Company's intangible assets consist of copyrights and trademarks. Copyrights are generally amortized on a straight-line basis over 31 years. Trademarks have indefinite lives as they are expected to contribute to cash flows indefinitely, thus they are not amortized until their useful lives are no longer indefinite.

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NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Impairment of Long-lived Assets

In accordance with FASB ASC Topic 350, *Intangibles, Goodwill and Other* ("ASC 350"), intangible assets determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually and more frequently if events and circumstances indicate that the asset might be impaired. ASC 350 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values and reviewed for impairment in accordance with FASB ASC Topic 360, *Property, Plant and Equipment – Impairment or Disposal of Long Lived Assets* ("ASC 360").

The Company is subject to the provisions of ASC 360, which requires impairment losses to be recorded on long-lived assets when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of the assets. In such cases, the carrying value of these assets are adjusted to their estimated fair value and assets held for sale are adjusted to their estimated fair value less selling expenses.

Income Taxes

The Company uses the asset and liability method of accounting for income taxes in accordance with FASB ASC Topic 740, *Income Taxes* ("ASC 740"), where deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

In accordance with FASB ASC Subtopic 740-10, *Income Taxes*, the Company provides a valuation allowance against its deferred tax assets when circumstances indicate that it will, more likely than not, no longer be realized.

The Company does not recognize accrued interest related to unrecognized tax benefits in interest expense and penalties in operating expenses in the accompanying statement of operations.

The Company files income tax returns in the U.S. federal and California jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2010.

PARADOX ENTERTAINMENT, INC.
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NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Liquidity

The Company had an accumulated deficit of \$8,325,982 and a net loss of \$1,692,344 as of and for the year ended December 31, 2014. Based on the Company's projected operations for the year ending December 31, 2015, management believes that it has sufficient cash resources to fund operations and meet its obligations as they become due for the next 12 months, with the support from its parent company PEAB. However, actual results could differ from management's assessment.

NOTE 3. DEFERRED FINANCING COSTS

The Company incurred deferred financing costs of \$1,174,054 related to the notes payable issued to finance the production of Reclaim (see note 4 and 8). As of December 31, 2014, deferred financing costs amounted to \$272,143, net of accumulated amortization of \$901,911. During 2014, \$752,008 of interest expense related to the amortization of deferred financing costs is included in capitalized film development costs as of December 31, 2014.

Estimated future amortization for deferred financing costs is \$272,143 in 2015.

NOTE 4. CAPITALIZED FILM DEVELOPMENT COSTS

In 2014, the Company released the movie "Reclaim", which stars John Cusack and Ryan Phillippe. The Company incurred debt to finance the motion picture (see note 8) and production took place, primarily, in Puerto Rico. The Company obtained the right to sell the distribution rights of the movie in the United States.

For the year ended December 31, 2014, the amortization of capitalized film development costs amounted to \$1,950,256, which was recognized based on the percentage of revenues generated to ultimate revenues forecasted.

During the year ended December 31, 2014, net capitalized film development costs of \$461,347 were impaired based on the determination that estimated ultimate revenues of the related film development costs would not recover the full capitalized costs. Impairment losses were included in cost of revenues in the consolidated statement of operations for the year ended December 31, 2014.

NOTE 5. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following as of December 31, 2014:

Computer equipment	\$	59,723
Office furniture		33,205
		92,928
Less: accumulated depreciation and amortization		(76,828)
	\$	16,100

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NOTE 5. PROPERTY AND EQUIPMENT (Continued)

Depreciation and amortization expense related to property and equipment for the year ended December 31, 2014 amounted to \$9,468. No impairment losses of property and equipment were recognized for the year ended December 31, 2014.

NOTE 6. INTANGIBLE ASSETS

Intangible assets consisted of the following as of December 31, 2014:

Copyrights	\$	6,344,544
Less: accumulated amortization		<u>(1,996,259)</u>
		4,348,285
Trademarks		<u>2,740,455</u>
	\$	<u><u>7,088,740</u></u>

Amortization expense related to copyrights was \$207,452 for the year ended December 31, 2014. No impairment losses of intangible assets were recognized for the year ended December 31, 2014.

