

Net Element, Inc.
Form 10-KT/A
February 03, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K/A

(Mark One)

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

For the fiscal year ended

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

For the transition period from April 1, 2010 to December 31, 2010

Commission file number 000-51108

Net Element, Inc.
(Exact name of registrant as specified in
its charter)

Delaware
(State or other jurisdiction of incorporation or
organization)

20-0715816
(IRS Employer Identification Number)

1450 S. Miami Avenue,
Miami, Florida 33130
(Address of principal executive offices)

(305) 507-8808
(Registrant's telephone number, including area code)

Securities registered under Section 12(b) of the Exchange Act: None

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, par value \$0.001 per share
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

YES NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

YES NO

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Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES (None Required) NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

YES NO

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter.

Note. —If a determination as to whether a particular person or entity is an affiliate cannot be made without involving unreasonable effort and expense, the aggregate market value of the common stock held by non-affiliates may be calculated on the basis of assumptions reasonable under the circumstances, provided that the assumptions are set forth in this Form.

The aggregate market value of the voting common equity held by non-affiliates was \$218,562 based upon the last traded price of \$0.01 per share on January 21, 2011.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

At January 31, 2011, the number of shares outstanding of the issuer's common stock was 642,119,111 shares.

DOCUMENTS INCORPORATED BY REFERENCE

NONE

Explanatory Note

Net Element, Inc. is filing this amended Annual Report on Form 10-K/A in connection with the correction of typographical errors and certain other non-material disclosures and formatting changes to financial statement tabular presentations. The Annual Report is amended and restated in its entirety for the convenience of the reader.

Net Element, Inc. is filing this Annual Report on Form 10-K for the transition period from April 1, 2010 to December 31, 2010 as a result of a change in its fiscal year end from March 31 to December 31. Additionally, included in this Annual Report is information relating to the Company's acquisitions of Motorsport, LLC and Music1, LLC, each effective as of February 1, 2011, as more fully described herein. Net Element, Inc. had previously registered its securities pursuant to Section 12(g) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and has been a reporting company subject to the requirements of Section 13 of the Exchange Act since 2005.

Defined Terms

Net Element, Inc. is a corporation organized under the laws of the State of Delaware. As used in this report, unless the context otherwise requires, the terms "Net Element," "Company," "we," "us," "our" and "group" refer to Net Element, Inc. and its applicable, its majority-owned and consolidated subsidiaries.

Forward-Looking Statements

This report contains forward-looking statements that reflect the current views of our management with respect to future events. Forward-looking statements generally are identified by the words "expects," "anticipates," "believes," "intends," "estimates," "aims," "plans," "will," "will continue," "seeks" and similar expressions. Forward-looking statements are based on current plans, estimates and projections, and therefore you should not place too much reliance on them.

Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update any forward-looking statement in light of new information or future events, although we intend to continue to meet our ongoing disclosure obligations under the U.S. securities laws and under other applicable laws. Forward-looking statements involve inherent risks and uncertainties, most of which are difficult to predict and are generally beyond our control. We caution you that a number of important factors could cause actual results or outcomes to differ materially from those expressed in, or implied by, the forward-looking statements. These factors include, among other factors: the development or acquisition of profitable operating businesses, attracting and retaining competent management and other personnel, successful implementation of our business strategies, and successful integration and promotion of any business developed or acquired. If these or other risks and uncertainties materialize, or if the assumptions underlying any of these statements prove incorrect, our actual results may be materially different from those expressed or implied by such statements.

World Wide Web addresses contained in this report are for explanatory purposes only and they (and the content contained therein) do not form a part of and are not incorporated by reference into this report.

NET ELEMENT, INC.

Form 10-K
For the Year Ended December 31, 2010
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PART I

Item 1. Business.

