Renaissance Studio, Ltd. – STX Entertainment Summary

On Friday July 28, 2017, Don Skipper, the CEO of Renaissance Studio, Ltd. ("RSL"), and Bob Simonds, the CEO of STX Entertainment ("STX"), engaged in a conference call to explore collaboration opportunities.

The conversation was collegial but it ended without a path forward despite the multibillion dollar earnings opportunities that can be exploited together. I believe that a phone call is a poor venue for making such important evaluations. Therefore, I have created this summary to review the key points of the conversation with the goal of challenging inaccurate assumptions, resolving misperceptions and exposing multi billion dollar collaboration opportunities between RSL and STX.

STX Movie Project Performance Review

It is important to consider the cinematic and financial performance of STX movie projects to date as context for the discussion. Below is a summary of publically available financial data on STX films to date:

	Movie	Production Budget	Domestic Gross	Worldwide Gross	* Estimated P&A	Theater Takes	Gross Box Office Profit	ROI on Production Budget	Protagonist	A-List?	Reason for Failure
1	Free State of Jones	($50,000,000)	$20,810,036	$23,152,062	($28,150,000)	($11,576,031)	($66,573,969)	-133%	McConnaughey	Yes	Concept, content
2	Secret in Their Eyes	($20,000,000)	$20,180,155	$30,808,558	($23,920,000)	($15,404,279)	($28,515,721)	-143%	Julia Roberts	Yes	Concept, content
3	The Boy	($10,000,000)	$35,819,556	$68,220,952	($26,710,000)	($34,110,476)	($2,599,524)	-26%	Ensemble	No	Concept, content
4	Bad Moms	($20,000,000)	$113,257,297	$181,457,297	($32,150,000)	($90,728,649)	$38,578,649	193%	Mila Kunis	?	Major Success
5	Edge of 17	($9,000,000)	$14,431,633	$18,802,255	($19,450,000)	($9,401,128)	($19,048,873)	-212%	Hailee Steinfeld	No	Concept, content
6	Space Between Us	($30,000,000)	$7,885,294	$10,532,332	($28,120,000)	($5,266,166)	($52,853,834)	-176%	Asa Butterfield	No	Concept, content
	Sub Totals STX Produced	($139,000,000)		$332,973,456			($131,013,272)	-94%			
7	The Gift	($5,000,000)	$43,787,265	$58,978,653	($25,030,000)	($29,489,327)	($540,674)	-11%	Jason Bateman	?	Concept, content
8	The Bye Bye Man	($7,400,000)	$22,395,806	$25,863,405	($22,200,000)	($12,931,703)	($16,668,298)	-225%	Ensemble	No	Concept, content
9	The Circle	($18,000,000)	$20,497,844	$33,907,844	($31,630,000)	($16,953,922)	($32,676,078)	-182%	Emma Watson/Tom Hanks	Yes	Concept, content
10	Hardcore Henry	($2,000,000)	$9,252,038	$14,348,753	($30,150,000)	($7,174,377)	($24,975,624)	-1249%	Ensemble	No	Concept, content
11	Their Finest	($13,000,000)	$3,603,484	$12,120,059	($3,300,000)	($6,060,030)	($10,239,971)	-79%	Gemma Aterton	?	Concept, content
12	Desierto	($3,000,000)	$2,002,036	$4,940,419	($1,680,000)	($2,470,210)	($2,209,791)	-74%	Ensemble	No	Concept, content
	Totals	($187,400,000)	$313,922,444	$483,132,589			($218,323,706)	-117%			
	Averages	($15,616,667)	$26,160,204	$40,261,049			($18,193,642)				
Domestic Revenue as % Total Revenues			**65%**								
1	Major Successes	8%	Defined as a gross profit greater than 2x the production budget								
0	Successes	0%									
0	Minor Successes	0%									
1	Total Successes	8%									
11	**Total Failures**	**92%**									

*** Note: P&A expenses are estimated at $10,000 per screen which has been an industry norm.**

Please forgive the small size of the data in the chart and increase the zoom factor on your software.

Important comments on the chart:

- RSL does not have access to detailed financial results for STX or its projects so most of the data is from 1) the Numbers.com website and 2) educated estimates on the P&A expenses. The actual P&A expenses could be substantially higher or lower on any project but are generally reasonable in the aggregate.
- This chart is not a financial statement for STX because STX does not own all the revenues and does not incur all the expenses. It is intended as a point of reference for the box office performance of its projects. It is also a measure of the efficacy of its content evaluation metrics and development methodologies.
- There may be significant non theatrical right sales, DVD, streaming and other aftermarket revenues but there are also international P&A costs, distribution expenses and corporate G&A and other expenses that are not included in this analysis.
- STX often takes measures to limit its loss exposure on its projects but these techniques can also limit the STX earnings receipts from successful projects.