Estimated future amortization expense on intangible assets with definite lives is as follows:

Years ending December 31,		
2015	\$	204,663
2016		204,663
2017		204,663
2018		204,663
2019		204,663
Thereafter		<u>3,324,970</u>
	\$	<u><u>4,348,285</u></u>

NOTE 7. RELATED PARTY TRANSACTIONS

Management Fees – PEAB

On January 1, 2007, the Company entered into a consultancy agreement with PEAB, which expired on December 31, 2010. The Company subsequently extended the consultancy agreement annually until December 31, 2013. As of December 31, 2014, total unpaid management fees amounted to \$337,527, which are included in accrued expenses on the accompanying consolidated balance sheet. The Company paid management fees of \$112,473 during 2014.

Consultant Expense – PEAB

In prior years, the Company incurred consulting expenses for services provided to the Company by the Chairman of the Board and other board members. The unpaid balance of \$680,000 is included in accrued expenses in the accompanying consolidated balance sheet as of December 31, 2014.

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NOTE 7. RELATED PARTY TRANSACTIONS (Continued)

Notes Payable to PEAB

The Company has two promissory note payables to PEAB with outstanding balances of \$6,026,203 and \$3,199,622, for a total of \$9,225,825 as of December 31, 2014, which accrue interest at 2.5% per annum. The entire principal balances and any unpaid interest are due, in full, upon maturity of the notes on January 1, 2017. Interest is accrued and due annually in arrears on December 31.

Interest expense related to these notes was approximately \$251,000 for the year ended December 31, 2014, and is included on the accompanying consolidated statement of operations. The remaining unpaid accrued interest balance of \$2,025,614, which includes \$1,844,741 from the prior year, is included in accrued expenses in the accompanying consolidated balance sheet as of December 31, 2014.

Total future minimum payments of \$9,225,825 under the notes issued to PEAB as of December 31, 2014 are classified as noncurrent liabilities in the accompanying consolidated balance sheet as of December 31, 2014, and will be due in 2017.

NOTE 8. NOTES PAYABLE

Notes payable as of December 31, 2014 consisted of the following:

Two promissory notes with balances of \$300,000 and \$400,000; interest at 20% per annum for each note only on the first year outstanding; interest payable annually; and all outstanding principal and interest due on demand. The notes are secured by substantially all assets of the Company.	\$ 700,000
Promissory note issued to finance the production of Reclaim with an original balance of \$3,919,301; compounded interest at 13% per annum in arrears; and all outstanding principal and interest maturing in October 2015. The note is secured by substantially all the assets of the Company.	3,643,644
Loan indemnification incurred in conjunction with promissory note above with an original amount of \$300,000; compounded interest at 24% per annum in arrears; and all outstanding principal and interest due on demand. The note is secured by substantially all the assets of the Company.	300,000
Promissory note issued to finance the production of Reclaim with an original balance of \$3,636,458; compounded interest at 15% per annum in arrears; and all outstanding principal and interest due on demand. The note is secured by substantially all the assets of the Company.	1,109,707

(continued)

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NOTE 8. NOTES PAYABLE (Continued)

Promissory note issued to finance the production of All Roads Lead to Rome with an original balance of \$1,515,708; compounded interest at 15% per annum in arrears; and all outstanding principal and interest maturing in January 2016. The note is secured by substantially all the assets of the Company. 1,515,708

Promissory note issued to finance the production of Reclaim with an original balance of \$1,613,986; compounded interest at 7% per annum in arrears; and all outstanding principal and interest due on demand. The note is secured by substantially all the assets of the Company. 632,435

Promissory note with an original balance of \$25,000; compounded interest at 8% per annum in arrears; and all outstanding principal and interest maturing in April 2015. The note is secured by substantially all the assets of the Company.	25,000
	7,926,494
	(6,410,786)
Less: current portion	
Notes payable, net of current portion	\$ 1,515,708

Interest expense related to these notes payable amount to approximately \$929,000 for the year ended December 31, 2014, of which approximately \$863,000 has been capitalized to film development costs.

Total future minimum payments of \$1,515,708 are due in January 2016.