Development of Business – Overview

Net Element, Inc. (formerly TOT Energy, Inc.) is an online media and technology company. Since April 1, 2010, we have pursued a strategy to develop and/or acquire technology and applications for use in the online media industry. In furtherance of this strategy, on December 14, 2010, we acquired Openfilm, LLC, a Florida limited liability company, engaged in the development of technology and operation of a website that supports the advancement of independent film on the Internet. Additionally, on February 1, 2011, we acquired Motorsport, LLC, a Florida limited liability company that holds 80% of the outstanding common stock of Motorsport.com, Inc., a Florida corporation engaged in the operation of a news and information website relating to the international motorsport industry, and Music1, LLC, a Florida limited liability company, that owns 97% of the membership interests of A&R Music Live, LLC, a Georgia limited liability company that owns and operates two websites that provide an online social community and marketplace for musicians, songwriters, producers and record companies and an opportunity to showcase artist talents. As a result of these acquisitions, we now operate several online media websites in the film, auto racing and emerging music talent markets.

We believe that the technology platforms and development expertise acquired from Openfilm will enable us to enhance the digital distribution of content in a variety of industries. Accordingly, we intend to explore the possibility of acquiring other internet portal properties and companies with similar goals of connecting people in various vertical markets, such as the medical, music, film, sports and legal markets.

Net Element, Inc. was organized on February 6, 2004 under the laws of the State of Delaware under the name Splinx Technology, Inc., which was a wholly-owned subsidiary of Splinx, LLC, a Florida limited liability company, and was spun-off pursuant to a merger with Ener1 Acquisition Corp., a Delaware corporation and wholly-owned subsidiary of Ener1, Inc., (Nasdaq: HEV), a Florida corporation, co-founded by our President, Mike Zoi, that designs, develops and manufactures high-performance, rechargeable, lithium-ion batteries and battery systems in the transportation and energy markets. The Company initially intended to develop advanced technologies in the three-dimensional or 3D computer graphics industry. Since October 28, 2003 (“Inception”), the date of formation of Splinx, LLC, through December 17, 2007, we operated in a development phase typical of a software company and focused on developing technologies and products and securing intellectual property rights while we developed relationships with potential customers and resellers. Under an agreement effective April 1, 2004 (the “Contribution Agreement”), Splinx, LLC contributed substantially all of its assets, liabilities and operations to the Company. Due to lack of significant sales, we substantially reduced our workforce and overhead costs beginning in September 2005. From September 2005 through July 2007, Ener1 Group, Inc., a related party, loaned us money to fund our operations. In July 2007, Ener1 Group, Inc. stopped funding our operations.

On December 17, 2007, (1) certain holders, who had received shares in the Company as distributions from Splinx LLC, transferred their ownership of 35,162,334 shares of common stock of the Company to Splinx LLC for nominal consideration, and (2) Bzinfon, S.A., a British Virgin Islands limited corporation (indirectly owned by an affiliate of Ener1 Group, Inc., a Florida company of which Mike Zoi (our current Chief Executive Officer and President) is a shareholder and director and which is the majority shareholder of Ener1, Inc.) and Ener1 Group assigned debt obligations of the Company to Splinx LLC in the amount of \$2,805,207 and \$845,864, respectively. Under a Purchase Agreement dated December 17, 2007, TGR Capital, LLC (which changed its name to Enerfund, LLC in September 2008), a Florida limited liability company (“Enerfund”), which is wholly-owned by Mike Zoi, acquired all of the membership interests in Splinx LLC, thereby giving Enerfund control of Splinx LLC.

Under an Exchange Agreement dated December 18, 2007, we agreed to issue 113,500,000 newly issued shares of the Company to Splinx LLC of which 8,500,000 shares were issued to Bzinfon and 2,125,000 were issued to a former affiliate of Splinx, LLC. Splinx LLC owned 98,157,334 shares of the Company as of December 17, 2007 and an aggregate of 201,032,334 shares after the completion of the Exchange Agreement on December 18, 2007. We had 100,757,769 shares outstanding at December 17, 2007 and 214,257,769 shares outstanding after the completion of the Exchange Agreement. In June 2008, Splinx, LLC changed its name to TGR Energy, LLC.