The point here is to demonstrate that 92% of STX movies were so poorly conceived that they could not create earnings at the box office level. While this is a common reality in the movie industry, the RSL "green light" standards require that potential movie projects must demonstrate high certainty of box office level earnings in order to insure a positive risk adjusted IRR.

Comments on the chart data:

The comments here are not intended as criticism of anyone. They are offered in the spirit of constructive candor. The first step to resolving any problem or issue is acceptance of its existence.

Low International Market Resonance	STX films have not been well designed to resonate with international audiences that make up 70% of the global market that is vital to financial success. 65% of STX box office revenues have come from domestic markets.
High Failure Rate	STX has only had one box office success to date and has posted a 92% box office failure rate vs the 75% industry average on $30 to $150 million films in 2016 & 2017.
Very Low Average Revenues	The domestic and international box office revenue averages are extremely low by any assessment.
Alarming Total Losses To Budget Ratio	**Total box office level losses are 117% of the total production budgets.**
"Valerian" Failure Is Looming	The emerging "Valerian" box office failure is not included in the chart and it will increase the STX box office failures to 12 out of 13.
Low Franchise Success	STX has only developed one possible franchise profile and it is relatively small in scale. Successful franchises are vital to consistent financial success.

The natural STX reaction to the data may be denial but is that a strategy for addressing the severity of the problems in serious way and optimizing an IPO profile for the future?

Yes, STX takes measures to limit its losses but avoiding losses is not the same as earning huge profits from box office successes. Distribution and other revenue sources are unlikely to cover STX G&A expenses if STX's annual G&A burn rate is above $50 million as reported in the press.

Of equal concern, is the very real possibility that the theater chains and the international sales agents and distributors will lose faith in STX's ability to originate and market successful films. Yes, several theater chains own an interest in STX and there may be contractual arrangements but how long will that equity interest in STX override the direct revenue problems with the STX films in their theaters?

Clearly, the content evaluation metrics that STX is employing are systemically flawed and likely to be a danger to the solvency of the company if action is not taken very soon to access much better projects. An educated assessment of STX's future slate reveals nothing beyond a "Bad Moms" sequel that projects box office success.

Key Discussion Points

During the conference call, Bob asserted that he was open to content solutions within certain parameters:

Content Evaluation Metrics

Bob suggested that movie projects should be supported by "algorithms" or other quantitative or content evaluation techniques with proven track records of projecting the future performance of movies. Bob asserted that he would value effective metrics but he is inundated with countless such techniques from more credible sources than RSL so why is the RSL approach any better?

- I pointed out that all of the metrics he is employing at STX are producing box office failures over 90% of the time so they are very ineffective and a direct threat to the long term solvency of STX.
- I also stated that advanced quantitative techniques are of limited value because a well educated assessment of movie project concepts, content and characters vs the viewing preferences of broad spectrum international demographics is a much more effective and less costly approach.
- It is not difficult to determine which movies will be box office successes or failures on an educated, qualitative basis with 90%+ certainty using the RSL content evaluation metrics. Most of the 10% of misses are projects that outperform expectations as "Bad Moms" did.
- The 12 of 13 box office failures that STX has released would have all been avoided by employing the RSL metrics but the metrics are of little value without the ability to actually acquire or create movie projects that will consistently succeed.
- It is very difficult to create movie concepts, content and characters with a diversity of compelling resonance elements that skillfully match the viewing preferences of broad spectrum international demographics. Therefore, RSL has developed proprietary screenwriting methodologies to insure consistent connectivity between movie project features and international demographic preferences.
- The RSL metrics and methodologies have been employed to create an initial inventory of 16 movie screenplays that are designed to launch up to 10 film franchises. The comparison chart below is useful in revealing why the RSL films will succeed at the box office and all but one of the STX films did not:

STX Movie Project	High concept?	Broad demographic appeal?	Revenue ceiling above $200 million?	Modest budget? Under $40 MM	Resonance Diversity?	Franchise Potential?	Strong global market potential?	Total score
Free State of Jones	0	0	0	-1	0	0	0	-1
Secret in Their Eyes	0	0	0	1	0	0	0	1
The Boy	0	0	0	1	0	0	0	1
Bad Moms	0	0	0	1	0	1	1	3
Edge of 17	0	0	0	1	0	0	0	1
Space Between Us	0	0	0	1	0	0	0	1
The Gift	0	0	0	1	0	0	0	1
The Bye Bye Man	0	0	0	1	0	0	0	1
The Circle	0	0	0	1	0	0	0	1
Hardcore Henry	0	0	0	1	0	1	0	2
Their Finest	0	0	0	1	0	0	0	1
Valerian	1	0	1	-5	3	1	3	4
Desierto	0	0	0	1	0	0	0	1