NOTE 9. COMMITMENTS AND CONTINGENCIES

Operating Leases

The Company is obligated under certain non-cancellable operating leases for its facility and parking structure, which expire through June 2017. The facility lease contains escalation clauses and is expensed on a straight-line basis; deferred rent liability was immaterial as of December 31, 2014. Total rent expense amounted to \$96,741 for the year ended December 31, 2014.

Future minimum lease payments under non-cancellable operating leases as of December 31, 2014 are as follows:

Years ending December 31,	
2015	\$ 92,894
2016	96,106
2017	48,872
	\$ 237,872

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NOTE 9. COMMITMENTS AND CONTINGENCIES (Continued)

Litigation

The Company is subject to certain legal proceedings and claims that arise in the normal course of business. The Company does not believe that the amount of liability, if any, as a result of these proceedings and claims will have a materially adverse effect on the Company's consolidated financial position, results of operations, and cash flows.

NOTE 10. STOCKHOLDER'S DEFICIT

Authorized Shares

As of December 31, 2014, the Company's Certificate of Incorporation authorizes the issuance of two classes of shares designated as preferred stock and common stock. The preferred stock has a par value of \$0.001 per share, and the common stock has a par value of \$0.001 per share. As of December 31, 2014, there were 1,000,000 shares of preferred stock and 1,000,000 shares of common stock authorized.

Preferred Stock

The preferred stock is designated as preferred Series A stock. There were 176,000 shares of preferred stock issued and outstanding as of December 31, 2014.

- Dividend Provisions – The Company may, but is not required to pay a dividend to the holders of record of the outstanding shares of preferred stock. The Board of Directors of the Company has the authority to determine the terms and conditions of any such dividends. No preferred Series A stock dividends have been declared by the Company's Board of Directors for the year ended December 31, 2014.
- Liquidation Preference – In the event of liquidation, dissolution or winding up of the Company, whether voluntary or involuntary:
 - (1) Each holder of the preferred stock shall be entitled to receive out of the assets of the Company, whether such assets are stated capital or surplus of nature, an amount equal to the sum of \$10 per share plus an amount equal to unpaid cumulative dividends, if any, without interest, with respect to the holder's shares of preferred stock.
 - (2) No payment shall be made or any assets distributed to the holders of common stock or any junior class of preferred stock until all holders of preferred stock have received payment in full.

After the holders of preferred stock shall have been so paid, they shall not be entitled to share in any further distributions of the assets of the Company. A merger or consolidation of the Company with any other corporation, or a sale of any or all of the assets of the Company, shall not be deemed a liquidation, dissolution or winding up of the Company.

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NOTE 10. STOCKHOLDER'S DEFICIT (Continued)

Preferred Stock (Continued)

- Voting Rights – The holders of preferred stock shall possess no voting rights or powers except for the following:
 - (1) Each share of preferred stock shall be entitled to one vote on each matter on which holders of common stock shares are entitled to vote. Except as provided in (2) below, the preferred stock shall not vote as a separate class, but shall vote jointly with holders of common stock and the holders of any other classes of the Company securities designated as voting together with the common stock.
 - (2) Notwithstanding (1) above, the holders of preferred stock shall vote separately as a class on each of the following matters and on any other matter for which the approval of the holders of preferred stock is required by applicable law: any matter relating to a change in the rights of the preferred stock or the rights of the holders of preferred stock.
- Redemption Rights – A holder of preferred stock may require the Company to purchase all or any portion of such holder's shares of Series A preferred stock:
 - (1) At any time and from time to time on or after May 15, 2011.
 - (2) At any time, in connection with a sale of not less than 80% of the then-outstanding shares of common stock by means of a tender offer or merger, other than a tender offer or merger pursuant to which equity securities are issued to holders of the Series A preferred stock for at least 80% of the consideration for their shares preferred stock or the common stock into which the preferred stock is convertible.
 - (3) The purchase price for any shares of preferred stock purchased by the Company shall be equal to the liquidation preference, as defined. The Company will pay the purchase price in any combination of cash and a promissory note, as determined by the Company in its sole discretion.

The redemption rights may be exercised by a holder of preferred stock in whole or in part at any time specified by the surrender of the certificates for the preferred stock to the Company and delivery of a duly executed notice of redemption. No redemptions were exercised in the year ended December 31, 2014.

