


Hollywood Facing a Digital Seismic Shift

New digital technologies driving up content library values:
Why MGM is worth over \$5 Billion

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- **The advent of digital technology is rapidly altering the landscape of** studio and entertainment businesses, HDTV technology soon to arrive
 - **Hollywood studios are experiencing rapid increases in the value of their** media libraries driven by the prospect of digital and the new technologies, distribution and markets it is creating
 - **Otherwise rational companies are chasing high priced studio acquisitions** as broadband distribution platforms and new technologies multiply in consumers homes
 - **Studio windows and release patterns are being altered throughout the world** to maximize revenue and reduce piracy
 - **New business models will require investment in digital technologies,** competitive distribution platforms, and more sophisticated rights management applications

Hollywood's Seismic Shift

The film and programming entertainment industry currently stands poised for a seismic shift. This wave of change is generated by rapidly increasing options consumers have to view and pay for most popular TV shows, films, and programming.

The change is spurring sophisticated companies such as Comcast, Sony and Time Warner to greatly increase their exposure to the volatile film business by pursuing costly acquisitions:

- Sony Corp. announced its acquisition of the chronically troubled Metro Goldwyn Mayer Inc., outbidding Time Warner, which jumped into the bidding with another \$5 billion bid. The prize? MGM's massive 4,000 title library of movies, which includes the ever-popular James Bond and Pink Panther franchises.
- NBC, owned by financially conservative General Electric, recently closed its \$5.4 billion deal to acquire Universal Studios and its cable channel assets.
- Comcast's recent \$54 billion hostile takeover attempt was spurred by its desire to control Disney's huge and treasured library of movie, cable content, and distribution for its digital video-on-demand offerings.

Content libraries are the weapons of choice in the upcoming digital warfare. Distributors of all kinds – cable companies, broadcasters, studios, satellite, and Internet companies – are positioning to transform their owned content to delivering digital video services to the home. Armed with massive libraries, distributors are planning to extend far beyond today's technologies.

Digital Technology is Transforming Content Owner Businesses

The advent of digital technology is altering the landscape of the entertainment business, fueling changes in the way television programming is sold and marketed, creating a dizzying patchwork of windows, and altering release patterns globally. From the vantage point of studios and content creators, companies with sales, marketing and distributor relationships are required in order to leverage content in these mushrooming distribution opportunities.

Gone are the days when box office receipts were the sole determinant of a movie's success. Today, theatrical exposure is just one window in the revenue life of a title, continuing a 20-year decline in its relative importance. The Home Video market of rentals and sales of DVD and VHS is a \$26 billion business that barely existed two decades ago. Home Video sales and rentals generate over 50% of Hollywood's revenue, far in excess of the \$9 billion studios grossed at the box office in 2003.

Equipment sales of DVD players are fueling the explosive growth. Nearly 60 million US homes had a DVD player at the start of 2004, up 50% from a year

earlier. Prices for DVD players are declining rapidly, with the average beginning to approach \$100. Declining prices and low international DVD penetration will continue to provide substantial opportunities for growth.

The battle for studios is to get their product, new and old, onto the physical and virtual shelf. New retail outlets on the web are creating new business models. DVD distributor Netflix is utilizing the Internet to reinvent the video rental, and is attracting big-name competition like Blockbuster and Walmart.

Simultaneously, tens of billions of dollars are being invested in constructing, upgrading, and acquiring new broadband platforms to handle the immense bandwidth needed to deliver video content. Consumer demand is rising for movies over these new platforms, as well as for advanced digital equipment and gadgets that increase the use and consumption of movies.

The upcoming battle for the HDTV technology for consumers' homes is reminiscent of the VHS vs. Beta of 20 years ago. In one corner, we have the Blu-ray format, backed by Sony, Philips, Samsung, Sharp, and Hitachi; in the other corner, is the HD-DVD technology, backed by a consortium led by Toshiba and NEC. Now that it owns over half the movies ever made by Hollywood, Sony, following its acquisition of MGM, has a strong voice in the decision for the new generation of home HDTV players, and an added financial incentive.

Alternative Distribution Platforms

Digitization of media has introduced new means of distribution that are usurping existing platforms. Content owners are investing in distribution as never before so they can augment the value of their media libraries.

As the constraints of narrowband evaporate with the widespread adoption of broadband, Internet distribution of movies is growing. Several players are emerging with video on demand (VOD) and subscription services. Companies like MovieLink, CinemaNow, and MovieFlix have created easy to use Internet delivery systems that provide movies pay services for as little as \$9.95 per month, about the same cost as HBO. CNN and the NBA have created news and sports pay services. Broadband content players are pushing to increase their exposure with distribution to cable, DSL and wireless broadband.

Pay-TV supplier Starz Encore has teamed with RealNetworks to launch an Internet-based subscription VOD service. At \$12.95 a month, customers can download 100 movies, which are updated weekly (from Disney, Universal, MGM, Sony, Fox, and others) at starz.com, with features include fast-forward, rewind, and pause.

Cable operators are having a hard time keeping up with demand for digital set-top boxes equipped with Tivo-like digital video recorders (DVRs) and video on demand. High definition TVs, flat panel displays, and home theater sound systems are selling in unprecedented numbers, making them the fastest growing segments in the consumer electronics industry. Effective July 2004,

TV manufacturers were mandated to build digital security cards into sets, eliminating the need for cable's digital set-top boxes.

On the horizon is a new category of personal media players (PMPs) to easily handle music, video, photos, and more. Archos has begun marketing for \$600 a digital video player the size of a PDA with a 4-inch TV screen that can store and play over 120 hours of video. With the added compression delivered with MPEG-4 in 2005, storage capacity will triple. Elsewhere, DVD consumption is being transformed with the advent of disposable, single play disc technology.

As broadband platforms flourish and equipment makers tap into ever expanding digital alternatives, the demand for film, programming and entertainment will expand. Revenue from all streams of motion picture content is expected to grow 60% by the end of the decade to roughly \$65 billion. Content ownership will be the key to tapping into this revenue.

Expanding opportunities for video distribution no longer mean that a poor opening weekend or a short run in the theaters kill the financial outlook for a movie. As Home Video grows with no end in sight and international DVD markets still open, content owners see the future as unbounded. Studios are recognizing the growing interplay between technologies and windows. Miramax successfully promoted its DVD release of "Kill Bill Vol.1", selling \$40 million on its first day, which served to amplify the open of "Kill Bill Vol. 2" a few days later, making it the box office winner for the week.

Studios are realizing content volume and control of global distribution aid the battle against movie piracy, along with digital watermarking and world-wide, same-day premiere dates (The Matrix Reloaded, 2003). Studios continue to lose billions of dollars from illegal copies, but the media industry may have learned from its music industry colleagues. With the advent of digital and broadband distribution, the genie is out of the bottle.

Monetizing the Future

Harnessing this digital transformation will require Hollywood to respond with new business ideas, innovative thinking, and investments in distribution and information technology and models in order to take advantage of the value within its ever expanding film libraries.

The entertainment industry must be ready to provide the same options and utility to consumers who might be able to get for free from an illegal bootleg download. By utilizing technology advances in their attempt to slow theft, media and entertainment companies are radically increasing the operational complexities, while at the same time maximizing the revenue gleaned from each new release and library title.

Media and entertainment firms will realize the value of their content as they leverage new and existing distribution to provide the entertainment consumers desire, without concern for how it's viewed. Consumers are proving the value of content whether they watch it at the local theater or on their own home TVs.

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