RSL Movie Project	High concept?	Broad demographic appeal?	Revenue ceiling above $200 million?	Modest budget? Under $40 MM	Resonance Diversity?	Franchise Potential?	Strong global market potential?	Total score
America 2.0	5	3	5	1	5	5	3	27
Treachery	3	2	2	1	2	5	2	17
Mastermind	3	3	3	1	1	5	3	19
Resurrection	3	3	3	1	3	5	2	20
Cataclysm	3	3	3	1	3	5	2	20
Divided We Fall	3	2	3	1	4	3	2	18
End Game	3	2	3	1	2	3	2	16
Insurrection	3	2	3	1	2	3	2	16
Donahue Origins	3	2	4	1	3	3	3	19
The Coming	4	3	3	1	3	1	2	17
Metamorphosis	2	4	3	1	4	2	3	19
Not Without Honor	2	3	2	1	2	1	2	13
Vendetta	0	2	1	1	1	1	2	8
The Warning	2	2	1	1	2	1	2	11
Day of Reckoning	3	3	2	1	3	1	2	15
Revelations	4	3	4	1	4	2	4	22

The reflex reaction is to assume that RSL has “over rated” its projects relative to the STX films but a full review of the RSL projects would reveal the general efficacy of these ratings. The comparison also reveals the reasons that RSL would have not produced or distributed any of the STX films.

These are only a high level project evaluation cut from the RSL evaluation metrics that 1) assess and rate every movie scene on 25 different resonance elements vs demographic preferences and 2) assess and rate over 100 success factors on every RSL project versus other projects and released films in the genres.

"A List" Attachments

Bob generally asserted the common premise that "A-List" acting attachments are vital to 1) project financial success and 2) getting theaters and international distribution channels to acquire and release STX films. Several comments:

- Any serious review of movie financial performance will reveal that there is almost no overall positive correlation between "A-List" attachments and financial success.
- Yes, well know actors often get access to roles in better films but they are very seldom the reason for financial success and they are often part of the reasons for earnings failure because they almost always fail to attract enough marginal net revenues to cover their compensation premiums.
- From a production equity point of view, a $10 million "A-List" compensation premium means that the movie must generate an additional $35 million in gross revenues and this almost never happens.
- In truth, there are many actors who can help convert a great script and marketing strategy into a financially successful film but there are no "A-List" actors who can turn poor concepts, content and characters into financially successful movies.
- The assertion that "A-List" attachments are a release requirement is dubious. A review of the chart on page 1 of this summary reveals that only 3 of 13 (including Valerian) STX films have had true "A-List" protagonists but they were released. The three films with "A-List" protagonists were huge box office failures.
- If "A-List" list attachments are a requirement, they could be added to the RSL film projects. However, this would unnecessarily increase production costs and reduce earnings and eventually lower IPO proceeds by a 30x to 300x factor per ineffective "A-List" premium dollar spent.

In reality, "A-List" attachments are a lazy fig leaf for poor content for decision makers who are unable or unwilling to invest the time to review the merits of movie projects and their likelihood to resonate with large global audiences.

Capital Risk Exposure

Bob generally asserted that he has hundreds of millions of dollars of capital commitments to fund future projects but he also stated that he has almost no net risk exposure on that capital if it is employed. I had difficulty reconciling these two assertions. Why is so much capital needed if it is almost never at risk?

IPO Strategies

Bob generally asserted his expectation that STX will deliver a $3.5 billion IPO to STX shareholders in 9 months and that his assertion is supported by investment bankers. I cannot know the details that support this assertion and there is extreme irrationality in the public equity markets in the movie industry. However, as a career capital markets analyst I do not see a rational IPO profile even if the "Bad Moms" sequel succeeds. There is also the reality that an IPO is a one time event for any STX shareholder who sells on the IPO date and a $3.5 billion valuation is far below the potential value of STX in collaboration with RSL.