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NOTE 10. STOCKHOLDER'S DEFICIT (Continued)

Preferred Stock (Continued)

- Mandatory Redemption – The Company may redeem all or any portion of the then-outstanding shares of preferred stock at any time and from time to time, in whole or in part. In the event that the Company redeems less than all shares of preferred stock then outstanding, shares will be redeemed on a pro rata basis from each holder based on the number of shares of preferred stock then owned by each holder as reflected on the books of the Company, subject to adjustment at the election of the Company to avoid fractional shares. The purchase price for any shares of preferred stock redeemed by the Company shall be equal to the liquidation preference as defined, payable in cash. Any redemption shall be deemed to have been made at the close of business on such date as is designated in the notice of redemption sent by the Company to its holders of Preferred Stock.

- Assignability – Outstanding shares of preferred stock may not be assigned or otherwise disposed of by the holder.

Common Stock

As of December 31, 2014, there were 104,400 shares of common stock issued and outstanding.

NOTE 11. EMPLOYEE BENEFIT PLAN

In May 2009, the Company adopted a defined contribution 401(k) plan (the "Plan"). Vesting and the allocation of Company contributions to the employee accounts are determined in accordance with the terms of the Plan. Eligible employees may elect to have a portion of their compensation deferred and contributed to the Plan. Matching contributions to the Plan by the Company are discretionary. The Company did not contribute to the Plan for the year ended December 31, 2014.

NOTE 12. INCOME TAXES

The Company accounts for income taxes in accordance with the provisions of ASC 740.

The provision for income taxes as of December 31, 2014 is as follows:

Deferred:	
Federal	\$ 70,075
State	18,219
	<u>\$ 88,294</u>

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NOTE 12. INCOME TAXES (Continued)

The reconciliation of the federal statutory income tax rate to the effective income tax rate is as follows:

Federal taxes statutory rates	34.00%
State taxes statutory rates	5.81%
Meals and entertainment	(0.03%)
True-up of prior year deferred tax liabilities	(0.03%)
Increase in valuation allowance	(45.24%)
Other	(0.09%)
Effective rate	<u>(5.58%)</u>

Deferred income taxes reflect the net effects of temporary differences between the amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

Net deferred income taxes consisted of the following as of December 31, 2014:

Current deferred tax assets:	
Accrued vacation	\$ 7,218
Accrued related party expenses	1,303,682
Deferred revenue	192,042
Other	3,176
Total current deferred tax assets	<u>1,506,118</u>
Noncurrent deferred tax assets:	
Deferred state taxes	49,000
Net operating loss	2,448,761
Tax credits	25,578
Other	2,493
Less: valuation allowance	<u>(3,522,796)</u>
Total noncurrent deferred tax assets	<u>(996,964)</u>
Total deferred tax assets	<u>509,154</u>
Noncurrent deferred tax liabilities:	
Amortization – trademarks	(698,413)
Depreciation and amortization	<u>(509,154)</u>
Total deferred tax liabilities	<u>(1,207,567)</u>
Net deferred tax liabilities	<u>\$ (698,413)</u>

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NOTE 12. INCOME TAXES (Continued)

Federal net operating loss ("NOL") carryforwards in the amounts of \$5,843,392 expire in varying amounts between 2024 and 2034. California state NOL carryforwards in the amounts of \$5,226,331 expire in varying amounts between 2016 and 2034. Realization of the NOL carryforwards is dependent upon generating sufficient taxable income prior to the expiration of the loss carryforwards.

California suspended the NOL deduction for taxable years beginning in 2008 through 2011, with the exception for small businesses. However, all taxpayers may use the NOL deductions in tax years beginning on or after January 1, 2012.

Due to the uncertainty of the Company's utilization of the NOL carryforwards in the near term, management has recorded a valuation allowance against the related deferred tax assets as of December 31, 2014.

NOTE 13. SUBSEQUENT EVENTS

The Company has evaluated subsequent events that have occurred from January 1, 2015 through April 14, 2015, which is the date that the consolidated financial statements were available to be issued, and determined that there were no subsequent events or transactions that required recognition or disclosure in the consolidated financial statements.