

**IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK**

MELISSA FERRICK, et al.,

Plaintiff,

vs.

SPOTIFY USA INC., et al.,

Defendants.

No. 1:16-cv-08412 (AJN)

CORRECTED

**EXHIBIT B-1 TO THE DECLARATION OF JOAO DOS SANTOS
IN SUPPORT OF PLAINTIFFS' MOTION FOR FINAL APPROVAL**

VOLUME 5 of 7

Exhibit B-1

- 1 “Spotify: A Global Streaming Leader”
- 2 “Spotify Showing Momentum Ahead of Possible Listing”
- 3 “Exclusive Report: Spotify Artist Payments Are Declining in 2017, Data Shows”
- 4 “Spotify Research Report: The Rock Star of Streaming Services”
- 5 TuneCore Blog: How We’re Getting Your Mechanicals From Streams”
- 6 “Spotify Hit With \$150 Million Class Action Over Unpaid Royalties”
- 7 “Publishers Said to Be Missing as Much as 25 Percent of Streaming Royalties”
- 8 “Independent labels claimed 35% market share in the US last year ... by ownership”
- 9 “Understanding and Measuring the Illiquidity Risk Premium”
- 10 “Pandora Media Corp – Spotify Sub Leap Evidence of Expanding Market For On-Demand”
- 11 “US’ Music Streaming Royalties Explained”
- 12 Consolidated Financial Statements as of December 31, 2016 and Independent Auditor’s Report
- 13 “Exclusive Report: Spotify Artist Payments Are Declining in 2017, Data Shows”
- 14 “Independent labels have a 37.6% global market share, says new report”
- 15 “An International Legal Symposium on the World of Music, Film, Television and Sport: Enterprise Valuation”
- 16 “A Primer for Valuation of Music Catalogs”
- 17 “Music Publishing’s Steady Cash Lures Investors”
- 18 “Spotify, Valued at \$13 Billion, to Launch Direct Listing on NYSE: Sources”
- 19 “Inside Spotify’s Financials: Is There a Path to Profitability Or an IPO?”
- 20 “Global Music Investing 2.0: More Options = More Subs”
- 21 “Spotify’s Product Roars Ahead Amid Business Model Challenges”
- 22 “Streaming Music Topic Primer”
- 23 “Mechanical and Performance Royalties: What’s the Difference?”
- 24 “64 Amazing Spotify Statistics and Facts (October 2017)”
- 25 “Apple Music Saw Over 40M Users On Mobile Last Month, Leading Spotify by 10M”
- 26 “Big Publishers Feeling Cheated After Spotify’s Small Publisher Deal”
- 27 “Spotify Now Processes Nearly 1BN Streams Every Day”
- 28 “Spotify’s Losses Grow Despite Revenue Doubling in 2012”
- 29 “The Spotify Settlement with NMPA: What it Means for Music Publishers”
- 30 “Spotify Music-Streaming Service Launches in U.S.”
- 31 “Spotify vs. Apple Music: Which Service is the Streaming King?”



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INDEPENDENT LABELS HAVE A 37.6% GLOBAL MARKET SHARE, SAYS NEW REPORT



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(/REGION/FR) JUNE 6, 2016

BY MUSIC BUSINESS WORLDWIDE
(HTTPS://WWW.MUSICBUSINESSWORLDWIDE.COM/AUTHOR/MBW/)

New research undertaken by The Worldwide Independent Network (WIN), has concluded that the true global market share of independent record labels is 37.6% – significantly higher than the sub-30% share the sector regularly ends up with in other analysis.

The new report, entitled WINTEL, was commissioned by WIN to analyse the global economic and cultural impact of the independent music sector.

Authored by Mark Mulligan of MIDIA Research in conjunction with Dr. Chris Bilton from Warwick University's Centre for Cultural Policy, it discovered that independent labels generated \$5.6 billion for the global music business in 2015.

So why the big difference in independent market share compared to previous reports? Because WIN's research bases market value on rights ownership rather than distribution power.

In other words, those independent labels and artists whose music is distributed by Universal, Sony and Warner would still be counted as independent.

A prime example would be Taylor Swift – well known as a Universal act, but actually signed to indie Big Machine and distributed through UMG.

"WITH A 37.6% MARKET SHARE BASED ON RIGHTS OWNERSHIP, THE INDEPENDENT MUSIC COMMUNITY IS PLAYING AN INCREASINGLY IMPORTANT PART WITHIN THE GLOBAL MUSIC INDUSTRY."

ALISON WENHAM, WIN

It's the same story for Glassnote's Mumford & Sons and other top-level artists – and hit tracks like Major Lazer's Lean On, released by Because Music in France but distributed by Warner in major territories.

The WINTEL report establishes that approximately 52% of independent labels use major labels or major label-owned distributors to get their music out.

WIN argues that market share stats based on rights ownership rather than distribution power should be used by digital music companies such as Apple, Google and Spotify in negotiations.

To emphasise this point the report also makes clear that digital music, and streaming in particular, has created increased opportunities for independent labels and that in virtually every country, independent labels have significantly higher market share in streaming than they do in physical formats.

Beneath the global figure, trends range wildly in different territories – with independent label market share ranging from just 16% in Finland up to 88% in South Korea.

Alison Wenham, CEO of WIN said, "This is an important report, giving us the first truly global overview of the economic and cultural value of independent music.

"With a 37.6% market share based on rights ownership, and a contribution of \$5.6bn it is clear that the independent music community is playing an increasingly important part within the global music industry. Quite apart from the significance of the independent sector's real market share, the vital contribution to the creation of local music in countries around the world assures that the cultural value and contribution of music is in very good hands with the independent sector."

WINTEL was unveiled at Midem last week and is available in print and online at www.winformusic.org (http://www.winformusic.org).