Until December 31, 2010, short term financing was provided by TGR Energy, LLC (“TGR”), an entity controlled by our president, Mike Zoi, pursuant to a Subscription Agreement dated August 7, 2008 (the “Subscription Agreement”). TGR agreed to provide up to \$2,000,000 (the “Investment Amount”) in exchange for up to 100,000,000 shares of common stock and warrants to purchase up to 50,000,000 shares of common stock at an exercise price of \$0.05 per share. Pursuant to the Subscription Agreement, TGR funded the Investment Amount as required in our operational budget. On January 12, 2010, TGR agreed to increase its funding commitment from \$2,000,000 to \$4,000,000 in exchange for up to an additional 100,000,000 shares of our common stock and warrants to purchase up to 50,000,000 shares of our common stock at an exercise price of \$0.05 per share for a period of five years from date of issuance. TGR has funded the full amount required under the Subscription Agreement.

On December 31, 2010, we entered into a Subscription Agreement with Enerfund, LLC (a company controlled by Mike Zoi) (the “Enerfund Subscription Agreement”) pursuant to which we received an aggregate of \$2,000,000 in exchange for 200,000,000 shares of our common stock and warrants to purchase 100,000,000 shares of our common stock at an exercise price of \$0.05 per share for a period of five years from date of issuance. The proceeds of the Enerfund Subscription Agreement will be used to fund our operations.

On July 16, 2008, we entered into a Joint Venture Agreement (the “JV Agreement”) with Evgeny Bogorad (“Bogorad”), owner of Sibburnefteservis, Ltd. of Novosibirsk, Russia, an oil services company (“SIBBNS”). Pursuant to the JV Agreement, Bogorad contributed certain of SIBBNS’ assets and personnel to a joint venture company named TOT-SIBBNS, Ltd., a Russian corporation (“TOT-SIBBNS”). An independent appraisal company appraised the contributed assets at USD\$6,221,881. We ended development stage activity on July 16, 2008 when we acquired a 75% interest in the TOT-SIBBNS joint venture and began operations in the oil and gas service industry, including the exploration, development, production, and marketing of crude oil and natural gas in Russia and Kazakhstan. At the closing on July 16, 2008, we issued to Bogorad 3,000,000 shares of our common stock in exchange for a 75% interest in TOT-SIBBNS.

TOT-SIBBNS obtained its first contract and began drilling operations in the Fall 2008. However, financial constraints and the declining price of oil resulted in a suspension of drilling operation in January 2009. Drilling operations did not recommence during the Winter 2009 and most employees were furloughed in April 2009.

TOT-SIBBNS had expectations of continuing exploratory drilling (both through its existing customer and new customers) for the 2009/2010 drilling season as the price of oil had risen significantly and TOT-SIBBNS was able to secure an additional drilling contract in November 2009. However, in January 2010, it became questionable whether activities with TOT-SIBBNS’ initial customer would recommence in the short term, and there remained uneasiness in the market over the continued improvement in crude oil prices, which had a negative impact on the exploratory drilling market in Russia at that time. Accordingly, on January 27, 2010, after several weeks of exploring other business opportunities, we altered our business focus and decided to exercise our option to unwind the joint venture and pursue other development opportunities.

We executed an unwind agreement with TOT-SIBBNS whereby we exchanged our 75% interest in TOT-SIBBNS for the 3,000,000 shares given to Evgeny Bogorad in 2008. The unwind of the joint venture was consummated as of March 31, 2010. The unwind of the TOT-SIBBNS joint venture has been accounted for using the guidance provided in ASC 845 (previously APB 29), as a disposal “other than by sale” similar to a spin-off transaction, with the shares received reflected as treasury stock and recorded on our balance sheet at its carrying basis in the net assets of the joint venture as of March 31, 2010.