Mass Insanity In The Capital Markets Of The Movie Industry

STX is not an unusual case in the movie industry. A strong argument can be made that mass insanity dominates the capital markets of the motion picture industry. Please consider the following:

- MGM files bankruptcy in 2010 and creditors take over the company. Creditors and equity holders lose hundreds of millions of dollars.
- Relativity Media files bankruptcy in 2015 and creditors take over. Creditors and equity holders lose hundreds of millions of dollars.
- Legendary Entertainment sells to Dalian Wanda in 2016 for $3.5 billion and loses over $500 million in the first year thereafter prompting the early exit of Thomas Tull and a unleashing a financial disaster for Dalian Wanda.
- Countless "film funds" and wealthy investors have invested billions of dollars in movies that have lost money and they have exited the industry with huge capital losses.
- Lions Gate goes from $1.1 billion in market cap in January 2012 to $5.5 billion in September 2013 on the strength of one successful film franchise. The one successful franchise expired 2 years ago but LGF continues to trade near $6 billion market cap at above a 300x P/E multiple even though it has posted pretax losses the last two years (a $134 million pretax loss for FYE 3/31/17), it has over $350 million in annual G&A expenses and over $3.5 billion of debt.
- Netflix has gone from about $12 billion in market cap 4 years ago to **<u>$78 billion</u>** today with a 235x P/E multiple even though its net earnings were only **<u>$187 million</u>** with **<u>negative $1.5 billion</u>** of cash flow from operations in FYE 12/31/16 and it has almost $5 billion of debt.
- Big funds and investors continue to buy and hold Lions Gate and Netflix at P/E multiples above 200x and take the extreme devaluation and insolvency risks despite the obvious financial reality that they are both extremely over valued and over leveraged and have no prospects to deliver earnings that would support these high valuations in the future.
- Paramount posted a **<u>$445 million operating loss</u>** for Viacom in its FYE 9/30/16.
- Sony Pictures post a **<u>$732 million operating loss</u>** for Sony in its FYE 3/31/17.
- TPG, Hony Capital, The Huayi Brothers and others have invested hundreds of millions of dollars in the creation of STX Entertainment since 2014. STX has built good distribution infrastructure but 12 out of the 13 films that STX has released to date have been box office failures and its one major TV show "State of Affairs" was a one season failure.

Despite all of the above and the extreme global dearth of movie content that is well designed to achieve strong market acceptance, countless people, corporations, funds and other entities are aggressively raising billions of dollars for "film funds" and supporting companies like STX that will invest in motion picture projects that will 1) lose money over 80% of the time and 2) have almost no hope to create a compelling IPO profile that can exploit the extreme irrationality of P/E multiples in the 30x to 300x range in the M&A and equity markets of the movie industry.

Yes, Fox, Disney, Universal and Warner Brothers posted operating earnings from filmed entertainment that were almost all traceable to big budget "tentpole" franchise successes, not the low concept independent films that STX is releasing and the film funds support that lose money over 90% of the time for equity investors.

Perhaps I am dense but could it be any more obvious that STX needs a major business model and content development course correction to avoid a MGM or Relativity insolvency end game? Even if insolvency is somehow avoidable through a miraculous IPO, how does it make any rational sense to remain on the current course and ignore the major content and business practices solutions that RSL represents if the STX shareholder goal is to avoid insolvency and maximize IPO potential and proceeds?

Summary

I am not privy to all of STX's financial information, contractual arrangements, business plans and loss mitigation strategies. However, it is clear from the public evidence that:

- STX's content evaluation metrics are deeply flawed and
- STX is having great difficulty acquiring premium content and film franchise profiles and
- STX shareholders would be much better off producing movie that achieve box office success 90% of the time than fail to do so 90% of the time.
- There is no evidence in STX's future slate that box office successes will increase in the future.

Yes, the "Bad Moms" sequel may do okay but is it really enough to cover the losses on the other STX projects and G&A and interest expenses and serve as a credible IPO foundation in 9 months?

I am privy to the STX movie slate of the past and the publically announced future slate. I know the details of the RSL project inventory and its ability to deliver compelling product features that match the viewing preferences of broad spectrum international demographics to insure strong and consistent market acceptance. I can assert with absolute certainty that the RSL projects are far superior to the STX project inventory and franchise profiles if maximizing earnings and ensuring the most compelling IPO profile and valuation in the future are the STX shareholder goals.

RSL has created 1) the business model, 2) the business plan, 3) the risk management techniques, 4) the advanced marketing strategies, 5) the effective content evaluation metrics, 6) the screenwriting methodologies, 7) the 16 projects and 8) the 10 franchise profiles to deliver a $6+ billion IPO to investors.

This IPO amount is **additive** to any IPO that STX might achieve with its current business practices and it can be achieved on a primary equity investment of $50 million and a $100 million credit line.

What is the logic for not investing the time to seriously evaluate the RSL metrics, methodologies, strategies, project content and franchise profiles that literally represent a $5 to $10 billion IPO windfall opportunity for STX shareholders?

The conversation ended with Bob asserting that he could not make a credible argument to his investors to support RSL. Implied in this assessment is the irrational reality that he is willing to continue to recommend investments in movie projects that fail at the box office over 90% of the time.

I would suggest that this summary demonstrates compelling reasons to reconsider Bob's initial assessment in the interests of STX shareholders.