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AN INTERNATIONAL LEGAL SYMPOSIUM ON THE WORLD OF MUSIC, FILM, TELEVISION AND SPORTS

Enterprise Valuation

MODERATOR

Harold Flegelman, Director of the Graduate Program in Entertainment, Arts and Sports Law, University of Miami Law School

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Bradford Cohen, Esq., Venable LLP

Michael Olsen, President, eOne Music

Stephen Prough, Co-Founder and Managing Director, Salem Partners

John Redmond, Assistant Professor of Professional Practice, Music Business and Entertainment Industries, Frost School of Music, University of Miami

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Enterprise Valuation

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By John Redmond

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By Brad Cohen

Sports Valuation
By Charles Baker

**The University of Miami School of Law Entertainment and Sports Law
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**An International Legal Symposium on the World of Music, Film,
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April 7, 2016

ENTERPRISE VALUATION

The monetization of music, motion picture and sports assets is driving growth, whether through acquisition, consolidation, or private or public offering of securities. What should lawyers know about how such assets are valued, in order to advise clients who are intent upon investing wisely.

Moderator

Harold Flegelman, Esq., Director of the Graduate Program in Entertainment, Arts and Sports Law, University of Miami Law School, Coral Gables, FL

Panelists

Charles H. Baker, Esq., Partner, DLA Piper, New York, NY

Bradford Cohen, Esq., Venable LLP, Los Angeles, CA

Michael Olsen, President, eOne Music, Nashville, TN

Stephen Prough, Co-Founder and Managing Director, Salem Partners, Los Angeles, CA

John Redmond, Assistant Professor of Professional Practice, Music Business and Entertainment Industries, Frost School of Music, University of Miami, Coral Gables, FL

Music Catalogs

Valuation Methods and Pitfalls

Michael Olsen, Esq.
SVP Legal and Business Affairs
Entertainment One

Market Value

The highest price a willing buyer would pay and a willing seller would accept, both being fully informed, and the property being exposed for sale for a reasonable period of time.

Common Methods of Valuation

Multiple of EBITDA

Earnings Before Interest, Taxes, Depreciation and Amortization

This method is most useful when acquiring an operating company.

Common Methods of Valuation

Multiple of EBITDA

If the company in question has an operating history and the transaction in question is more financial in nature, where it is not anticipated that the target can be combined into the acquiring entity thereby creating any significant savings in G&A, then the acquirer tends to look at either the trailing 12 months of EBITDA or possibly a three year running average. In recent years the multiples seem to have been in the 3 to 5 times EBITDA range for valuation.

Methods of Valuation

Discounted Cash Flow (DCF)

According to the discounted cash flow valuation model, the intrinsic value of a company is the present value of all future free cash flows, plus the cash proceeds from its eventual sale. The presumption is that the cash flows are used to pay dividends to the shareholders. In this analysis, the catalog is looked at on a title by title basis from both a historical sales prospective and predictions are made regarding future sales over the next 5-10 years to determine a reasonable projection of future revenue. Projections are then made for cost of goods sold expense and marketing expense. From this, a basic gross profit or free cash projection for the next 5 to 10 years is determined. Most buyers will then apply a range of discount rate to the free cash of anywhere between 8% and 18% depending on the assessed risk in the projections and their cost of capital (WACC). It is also typical to apply a terminal value to the ending free cash flow number which could be 3 to 6 times the final free cash flow.

Methods of Valuation

Discounted Cash Flow (DCF)

The DCF model works best for catalog acquisitions.

It frequently assumes the catalog of IP will be integrated into the acquiring entities overhead and infrastructure.

In the current constantly changing environment it can be very difficult to project future earnings.

Methods of Valuation

Market Comparables

The final method is in some ways the most accurate and in others that most difficult. That is to look at comparable transactions in recent history of comparable companies to determine the prices paid. The upside with this method it is probably the most accurate method to determine what the current market will bear. The downside is that most of the transactions in this space are private in nature and there is very little accurate data on purchase prices paid. In what has been admittedly a very difficult market over the past few years for the recorded music business this may be the best model because there is no question that there are few buyers and valuations have been depressed when viewed by the analytical methods above.

Factors affecting Quality of Revenue Projections and Value

- Assignability of Agreements
- Quality of the Paperwork – Contracts, Royalty Statements, Accounting Statements, Sales Statements
- Current distribution agreements. Are they a positive or a negative. Can they be ended/When/ Fees
- Outbound Licenses granted. Have any domestic or international licenses been granted which diminish value.
- State of Royalty Payments – Artist Audits
- State Mechanical Payments – HFA/Publisher Problems
- Term of exploitation of key titles (Perpetuity vs. License terms)

Factors affecting Quality of Revenue Projections and Value

- Unrecoupable Balances – Significant balances mean lower cash royalties in the future.
- Concentration of Sales History – Many titles vs a few hits
- Concentration of Account Base- Are all of the sales coming from a few accounts
- Field Inventory
 - Hot Titles – Selling through current inventory
 - Dead Titles – Returns problems – who absorbs.
- Pricing Issues – Has the seller been discounting the titles, which will affect the ability to charge a higher price in the future
- Terminations – Are there any key titles subject to copyright terminations.


Factors affecting Quality of Revenue Projections and Value

- Futures
 - Are there options for quality records in the agreements.
 - Are the cost of the options unreasonably high
 - Are there any unreasonable commitments to records that have been made.
 - Will the infrastructure and marketing expertise exist post transaction to deliver the revenue.
- Treatment of digital download and access (streaming) income in artists contracts. Are they paid at normal royalty rates or at 50%, is it unclear.
- General risks associated with making the future revenue projections a reality.
- Litigation and Audit Risks – Are there any audits or litigation that could impair any rights or create future royalty expense.

Key Take Aways

- You make money on the buy not on the sell
- Sellers always think its worth more than it is (particularly now).
- Risk diminishes value, uncertainty creates risk. Sellers need to get their house in order to the greatest extent possible to reduce risk.
- A valuation is only as good as the projections of future revenue and earnings. The more certainty in the projections the greater the value.
- If either the sales or buyer team does not include an experienced financial analyst who can accurately model the future expectations, get one!

Questions



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**Music Publishing Song
Catalog Valuation
ABA 2016**

John Redmond
Assistant Professor of Professional Practice
Music Business & Entertainment Industries Program
Frost School of Music

Financial Valuation Considerations

- Valuation not just about the numbers - firm and trustworthy?
- Need financial experts with understanding of music publishing business
- Analysis - royalty statements / royalty rates / licensed uses / who pays what and when?
- Future income estimates – various timetables of income delivery from all sources
- Income streams variance by importance / music genre / song to song
- Foreign Expectations - valuation and expectations applied to foreign territories

Legal Valuation Considerations

- Various publishing agreements involved with purchase
- Similar to financial, need legal experts with full understanding of the music publishing business
- Song splits - co-writer and ownership shares
- How splits affect administration - multiple publishers
- Restrictions? - synchs: commercials / film / TV
- Duration of rights and ownership – can vary song by song / agreement by agreement
- Important songs - life of copyright or reversions
- Any songs subject to termination?