Korlea-TOT Energy s.r.o. (“KORLEA-TOT”) is our 51% joint venture with Korlea Invest Holding AG of Switzerland (“Korlea”) who is a provider and trader of energy assets in the Czech Republic. The joint venture, Korlea-TOT, established as of July 17, 2008, was expected to assist in the marketing of oil assets sourced by us and our contacts and affiliates. There has been no activity to date with this joint venture. Accordingly, in November 2010, we sent Korlea notice of our intention to unwind this arrangement. We intend to sell our ownership in the KORLEA-TOT joint venture to Korlea in exchange for a cash payment equal to 51% of the cash balance in the joint venture on the date of unwind. Consummation of this transaction will be subject to obtaining certain approvals and making certain filings overseas. It is expected that this transaction will be completed during the first quarter of 2011.

Since April 1, 2010, we have engaged in the development of an alternative energy services business and we have concurrently pursued a strategy to develop and/or acquire technology and applications for use in the online media industry. In furtherance of this strategy, we acquired Openfilm, LLC, a Florida limited liability company, engaged in the development of technology and operation of a website that supports the advancement of independent film on the Internet, as more fully described below. We believe that our technology platforms and development expertise will enable us to enhance the digital distribution of content in a variety of industries. Accordingly, in addition to our acquisition of Openfilm, we intend to explore the possibility of acquiring other internet portal properties and companies with similar goals of connecting people in various vertical markets, such as the medical, music, film, sports and legal markets. In this regard, on February 1, 2011, we acquired Motorsport, LLC and Music1, LLC, each as more fully described below. As of December 31, 2010, we have terminated our efforts to develop an alternative energy

services business in order to focus on our growing online media businesses.

In pursuing our strategy to develop an online media company, from time to time, we may be engaged in various discussions to acquire businesses or formulate joint venture or other arrangements. Our policy is not to disclose discussions or potential transactions until definitive agreements have been executed. Where appropriate, acquisitions will be financed with equity shares and this may result in substantial dilution to existing stockholders.

Several factors raise significant doubt as to our ability to continue operating as a going concern. These factors include our history of net losses and, from March 31, 2010 until December 14, 2010, due to the unwind of the TOT-SIBBNS joint venture, we had no significant operations until the acquisition of Openfilm. Additionally, as of December 31, 2010, we had a working capital deficit. Management recognizes that we must raise capital sufficient to fund business activities until such time as we can generate sufficient revenues and net cash flows in amounts necessary to enable us to continue contemplated operations, of which there can be no assurance. We are dependent upon TGR, Enerfund or Mike Zoi (as a result of his controlling interest in TGR and Enerfund and our dependence on the continued support of our operations by Mr. Zoi) to fund our operations. Our independent auditors' report on our financial statements for the year ended December 31, 2010 contains an explanatory paragraph about our ability to continue as a going concern. Management believes that our current operating strategy, as described in the preceding paragraphs and the proceeds received from the Enerfund Subscription Agreement and expected continued financial support from Mr. Zoi, provides the opportunity for us to continue as a going concern; however, there is no assurance this will occur and Mr. Zoi is not obligated to continue to fund our operations.

On November 11, 2010, our Board of Directors adopted a resolution changing our fiscal year end from March 31 to December 31. Management believes that this change will allow better alignment of our annual planning and budget processes with our new business strategy as we are no longer engaged in the seasonal oil and gas business.

Recent Acquisitions

Openfilm

As part of our strategy to develop an online media company, on December 14, 2010, we entered into a purchase agreement (the "Openfilm Purchase Agreement") with the members of Openfilm, LLC, a Florida limited liability company engaged in the development of technology and operation of a website that supports the advancement of independent film on the Internet. Mike Zoi, our President, through his control of Enerfund, LLC and MZ Capital, LLC, both Florida limited liability companies, held approximately 70% of Openfilm's outstanding membership interests prior to the acquisition by the Company. Pursuant to the Openfilm Purchase Agreement, we acquired all of the outstanding membership interests in Openfilm by exchanging for such interests an aggregate of 107,238,421 shares of our common stock to the security holders of Openfilm, of which 45,937,500 shares were issued to Enerfund (a company controlled by Mike Zoi), 29,062,500 shares were issued to MZ Capital, LLC (a company controlled by Mike Zoi), 24,950,000 shares were issued to Dmitry Kozko, CEO of Openfilm, and an aggregate of 7,288,421 shares were issued to the remaining seven non-controlling security holders of Openfilm. Upon completion of the acquisition transaction on December 14, 2010, Openfilm became a wholly-owned subsidiary of the Company. Additionally, in connection with the acquisition of Openfilm, we established NetLab Systems, LLC (NetLab), a Florida limited liability company, and transferred the ownership of certain intellectual property assets from Openfilm to NetLab. Openfilm and NetLab entered into a Technology Transfer and License Agreement granting Openfilm the right to use certain technology transferred to NetLab. For more information, see "– Licensing Arrangement between Openfilm and NetLab" below. Research and development activities are conducted primarily through Zivos, LLC, a Ukrainian limited liability company and wholly-owned subsidiary of Openfilm. Up until the date of acquisition, Openfilm operations were funded primarily by entities controlled by our President, Mike Zoi.

Motorsport.com

On February 1, 2011, we entered into a purchase agreement (the "Motorsport Purchase Agreement") with Enerfund, LLC, an entity controlled by Mike Zoi, to purchase all of the issued and outstanding interests of Motorsport, LLC, a Florida limited liability company that held 80% of the outstanding common stock of Motorsport.com, Inc., a Florida corporation engaged in the operation of a news and information website relating to the international motorsport industry. Motorsport, LLC purchased the interest of Motorsport.com, Inc. on December 17, 2010. The remaining 20%

of the outstanding common stock of Motorsport.com, Inc. is held by the original stockholders (4 persons) of Motorsport.com, Inc.

Purchase Price. Pursuant to the Motorsport Purchase Agreement, on February 1, 2011, we paid Enerfund an aggregate of \$130,000 (excluding a \$20,000 contingent payment relating to the purchase of certain domain names) and agreed to take over responsibility for the obligations contained in the purchase agreement of December 17, 2010, which includes, among other things, the aggregate payment to the original stockholders of Motorsport.com, Inc. of an additional \$450,000 payable in four quarterly installments commencing on December 1, 2013. In the event the domain names and related registrations are unable to be purchased on or before June 16, 2011, then we will not have to make the contingent payment (\$20,000). The original sellers have a security interest in the domains of Motorsport.com, Inc. as collateral for payment of the additional purchase price. Failure to pay the additional purchase price when due may result in forfeiture of the shares in Motorsport.com, Inc. held by us.

Purchase Option on Outstanding Shares. In addition, we will have the option until December 16, 2018 to purchase the remaining interests of Motorsport.com, Inc. currently held by the original stockholders. We may exercise this option at any time upon thirty days prior written notice and the payment, in cash or preferred stock of Motorsport.com, Inc., as follows:

- (i) until December 16, 2015: \$0.1075 per share;
- (ii) from December 17, 2015 through December 16, 2016: \$0.1185 per share;
- (iii) from December 17, 2016 through December 16, 2017: \$0.1305 per share; and
- (iv) from December 17, 2017 through December 16, 2018: \$0.1435 per share.

At our option, we can pay the foregoing purchase price for the additional shares held by the original sellers in either (i) cash or (ii) preferred stock of Motorsport.com, Inc., which preferred stock will have a dividend payment equal to 2.5% of the value of the preferred stock on the date of issuance payable quarterly from the date of issuance. We may redeem any preferred stock issued at any time upon the payment in full of the value of the preferred stock as of the date of issuance.