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3

Song Legacy and Momentum

- Purchaser/client needs infrastructure in place to carry on and build song legacy and income
- Both creative and business infrastructure to do the job
- Creative - covers / synchs / promotion and marketing initiatives – knowledge and enthusiasm to work the new catalog
- Business - copyright, royalty, song data systems / income tracking and policing resources
- Are master owners linked to important song on board and willing to actively team work with you?

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4

Valuation Focus

- Valuation should focus on catalog's top earners
- Typical top 5% of song catalog earns 95% of income
- This view is not discounting other songs or their current and future value and potential
- Will need detailed historical analysis of top earners 50 / 100 / 250 / 500 of song catalog (John: PolyGram Music Publishing example)
- Song history and breakdown of sources of earnings: mechanical / performance / synchronization (TV, Film, commercials, home video and video games) / print etc. over the previous 3-5 years or better if attainable

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5

Valuation Models

- Typical song catalog buyers: music publishers, banks, lenders, hedge fund and pension fund investors

Some Evaluation Models

- 1: Traditional Net Publisher Share times a Multiple
 - 2: Internal Rate of Return (IRR)
 - 3: Cash Flow Comparison Analysis
- All methods *assume and rely on* the supplying of accurate song financial data plus the agreements attached to the song catalog are in place - Not always the case - scrutinize carefully

Evaluations can be mix of methods

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6

Traditional NPS times a Multiple Formula

The Multiple

- Actual purchase price is typically based on a **multiple** of the **average net earnings** of the song catalog over the most recent 3 - 5 fiscal or calendar years

Formula

- 1: Add the preceding 3-5 years catalog Gross Receipts
- 2: Subtract thru payments (IE: royalty payments to songwriters and co-publishers etc.)
- 3: Divide the result by the number of years totaled to find the average annual Net Income (NPS/ Net Publisher Share)
- 4: Multiply the average annual NPS by a **multiple** to obtain dollar figure

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7

Traditional NPS times a Multiple Formula

Establish Song Catalog's Net Income

Year	Gross Income	Less Royalties Paid or Due	Net Income
1 - 2013	\$300,000	\$225,000	\$75,000
2 - 2014	350,000	260,000	90,000
3 - 2015	450,000	325,000	125,000
Totals	\$1,100,000	\$810,000	\$290,000

Divide aggregate (3-year) Net Income by number of years considered to establish average annual NPS (Net Publisher Share/ Net Income)

IE: $\$290,000 \div 3 \text{ years} = \$96,667$ Average Net Income

Apply Net Income x Multiple = Catalog Dollar Value

IE: Multiple of 10: $\$96,667 \times 10 = \$966,670$ (catalog \$ value)

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8

Traditional NPS times a Multiple Formula

Establishing the Multiple

- Typical *Multiples* between 8-18

Higher and lower *Multiples* can also depend on factors such as:

- 1: **Marquis value** or importance of the song catalog
- 2: **Duration of rights** to key copyrights being acquired
- 3: **Contractual commitments** to pay advances to writers
- 4: **Advances owed** to publisher by writer
- 5: **Advances owed** to licensees by publisher
- 6: **Income trend analysis** (previous 3-5 years - rising or falling?)
- 7: **Future commercial potential** catalog appraisal
- 8: **Other bidders** in the mix?

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9

Traditional NPS times a Multiple Formula

Strengths and Weaknesses

- Reliable and been road tested for decades
- Can be very accurate - using real numbers
- More calculation - less speculation
- Multiple - based on willing buyer and willing seller
- This traditional model can be more complex, time consuming and labor intensive

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10

Internal Rate of Return or "IRR"

- IRR = percentage rate of return that will eventually pay for the total cost of the asset or song catalog
- Method typically used by investment banks, hedge and pension funds, insurance companies - *Favors high rates of return*
- IRR is the average annual return earned through the life of the investment - can be computed in several ways

Example: Song catalog price: \$1 million

- Average NPS (Net Publisher Share) is \$100k over 10 year period
- The IRR or percentage rate of return is 10% over 10 year period
- If investment bank needs a 25% IRR - out of the bidding
- May be good for a smaller music publisher who may only need 10% to justify catalog purchase

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11

Cash Flow Comparison Analysis

Cash Flow Comparison Formula: total of declining net income flow (NPS) is song's value

- 1: Create an earnings (NPS) and timeframe comparable document
- 2: List similar *hit* songs in the same music genre to yours with their corresponding NPS earnings by quarter (5 - 10 years) (#1s and top 10s top 20s etc.)
- 3: The first Q NPS would be a 100% value and subsequent quarters decline in percent value
- 4: Insert your songs into the formula for an estimate of what your songs might earn over time

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Cash Flow Comparison Strengths and Weaknesses

- Assumes all song income declines in a similar way over time
- Excludes concept of new covers of the songs with possible additional revenue generated
- Assumes songs in same music genre are similar / same income
- Assumes music trends remain the same (IE: rock songs same value yesterday, today and tomorrow?)
- Difficult to find song data for calculations (unless major publisher)
- Based on sample numbers - not actual numbers of your songs
- Used by conservative valuers, which usually include banks and larger institutional publishers
- Larger the sample, the more accurate the model

Financial Checklist

- Seller's books and records are examined and compared with actual royalty statements from PROs, Harry Fox, record companies, sub-publishers and major users such as ad agencies and film producers
- Examination of statements issued to songwriters/co-publishers/3rd parties
- Examination of relevant bank records to substantiate royalties paid by the seller
- Examination of advances paid and owed to writers/co-publishers/sub publishers and 3rd parties
- All pipeline monies owed to and by the seller substantiated

Legal Checklist

- Copyright registrations, contracts, licenses, obligations
- Copyright claims are valid?
- Remaining terms of copyright / any reversions / subject to termination
- Ownership percentages are accurate
- Library of Congress copyright search
- All contracts signed
- Chains of title checked
- No restrictions on selling or transferring copyright in event of sale
- Court records searched for loans, claims, liens
- Search for any pending litigation
- Foreign agreements / commitments

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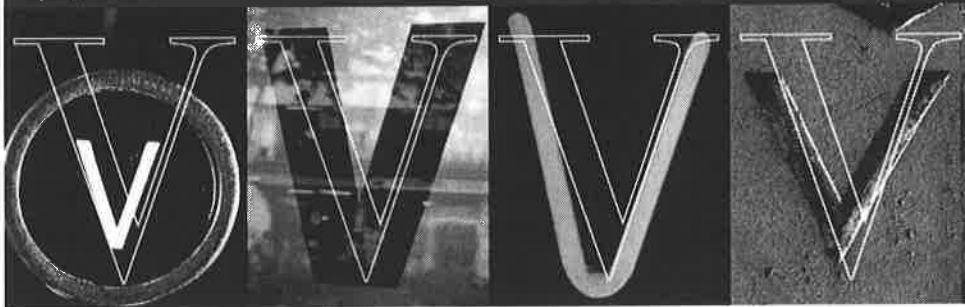
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Preserving Confidentiality and Protecting Wealth for the High-Profile Sports and Entertainment Client

ABA's 7th Annual International Legal Symposium on the
World of Music, Film, Television, and Sports

Brad Cohen
Partner
Venable LLP

April 7, 2016



About Venable LLP

Venable is an **American Lawyer Global 100** law firm. With nearly **650 attorneys** in nine offices across the country practicing in all areas of corporate and business law, complex litigation, intellectual property and regulatory and government affairs.



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Brad Cohen, Partner



Mr. Cohen advises on business planning related to complex, corporate transactions including mergers and acquisitions, financing and succession planning, addressing the business, income and estate tax issues on an integrated basis. He also advises clients on tax controversy, executive compensation (including deferred compensation) and tax aspects of marital settlement negotiations.

Mr. Cohen is best known for his business and tax advice related to the motion picture, television, music, emerging media and sports industries. One of the focuses of his practice is coordinating the relationships among the entertainment, advertising and nonprofit industries.

Mr. Cohen has incorporated his personal commitment to philanthropy into a key element of his legal practice, providing multi-faceted counsel to clients regarding their involvement in charitable endeavors, including developing strategic plans, outlining the associated tax benefits and identifying the appropriate corporate brands and sponsorships. Most recently, Mr. Cohen acted as principal counsel, representing the lead donor who financed the acquisition, delivery and permanent exhibition of the Space Shuttle Endeavour located at the California Science Center in Los Angeles.

Mr. Cohen was a lobbyist before the United States Congress for the Tax Reform Research Group. He is also an Ironman Triathlon finisher.

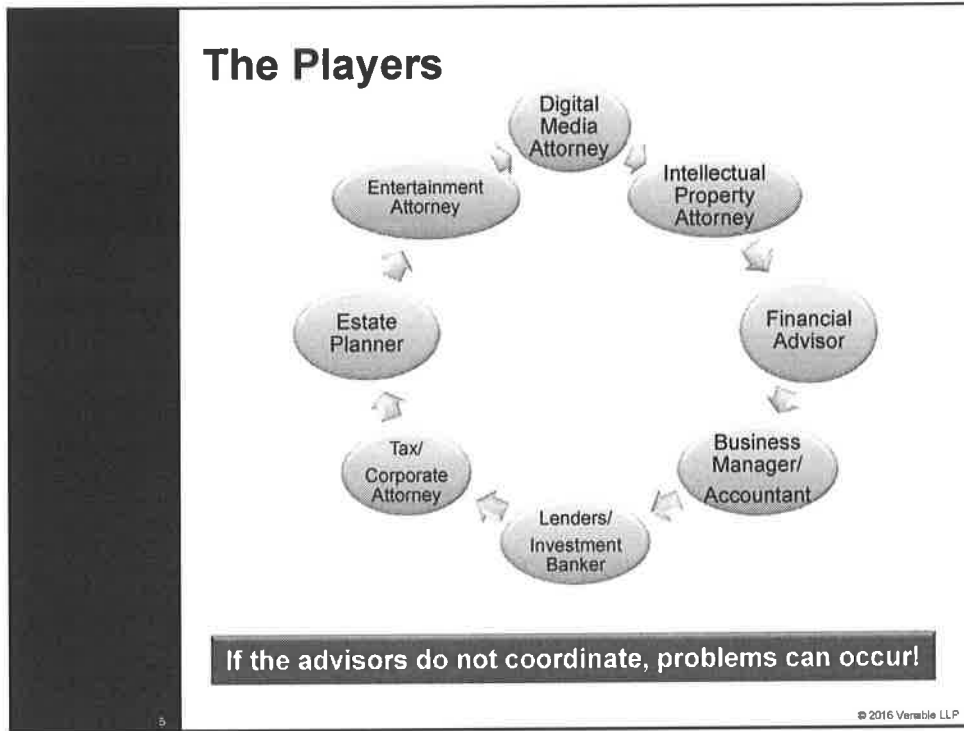
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Overview

- **Federal Income Tax**
- **Ordinary Income & Long Term Capital Gain**
- **Sale vs. License**
- **Asset vs. Income Stream**
- **Choice of Entity**
- **Medicare Tax**
- **Allocation of Purchase Price**
- **Revenue Proposals**
 - **Presidential Candidates**

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Federal Income Tax

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Maximum Federal Income Tax Rates

- **Ordinary Income 36.9%**
+ Medicare 0.9%
- **Long-Term Capital Gain 20%**
+ Medicare 3.8%



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2010 Health Care Act imposes a 3.8% Medicare tax on investment income, and increases the employee portion of the Medicare insurance tax on employment income by 0.9% from 1.45% to 2.35%.

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SELECTED FEDERAL INDIVIDUAL INCOME TAX RATES	
Ordinary Income Tax Rates	39.6% tax-bracket for incomes greater than \$400k (\$450k if married, filing jointly) plus...9%
Qualified Dividends/Long-Term Capital Gains	20% for earning greater than \$400k (\$450k if married, filing jointly) plus...3.8%
Medicare Tax on Net Investment Income	3.8% for modified adjusted gross incomes greater than \$200k (\$250k if married, filing jointly)
Medicare Tax on Employer Income	1.45% plus 0.9% = 2.35%
Alternative Minimum Tax Threshold	\$52,800 (Single); \$83,100 (Joint) Indexed for inflation
Estate Tax	40% for estates larger than \$5.43 million per person; adjusted for inflation (2015)

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Federal Long-Term Capital Gains

Three income tax brackets become four brackets with 3.8% Medicare tax.