Music1

In furtherance of our strategy to become an online media company, on February 1, 2011, we acquired Music1, LLC, a Florida limited liability company, from Enerfund (an investment company controlled by Mike Zoi), for an aggregate purchase price of \$15,000. Music1, LLC owns 97% of the membership interests of A&R Music Live, LLC, a Georgia limited liability company that owns and operates two websites that provide an online social community and marketplace for musicians, songwriters, producers and record companies and an opportunity to showcase artist talents. Music1, LLC purchased its interest in A&R Music Live, LLC on November 8, 2010. The remaining 3% of the membership interests of A&R Music Live, LLC is owned by Stephen Strother, the Founder and President of Music1. We are required to invest at least \$500,000 in Music1 by December 31, 2012 (which amount may include salaries and other expenses of Music1). In the event such amount is not invested in Music1 by December 31, 2012 or the employment agreement of Mr. Strother is terminated other than for cause or good reason on or before May 7, 2012, then Mr. Strother will have the right to repurchase Music1 for \$1.00. Additionally, Mr. Strother has granted a royalty free license to Music1 to use certain technology owned by him for the term of his employment agreement. For more information, see “ – License Agreement with Stephen Strother” below.

Business Description

As a result of the acquisitions described above, we operate several online media websites in the film, auto racing and emerging music talent markets, as more fully described below. We intend to continue to seek additional opportunities to exploit our technologies in other vertical markets, such as legal and medical.

Openfilm Development of Business

Openfilm, LLC was formed as a Florida limited liability company on November 16, 2007 under the name Zivos, LLC. On April 9, 2008, Zivos, LLC changed its name to Openfilm, LLC. Openfilm is an online media company that supports a community of independent film enthusiasts and filmmakers. Openfilm owns and operates a website (www.Openfilm.com), which is based on a proprietary video platform (licensed to Openfilm by NetLab) and certain know-how and methods developed by Openfilm that unite elements of the film industry that are of most interest and value to Openfilm’s users in a single location. Openfilm derives revenues from video advertising, video content syndication, display advertising and membership fees, as well as, contest entry fees, as discussed more fully below.

Openfilm has developed an award-winning website that currently showcases over 7,200 films of various lengths and genres, aggregated from film festivals, film schools and independent filmmakers from around the world. Films are displayed online in large HD video format and filmmakers are able to upload their films and interact with other users through a networking platform.

Openfilm offers aspiring filmmakers an opportunity to have their work seen by a distinguished group of Hollywood insiders who make up the Openfilm Advisory Board, including actor James Caan (Chairman), fellow Godfather co-star Robert Duvall, director Marc Rydell and actor and filmmaker Scott Caan. Advisory Board members act as a group of “mentors” who interact with Openfilm’s premium members through online web chats that are held on a periodic basis. The Advisory Board members also serve as judges for various competitions promoted by Openfilm.

The proprietary technologies and software platform developed for Openfilm have applications in many other vertical online markets that will enable Openfilm and NetLab to generate revenues through the sale of software licensing, market reports, e-commerce transactions, festival services and others products and services. Openfilm believes that it is well positioned to capitalize on the rapidly growing independent film market (estimated by eMarketer, Inc., an independent digital marketing research company, to be in excess of \$4 billion annually), as well as the online advertising market (estimated by eMarketer™ to be approximately \$25.8 billion in 2010).

Openfilm.com Website

Openfilm.com is an online platform created from various proprietary technologies that provides a unique value proposition for independent filmmakers, advertisers, film festivals, film schools and viewers. The website provides its community of filmmakers and film enthusiasts with an opportunity to interact with each other and directly with “Hollywood insiders” who comprise our Advisory Board. Poised to capitalize on the emerging online video market, Openfilm believes its software (licensed from NetLab) will transform the way independent films are discovered, produced and distributed.

Openfilm.com offers filmmakers free basic services, including unlimited uploads and streaming of approved premium HD video content. In addition, Openfilm provides a revenue sharing program for filmmakers, including advertising revenues derived from distribution of their film content, thus allowing Openfilm to attract some of the best content creators in the world, as well as their existing fan bases.