INCOME		
Individual	Married Couple	L/T Capital Gains Rate
Up to \$36,250	Up to \$72,500	0%
Up to \$200,000 AGI	Up to \$250,000 AGI	15%
Up to \$400,000	Up to \$450,000	18.8%
Over \$400,000	Over \$450,000	23.8%

*Collectibles taxed at 28% (plus 3.8%)

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Ordinary Income



- **Personal Service - Employment Tax**
- **Non-Personal Service**
 - Licensing/Rents/Royalties
 - Sale of Non-Capital Assets; Inventory
- **Sale or Exchange of Capital Asset Held for Less than a Year**
 - Short-term capital gain taxed at ordinary income rates

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Long-Term Capital Gain

- **Sale or Exchange**
- **Capital Asset**
- **Held for more than a year**

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Sale vs. License

- Character of Gain?
- Step Up?
- Depreciation?



Sale vs. Abandonment

- Pilgrim's Pride
- 1034A

Asset vs. Income Stream

- Copyright
- Participation, Residual, License
- Songwriter's Share?
 - Technical Advice Memo 2007-0007
 - Royalty income not compensation income
- Step Up at Death?

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Sales vs. License of Copyrights



- **Income from a license does not result in Income in Respect of a Decedent**
 - See PLR 8501006
 - Income tax step-up in basis for the retained copyrights
- **Income from installment sale of copyrights results in Income in Respect of a Decedent**
 - No income tax step-up in basis for future income stream

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Capital Gains vs. Ordinary Income

■ Capital Assets

- Generally, property other than
 - Inventory or property held for sale in ordinary course of business
 - Trade or business property subject to depreciation
 - Specified self-created assets



■ Gain on Sale of Property

- Holding period
 - Begins when work is created
- Ordinary income and short-term capital gains
- Long-term capital gains
 - Held for more than 12 months
 - Taxed at lower rates than ordinary income
 - Currently maximum 23.8% federal rate
 - > 20% + 3.8% [for income over \$400,000 (single), \$450,000 (married)]
 - Collectibles 28% + 3.8%

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Capital Gains vs. Ordinary Income (continued)



Self-created copyrights are generally excluded from the definition of capital asset (ordinary income) BUT:

Section 1221(b)(3) exception to exclusion

- ✓ At election of taxpayer, musical compositions or copyrights in musical works treated as capital assets
- ✓ Applies to individuals, LLCs, partnerships and S Corporations
- ✓ Does not apply to C Corporations
- ✓ Exception does not apply to literary or artistic compositions!

WRITER'S SHARE?

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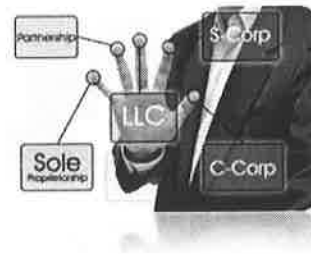
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Choice of Entity

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Choice of Entity

- **Sole Proprietorship**
- **Partnership**
 - General
 - Limited
- **Corporation**
 - C Corporation
 - S Corporation
- **Limited Liability Company (member managed/manager managed)**
 - Single Member
 - Multiple Member



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Individual/Sole Proprietorship/dba

- **Unlimited Liability**
- **One Level of Tax**
- **Not Preferred Entity for Personal Services in Entertainment Industry**
 - Withholding on Payment for Person Service
 - Employee vs. Independent Contractor

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General Partnership (2 or more Partners/Co-Owners)

- **Unlimited joint and several liability to all partners**
- **One level of tax**
- **Flow through of tax from partnership**
- **Character of gain on sale of partnership interest; generally determined by character of assets in partnership**
- **Not preferred entity for personal services in entertainment industry**
 - Withholding on payments for personal service

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Limited Partnership (requires general partner)

- Limited liability to limited partner(s)
- Unlimited joint and several liability to general partner(s)
 - Often use corporation or LLC as general partner
- One level of tax
- Flow through of tax from partnership
- Character of gain on sale of partnership interest; generally determined by character of assets in partnership
- Tax losses may be limited by basis/at risk
- Limited partners may get basis for partnership liabilities
- Not preferred entity for personal services in entertainment industry
 - Withholding on payments for personal service

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C Corporation Loan Out

- Limited liability to all shareholders
- Two levels of tax
 - OK for pure Service/Loan Out corporations
 - Can deduct reasonable compensation
 - Greater opportunity to deduct unreimbursed business expenses which would have been disallowed as a miscellaneous itemized deduction for AMT purposes
 - Zero out corporate income by year end bonus
- Personal service companies
 - "Performing" artists vs. Non-Performing Artists – in front of camera
 - Year end
 - Accounting method
 - Accrual may be mandatory for behind the camera
 - Greater than \$5 million of gross receipts for three consecutive years
- Okay for "performing artists" – Generally December Year End § 444 election
- Flat corporate tax at maximum 35% rates on corporate taxable income
- Okay for Non-Performing Artists (producers/writers/directors)
 - Deferral of income up to 3 months permissible year end (September/October/November)

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C Corporation Loan Out (continued)

- Do not create or contribute appreciated assets to corporation
- No flow through of corporate tax losses to shareholders
- No flow through of foreign tax credits to shareholders
- No withholding on payments from studio/record company to Loan Out Corporations
- Medical reimbursement plan – subject to anti-discrimination rules

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S Corporation Loan Out

- Limited liability to all shareholders
- Modified flow through of one level of federal tax
 - “Shareholder-employees” required to take substantial compensation and pay employment tax
 - CA has 1.5% tax on net taxable income
- Limitation of flow through of tax losses
 - Shareholders do not receive basis for entity debt
- Limitations of eligible shareholders
 - Number – 100
 - US taxpayers – no foreign shareholders
 - Individual (certain trusts)
 - Corporations 100% owned by S corporation
- Separate touring corporation
 - To isolate tour liabilities

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S Corporation Loan Out (continued)

- **Flow through of foreign tax credits**
- **Large behind camera income recipients**
 - May opt for S Corp to avoid accrual, but they likely lose the S election
- **Previous C Corporation that elects S Corporation**
 - 5 year built in gain period creates potential corporate tax on sale of appreciated assets
 - Corporate level tax if > 25% passive investment income (rents/royalties)
 - Loss of S election if > 25% passive investment income occurs in 3 consecutive years


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S Corporation Loan Out (continued)

- **Corporate level tax (double tax) on distribution of appreciated assets to S shareholders**
- **Year-end: Generally December**
- **Personal service companies are not required to elect accrual method**
- **Shareholders receive basis for capital contributions and for their loans to the S Corporation from shareholders**
- **No withholding on payment from studio/record company to Loan Out S Corporation**
- **No medical reimbursement plan**

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Single Member LLC



- Limited Liability to members
- Ignored for federal income tax purpose
 - CA Gross receipts tax (\$800/\$11,790)
- No entity limitation on tax loss flow through
- Withholding on payments for personal service

Multiple Member LLC

- Taxed similar to Limited Partnership except:
 - No general partner
 - However, limited liability even for managing members
 - CA Gross receipt's tax

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Partnerships/LLC

Common Structure for Ownership of Copyrights

(Not for Personal Service Loan Outs)

<ul style="list-style-type: none">■ One level of tax – partner level<ul style="list-style-type: none">- CA gross receipts tax on LLCs up to \$11,790■ No limitation on eligible partners■ Special allocations okay, except for family limited partnerships■ Contributions of property generally tax-free with a basis carryover<ul style="list-style-type: none">- Issue of whether participations, residuals, writer's share, and other rights constitute "property" under Section 721■ Contribution terminable by statutory heirs?	<ul style="list-style-type: none">■ No gain on distribution of copyrights<ul style="list-style-type: none">- Carryover basis■ Partner basis for entity liabilities■ Basis step-up in partnership assets upon partner's death BUT subject to income in respect of a decedent rules■ LLC vs. Limited Partnership<ul style="list-style-type: none">- CA gross receipts tax on LLCs- Limited liability – who is the general partner?- Can make an LLC the general partner of the limited partnership
--	---

*See proposed legislation
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Medicare Tax

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Section 1411 Medicare Tax Pass-Throughs

Businesses in the entertainment industry that are organized as pass-through entities (e.g., partnerships, LLCs, S corporations, etc.) should seek to maximize distributions and minimize compensation where member/partner/shareholder is an active participant in trade or business.

- Distributions not subject to either the 3.8% tax or the 2.35% tax (subject to reasonable compensation requirement)

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Section 1411 Medicare Tax Pass-Throughs

- Enter into nonqualified deferred compensation agreement in the case of loan out corporations; employee will be subject to the 2.35% tax on the deferred compensation but won't be subject to 3.8% on dividends.
- If partner/member/shareholder estate cannot be considered active participant in trade or business, recommend increasing compensation through use of nonqualified deferred compensation agreement plans.
 - Employee will be subject to 2.35% tax but not subject to the 3.8% tax

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Section 1411 Medicare Tax C Corporations

- C Corporations in the entertainment industry typically pay bonuses to the shareholder to reduce their taxable income.
 - Post-retirement compensation and post-death compensation may continue to qualify as active rather than passive income.
 - If so, then no 3.8 % tax.
- Reasonable compensation would only be subject to the 2.35% employee portion of Medicare insurance tax; the employer deduction would still be available.

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Allocation of Purchase Price

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Overview

- Purchase Price Allocation
- Direct asset sale vs. 338(h)(10)/336(e)
- Waterfall mechanics under 1060/338 regulations
- Key Buyer Considerations
- Key Seller Considerations
- Forms 8594 and 8883

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Purchase Price Allocation ("PPA") Generally

- **Defined as the allocation of the purchase price paid to the target's asset base.**
 - Tangible Assets
 - Intangible Assets – separately identifiable assets
 - Remainder is Goodwill
- **PPA impacts earnings of the acquired company as allocation will determine cost basis of assets for depreciation and amortization of acquired assets.**
- **PPA impacts tax obligation to be paid by the selling company or its owners.**

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Purchase Price Allocation Waterfall Mechanics Under 1060/338 Regulations

- **Section 1060 and 338 PPA is determined on a class-by-class basis.**
- **Purchase price must be allocated under the residual method to seven asset classes, in accordance with the order below**
- **Class I: Cash and general deposit accounts**
- **Class II: CDs, US government securities, marketable stock or securities, foreign currency**
- **Class III: Accounts receivable, mortgages, credit card trade receivables**
- **Class IV: Stock in trade / inventory**
- **Class V: All assets other than Class I, II, III, IV, VI, VII assets**
- **Class VI: Section 197 Intangibles other than goodwill and going concern value**
- **Class VII: Goodwill and going concern value**

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Direct Asset Sale vs 338(h)(10)/336(e)

- Purchase of a corporate enterprise may be accomplished by the purchase of stock or assets.
- Stock purchases can limit a buyer's exposure and simplify acquisition issues such as contract assignment issues.
- For tax reasons, a buyer may wish to purchase assets to benefit from a stepped-up basis of the assets to fair market value.

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Direct Asset Sale vs. 338(h)(10)/336(e) (continued)

- Section 338(h)(10) election (jointly made by buyer and seller) affords buyer the convenience of stock purchase combined with the benefit of the stepped-up basis of asset purchase.
- Target must be either (i) a U.S. corporate subsidiary of a selling consolidated group, or (ii) an S corporation.
- If a purchasing corporation acquires 80% or more of the target's stock in a qualified stock purchase ("QSP"), a section 338 election may be made to treat the stock purchase as an asset purchase if made within 8 ½ months after the month of acquisition (i.e., the election results in a deemed asset sale)
- A 336(e) election, made by the seller, has a similar effect; because it is not limited to targets bought by a corporation, it is more broadly available than 338(h)(10).

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Key Buyer Considerations

- Buyer may be willing to pay the seller a premium to induce it to make a Section 338(h)(10) election.
- Benefits from the asset basis step-up resulting from the election.
- Step up increases depreciation and amortization of target's assets, permitting amortization of intangible assets over 15 years.
- Asset mix that may favor an election (i.e., target assets short-lived for depreciation / amortization purposes, substantial target "fast-pay assets," or targets self-created intangibles converting into amortizable Section 197 intangibles).
- Election preferable to preserving target's NOLs which may be subject to limitations or expiration that may further reduce buyer's basis in target stock.

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Key Seller Considerations

- Deemed asset sale resulting from the election may result in more or less federal income tax than a straight stock sale.
- Marginal costs associated with the election should be part of price negotiations.
- As election is joint, sellers typically have some bargaining power in securing from buyers, usually in the form of a purchase price increase or gross-up payment.
- Outside basis vs. inside basis.
- Seller's net tax basis in its target stock ("outside basis") may be more or less than the target's net tax basis in its own assets ("inside basis"). If outside basis exceeds inside basis, a seller is generally disadvantaged by making the election because it would have recognized less gain had it sold the target stock.
- Outside basis for long-held consolidated target may be tax neutral for seller but a negotiating point if buyer will benefit.
- Net Operating Losses ("NOLs").
- If election made, a consolidated target's own NOLs available to offset gain on deemed asset sale.
- If no election, NOLs are unavailable to offset gain on sale of stock.
- S corporation shareholders making an election potentially face adverse federal income tax consequences – may need to be resolved with purchase price premium.
- Portion of corporate level gain is recharacterized as ordinary income under the "recapture" rules (may be significant compared to stock sale gain).
- Potential mismatch between ordinary income from recapture and a capital loss on the deemed liquidation.
- May result in a corporate level tax on built-in gain at time of election (exception to pass-through treatment).

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Relevant IRS Informational Returns

- **Form 8594 Asset Acquisition Statement – reporting under Section 1060.**
 - Both the purchaser and seller are required to file Form 8594.
 - Form 8594 must be attached to each filer's timely filed Federal income tax return.
- **Form 8883 Asset Allocation Statement – reporting under Section 338**
 - Both the old target (target as owned by seller) and new target (target as owned by buyer) must attach filing to each respective filers timely filed Federal income tax return.

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WHERE ARE WE NOW?



WHERE ARE WE GOING?



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Income Tax: Rates on Ordinary Income



Hillary Clinton

Adds a 4% surtax on income over \$5 million.



Ted Cruz

Establishes a flat rate of 10% on all ordinary income. Increases the standard deduction to \$10,000 per filer.



John Kasich

Establishes three brackets, with a top rate of 28%.



Bernie Sanders

Establishes four new brackets of 37%, 43%, 48% and 52%. The top rate applies to taxable income over \$10 million. Raises the rate of all brackets by 2.2%.



Donald Trump

Establishes four new brackets of 0%, 10%, 20% and 25%. The top rate applies to taxable income over \$150,000 for single filers and \$300,000 for joint filers.

Source: Tax Foundation

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Income Tax: Rates on Capital Gains and Dividends



Hillary Clinton

Adds a 4% surtax on income over \$5 million. Raises rates on medium-term capital gains (investments held for less than six years) to between 24% and 39.6%.



Ted Cruz

Lowers the rate on capital gains and dividends income to 10%.



John Kasich

Lowers the rate on long-term capital gains to 15%.



Bernie Sanders

Taxes capital gains and dividends at ordinary income rates for households with income over \$250,000.



Donald Trump

Eliminates the net investment income surtax.

Source: Tax Foundation

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Corporate Income Tax: Rate



Hillary Clinton
No specific proposal.



Ted Cruz
Replaces the corporate income tax with a 16% business transfer tax, which applies to all capital income and labor payments.



John Kasich
Lowers the top corporate rate to 25%.



Bernie Sanders
No specific proposal.



Donald Trump
Lowers the top corporate rate to 15%.

Source: Tax Foundation

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Estate Tax



Hillary Clinton
Increases the top estate tax rate to 45%, and lowers the estate tax exclusion to \$3.5 million.



Ted Cruz
Eliminates the estate tax.



John Kasich
Eliminates the estate tax.



Bernie Sanders
Increases the top estate tax rate to 65%, and lowers the estate tax exclusion to \$3.5 million.

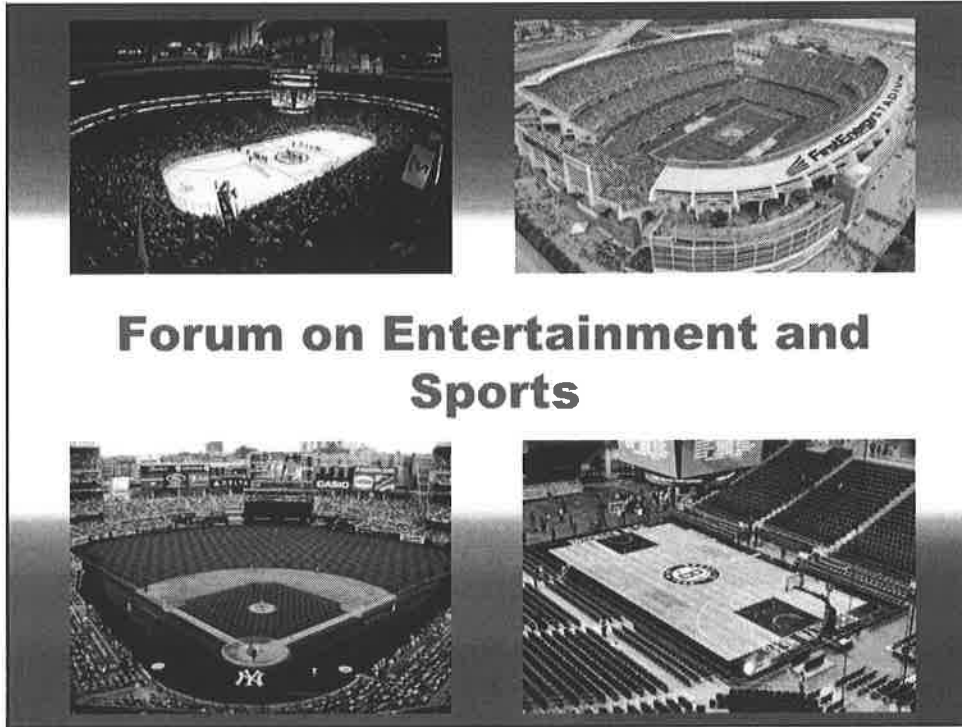


Donald Trump
Eliminates the estate tax.

Source: Tax Foundation

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Primary Sources of Revenue

- Gate Revenues (Ticket Sales)
- Media Rights
- Sponsorship
- Merchandising
- Real Estate Development

The slide includes several images illustrating revenue sources: the Bud Light logo with "OFFICIAL BEER SPONSOR" and the NFL logo; a photograph of a person in a "FOX Sports" jacket; a "2015 SEASON TICKETS HERE." sign; a photograph of a stadium; and a collection of sports merchandise including jerseys and hats.

Determining Team Valuation



- When valuing a franchise, how do we account for phenomenon's such as Jeremy Lin and the Knicks? Do these numbers represent the franchise's true value?
- What do the 2014 valuations tell us? Has this trend continued?



Forbes top 5	
1	Real Madrid \$3.44 bn
2	Barcelona 3.2 bn
3	Manchester United 2.81 bn
4	New York Yankees 2.5 bn
5	Dallas Cowboys 2.3 bn

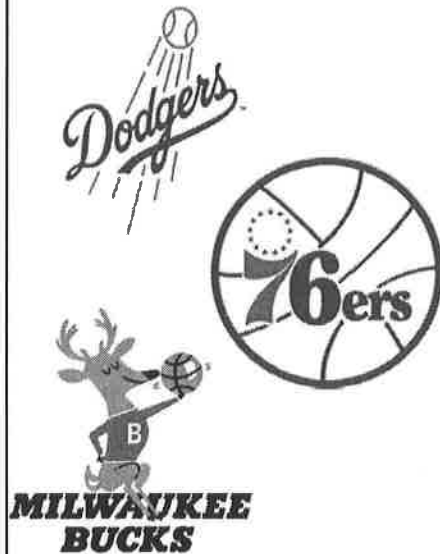
Private Equity & Sovereign Wealth Funds impact on Team Valuations



- Why are private equity and sovereign wealth funds buying into sports?
 - Diversify investment portfolios.
 - Upward trending valuations/accretion.
 - Exploding media rights deals and favorable CBA-related revenue splits, creating positive cash flow.
 - "Cool" factor of being in the exclusive member club as an owner of a team.



Private Equity & Sovereign Wealth Funds impact on Team Valuations



- Sports present an opportunity for investors to examine indicators of success that are unique to the sports industry. In addition to financial data, attendance records and win/loss records are clear signs of internal and external achievement. (*Alex Wheatley, 2012*)

Media Rights



- The NBA recently signed a \$24 billion, nine-year television contract with ESPN/ABC and TNT – works out to \$2.6 billion/year split between the 30 NBA franchises.



Media Rights



- The NHL recently (2013) signed a Canadian television deal with Rogers Communications for \$5.2 billion (Canadian) over 12 years, and in 2011 signed a 10 year / \$2 billion deal with NBC.



- NBC acquired the exclusive media rights to broadcast Premier League games in the US, as part of a three-year \$250 million deal with the Premier league.

Media Rights




- *Currently*, CBS, Fox, NBC and ESPN provide the NFL with a total of about \$5 – \$6 billion annually from contracts that run through 2021-22. By 2027, Navigate Research predicts such media rights revenues could reach \$17 billion/year.

Second Screen/Digital Viewing/Social Media




- Sports events only account for 2 – 3% of television programming every month. However, that small amount produces roughly 50% of Twitter's overall activity around TV.

Second Screen/Digital Viewing/Social Media



- The sports-related second screen market was forecasted at approximately \$745 million for 2014 and second screen sports revenues are expected to hit over \$2 billion by 2018.



Stadiums/Arenas: Impact on Team Valuations



- Stadiums often a pillar of sports deals.
- New state-of-the-art and technologically equipped stadiums.



Stadiums/Arenas: Impact on Team Valuations



- Priority for leagues and teams – new arenas help drive the value of sports franchises.
- The 170 suites at Levi's Stadium (SF 49ers) can accommodate 20-40 guests and cost up to \$60,000 depending on the game and the specific suite.



Stadiums/Arenas: Impact on Team Valuations



- Barclays Arena ranks third worldwide in number of tickets sold and it's second in terms of gross ticket sales revenue (\$46.9 million).




Breaking into the Business of Sports



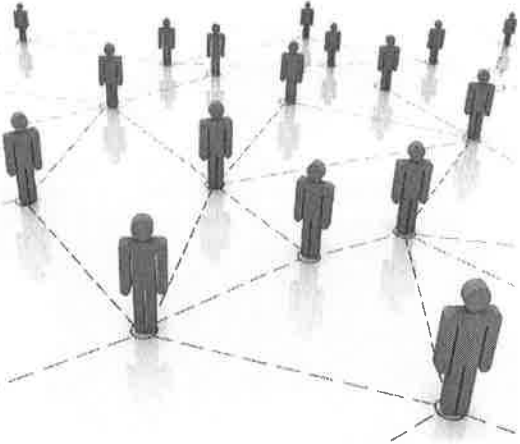
- Acquire and develop a core set of relevant skills **first**, then bring those skills into the sports sector ... you will be more marketable and provide greater value.




Breaking into the Business of Sports




- Develop your network and make contacts whenever the opportunity presents itself.
- Develop/maintain positive relationships.



Breaking into the Business of Sports



- Be authentic, genuine, confident and loyal.
- Take time to help those looking for advice, a connection or a sounding board.
- Separate yourself from the pack with your work ethic!



Charles Baker



- Mr. Baker's corporate practice encompasses mergers and acquisitions, private equity, corporate finance and restructurings, with a core focus in the sports, media and consumer sectors.
- Mr. Baker has represented buyers and sellers of sports franchises in the National Football League, National Basketball Association, National Hockey League, Major League Baseball, Major League Soccer and many of the European football leagues.
- Mr. Baker is ranked in *Chambers USA: America's Leading Lawyers for Business* as a leading lawyer for both his M&A practice and as a national Sports Law lawyer.



Partner
DLA Piper LLP (US)
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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on November 13, 2017, all counsel of record who are deemed to have consented to electronic service are being served with a copy of this document via the Court's SDNY Procedures for Electronic Filing.

/s/ Steven G. Sklaver
Steven G. Sklaver