Content

Openfilm has aggregated a content library of over 7,200 independently produced films from film schools, festivals, organizations and independent filmmakers. All content goes through various screenings to ensure it meets specified quality and copyright standards. The films are then converted to HD formats to ensure they will be seen in the highest quality on the Internet. The Openfilm library consists of short, feature-length and animated works.

Recognition and awards

To date, Openfilm has been recognized by industry publications and has received the following industry awards:

- Movie Maker Magazine named Openfilm one of the “top 50 websites for filmmakers” – June 2009
- 13th Annual Webby Award Official Honoree – May 2009
- Reelseo.com named Openfilm “The Lexus of Video Sharing Social Communities” – February 2009
- Video Maker Magazine named Openfilm “Video Sharing Site of 2008” – December 2008

Openfilm Growth Strategy

Openfilm intends to grow its membership base organically and through premium upgrades in membership status, and also to acquire online properties with targeted communities that will maximize traffic to the Openfilm website. Maximization of traffic to the Openfilm website will increase membership enrollment and provide an enhanced value proposition for advertisers.

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Additionally, Openfilm (in conjunction with NetLab) intends to provide services to film festivals and other film related enterprises, as well as other vertical markets that would benefit from the technology and know-how developed for Openfilm.

Revenue Streams

Openfilm has identified several revenue streams that it intends to develop further as resources permit as follows:

Advertising

Openfilm believes it is in a strong position to monetize its video content library through targeted advertising based on user behaviors and also through direct sales and distribution of films uploaded by its members. Openfilm utilizes proprietary technology (licensed from NetLab) that tracks online user activity on its website (in accordance with applicable Openfilm website privacy policies) and builds profiles based on the content metadata accessed to determine the interests of users. Based on user activity, targeted advertisements can be offered to specific users at different areas of the website or imbedded within the accessed content. Accordingly, multiple products and services can be offered to users that would be of interest to them based on their activity on the Openfilm website.

Openfilm will offer the two most commonly used ad monetization tools for video websites, but will bundle them with NetLab's proprietary technology to create higher return on investment (ROI) for advertisers. Openfilm believes it can significantly increase click-through-rates (CTR) using NetLab's proprietary technology and know-how as compared with currently available methods used on other websites. Openfilm's behavior tracking system will further add to CTR and enhance the user's experience on the website. Several types of advertising opportunities are offered through the Openfilm website:

Display Ads – traditional banner advertising placed throughout the site will be offered in standard sizes with a minimum insertion fee and specified rates for CPM (cost per 1,000 views). Premium subscription members will have the option to turn off banner advertisement exposure.

Video Insertions – small segmented video commercials inserted into video content, similar to how commercials are displayed on Television, and include video pre-roll, post roll, or mid-roll insertions. The current standard compensation metric is also based on CPM. Currently Openfilm has an arrangement with the leading ad provider in the market to provide insertion ads until Openfilm can fully launch its behavior tracking system, which will enable Openfilm to better target and place ads.

Video Overlay Ads – ads that play every 90 seconds located primarily at the bottom of film content that generate multiple impressions per content view. These ads are currently provided by ScanScout, the largest provider of overlay ads.

Currently, over 80% of all Openfilm.com advertising can be found on video content pages. Openfilm expects to be able to provide advertising opportunities with respect to approximately 70% of all traffic to its website.

Other revenue opportunities are available through sponsorship of a particular channel (content categories or groupings created by users) or event on Openfilm.com. Rates will generally be based on monthly CPM exposure.

Membership Fees

Openfilm offers viewers and filmmakers three levels of membership enrollment – Free, Plus and Pro membership plans. Free membership allows users to upload films and videos and comment on content of other members, and also

view live web chats and vote on and rate film content submissions. Premium membership services require payment of a monthly fee and are currently available at two distinct levels: