MEMORANDUM

SIGHTSOUND.COM

TO: Files
FROM: Alex LePore
DATE: April 12, 2000
RE: Company Stock Valuation

Background:

SightSound.com Incorporated (the "Company" or "SightSound.com") electronically sells films, music, and other video and audio recordings over the Internet ("Entertainment E·Commerce") as a retailer and Download Service Provider ("DSP").

In 1988, Arthur R. Hair filed for patent protection on a method and system to electronically sell and distribute digital video and digital audio recordings via telecommunications lines. On March 2, 1993, Mr. Hair received United States Patent 5,191,573, " Method for Transmitting a Desired Digital Video or Audio Signal". On October 7, 1997, Mr. Hair received United States Patent 5,675,734 as a continuation of Patent 5,191,573.

The Company (formerly known as Parsec Sight/Sound, Inc.) was incorporated on August 1, 1995, with Mr. Hair and Scott C. Sander as the sole shareholders. Also on August 1, 1995, Mr. Hair assigned Patent 5,191,573 and Patent 5,675,734, to the Company. The Company then entered into an Exclusive Patent License Agreement with Digital Sight/Sound, Inc. granting to Digital Sight/Sound certain exclusive rights to Patent 5,191,573 and Patent 5,675,734. Digital Sight/Sound was also incorporated on August 1, 1995, with Mr. Hair and Mr. Sander as the sole shareholders. Effective as of August 15, 1997, Digital Sight/Sound and the Company terminated the Exclusive Patent License Agreement, as amended, and replaced it with a Nonexclusive Patent License Agreement, granting to Digital Sight/Sound certain nonexclusive rights to the Patent claims. The Company then commenced a licensing program. On April 1,1999, Digital Sight/Sound was merged into the Company and the Company was renamed SightSound.com Incorporated.

As a limited demonstration of Entertainment E·Commerce, Digital Sight/Sound signed the band, The Gathering Field, to an electronic distribution contract on August 18, 1995, and, on September 27, 1995, Digital Sight/Sound became the first company to practice Entertainment E·Commerce and offer for sale digital recordings in download fashion via the Internet. Upon expiration of the Company's contract with The Gathering Field, the band signed a recording contract with Time Warner's Atlantic Records.

The Company envisions Entertainment E·Commerce as a "platform change" to stimulate the growth of the movie and music industries as well as the marketplaces for owners of other forms of video and audio recordings, and to provide the end customer with video and audio entertainment in a highly efficient manner. The Company is a download distributor and retailer of video and audio content such as film and music

The Company sells motion pictures in download fashion to Internet users. The Company also "rents" films over the Internet by offering the customer the opportunity to view a film a limited number of times or for a limited time period. The Company first began renting a full-length motion picture movie, "Pi", on April 13, 1999, pursuant to a license agreement with Artisan Entertainment.

As of February 1, 2000, the Company had approximately 135 films for sale or rental on its web site with over 90 additional titles under contract, being prepared for Internet distribution. The Company is currently in discussions with a number of companies about obtaining the rights to distribute other motion pictures over the Internet and anticipates that, through these discussions and the negotiation of additional license agreements, additional pictures will become available for sale on a continuing basis. The Company plans to issue a significant number of shares of its common stock in order to obtain such rights.

The Company also sells music in download fashion. As of February 1, 2000, the Company has the right to sell music from over 40 different CDs featuring over 30 different artists. The Company intends to offer audio-only nonexclusive patent license agreements to potential licensees desiring to conduct Entertainment E·Commerce involving audio recordings. This licensing program is part of an Intellectual Property Protection Program now being implemented by the Company to protect and advance its intellectual property position in the emerging Entertainment E·Commerce music industry. The Company is a development stage company and its business is new and evolving. There is no assurance that its business or any of its relationships or activities will be successful or profitable.

Pre 1999 Business & Financing Activities:

From March 1996 through March 1998 the company raised equity from a number of individual investors through a Private Placement Offering. The investments ranged from $0. 11 a share to $0.15 a share. It was clear over this period of time that the company's value did not change dramatically. In fact, the company attempted to launch several different music distribution strategies from 1995 to 1998 only to realize **less** than $600 in **gross revenue** for the entire three-year period.

From its inception through 1998 the Company solely focused on the music business. It was clear from numerous meetings and proposals that the major industry players were not prepared to distribute their products in digital fashion. The music industry is relatively consolidated with 76% of global music sales controlled by the five major record labels: Universal/PolyGram, Time Warner, Sony, BMG, and EMI. Thus, without an agreement to distribute music for the major labels the company concluded that its ability to be successful was severely limited. The company's attempt to become a successful music content retailer and DSP included pursuit of the following strategies;

- The company initially attempted to sign artists to agreements whereby the company would distribute the artist's music directly over the Internet. This did not prove successful since the only bands likely to enter such an agreement are bands that are not under contract with a record label. Successful artists are unlikely to distribute music directly to consumers since the traditional promotion and distribution clout offered by the recording industry is still very much valued and clearly needed to become a successful artist.

- The company approached record labels about outsourcing their Internet distribution strategy by permitting SightSound.com to sell music digitally in exchange for a thirty percent royalty payment. Alternatively, the company offered the labels a license on the use of the company's intellectual property. Some labels seriously considered the offer but ultimately rejected the notion to have their content digitally distributed for several reasons. First, the labels were afraid that the encryption would be hacked resulting in the free distribution of illegal copies. Secondly, the companies did not believe that SightSound.com's patent was valid. Third, the record labels prefer to distribute music without using a third party service provider.

- The last strategy the company pursued was to "produce" special music content, such as its Microshows®. Again, the company was not able to win the timely cooperation of the record labels or individual artists to successfully launch the strategy.

In the meantime other companies emerged in the digital distribution business. These companies were clearly competitive threats and in many cases found to be infringing on the use of the company's intellectual property. SightSound.com offered the companies considered to be infringing a license agreement. No one agreed to become a licensee. The companies either believed SightSound.com's patent claims did not apply to their specific method of doing business or that the patents were not valid.

During this period the company did receive good news that it believed to improve its overall value. On October 7, 1997, the company received notice of its second patent, "System for Transmitting a Desired Digital Video or Audio Signal." Even though the patent was issued prior to certain equity transactions in early 1998 the share price of those transactions was unaffected for two reasons. First, the underlying private placement memorandum had been issued prior to notice. Secondly, the company needed to more fully understand the implications of the patent notice.

Early in 1998 it became clear that the company had to aggressively protect its patents to protect its position in the industry. On January 23, 1998, SightSound.com filed a patent infringement suit against N2K, Inc. in Federal Court. Since that time, CDNow, Inc. has acquired N2K, Inc. SightSound.com anticipates that upon successful defense of its patent rights, other companies will eventually stop their infringing practices or, when appropriate, will execute a Nonexclusive Patent License Agreement to provide certain rights to legally practice Entertainment E·Commerce using the method and system protected by Patent 5,191,573 and Patent 5,675,734. However, in the event an infringer fails to execute a Nonexclusive Patent License Agreement, SightSound.com expects to defend its intellectual property vigorously, through litigation if necessary and will permanently enjoin such an infringer from practicing Entertainment E·Commerce.

SightSound.com intends to offer Nonexclusive Patent License Agreement(s) to potential Licensees desiring to conduct Entertainment E·Commerce for audio only. SightSound.com does not currently have plans to offer Nonexclusive Patent License Agreement(s) to potential Licensees desiring to conduct Entertainment E·Commerce for video applications. This licensing program is part of an Intellectual Property Protection Program now being implemented by SightSound.com to protect and advance its intellectual property position in the emerging Entertainment E·Commerce industry.

The company concluded in 1998 that the second patent greatly increased its value. The second patent was applied for in the form of a continuance of the original patent.
The purpose of the second application was to request that the Patent and Trademark Office ____________________________________. Furthermore, when an application is submitted to the PTO in the form of a continuance the applicant must alert the PTO of any "prior art" submitted to the applicant by a party who believed the applicant's patent to be invalid. Philips Electronics had notified the company of what it believed to be applicable prior art. The prior art was included with the company's application. The PTO considered the submission and

determined that the referenced items were inapplicable to the first patent. The PTO maintained that the original patent remained valid and issued the second patent.

Late, in 1998 the company raised more equity to continue funding new music distribution strategies. Even though the company did not have any success with the record labels up to this point the company continued to believe that a deal with a major label might be feasible based on its intellectual property position and the technological architecture it developed to this point. Based on this assumption the company raised its share price to $1.50 a share for a private placement offering it held from November 1998 through March 1999.

Business & Financing Activities Since January 1999:

January to April Unfortunately, the music industry opportunity never materialized. The music industry was being undermined by illegal distribution of music recordings via the Internet. SightSound.com had worked behind the scenes with major record labels from 1995, through 1998, in an attempt to educate them on the benefits of digital distribution and convince them to embrace Internet distribution as a method of choice for music. By early 1999 their refusal to adopt electronic commerce methods promoted by SightSound.com led to an explosion of piracy of musical recordings using the now popular MP3 format and numerous competitors leveraged interest in this music piracy to enter the music industry as "new record labels."

SightSound.com believes that over the next several years, order will be restored to the global music industry as intellectual property and copyright laws catch up with the capabilities of the Internet as a distribution medium. In the meantime, SightSound.com turned its attention and focus to providing the motion picture industry with its first line of defense against Internet piracy of motion pictures. Namely, the widespread availability of legitimate motion picture downloads to provide consumers with a legal alternative to Internet piracy.

In early 1999, SightSound.com was approached by the Microsoft Corporation, which disclosed the capabilities of its new video compression algorithm to compress video recordings to a size, which provides the same opportunity for digital distribution of movies that had previously been enjoyed by music. SightSound.com recognized a substantial risk that the motion picture industry would succumb to large-scale piracy just as the recorded music industry had. To preempt this possibility, SightSound.com dedicated significant resources to the development of a massively scalable electronic commerce capability for motion pictures. In essence, the company, believing a tremendous music distribution opportunity was available since it had received the second patent, found instead that it basically had to mortgage its future on a video distribution strategy that did not exist until the Microsoft discussions occurred.

From late January to April 12, 1999 the SightSound.com dedicated itself to becoming the first company to offer a full-length major motion picture for download sale. On April 13, 1999 the company achieved its mission when it made the movie "Pi", a film owned by Artisan Entertainment, available for rent or sale in download fashion over the internet. Artisan entered into a one-month distribution agreement. The company had slightly over 200 orders for the movie. The availability of a movie for download sale was designed to coincide with the April 13 release of Windows Media Technologies 4.0. The event drew tremendous attention from the entertainment industry and marked a definitive change in the Company's strategic direction.

May to August 1999 Immediately after the movie launch the company set out to raise additional capital. The setback it had suffered in not securing distribution or license agreements in the music industry was offset by the new opportunity that presented itself in video content distribution. The company had exhausted nearly all of its resources in preparing for the April 13th trial. The company determined that it would aggressively pursue the movie distribution strategy.

The company set out to raise twenty million dollars in a May 1999 Private Placement offering. The share price increased to $2.00 per share. The company felt this was an appropriate valuation. Even though a commercial music distribution industry as envisioned by the company had not yet materialized, the company believed the movie distribution opportunity that now emerged had greater economic potential. The Company also believes that an opportunity on the music side will materialize if the current piracy practices are properly dealt with.

SightSound.com recognized a substantial risk that the motion picture industry would succumb to large-scale piracy just as the recorded music industry had. To preempt this possibility, SightSound.com concluded it had to dedicate significant resources to the development of a massively scalable electronic commerce capability for motion pictures. The company estimated that it needed at least twenty million dollars to begin executing on its plan.

From May through the end of 1999 the company raised slightly over twelve million dollars. The proposed use of the funds included

- the expansion of its next generation technological architecture
- the defense of its intellectual property
- the ongoing cash burn rate for the sales, marketing, and administrative costs

Early in the offering period approximately $2.2 million was raised. Investors clearly understood the market potential and the quality of the SightSound.com solution. Many potential investors were concerned about the lack of available compelling content. The company designed a valuable technology solution. With consumer technology (i.e. high speed internet access, faster PCs, initial development of "smart TVs") well on the way available content was the key missing ingredient.

In June 1999 the emphasis on raising capital was reduced and the company's CEO, Scott Sander moved to California for the summer. From June through August Mr. Sander pursued countless business deals to secure the digital distribution rights to motion pictures. By September 1999 the company had slightly over 100 titles under contract. The titles were largely unknown productions from independent film producers. Although we did not have high expectations that the films would sell well, any sale was important to the company since it proved our business model: that consumers would pay for content. This is a radically different notion than having the content available for free through an advertising supported sight. While an advertising model might be more "financially successful" in the short term it is clear to the company that a revenue model that looks more like traditional video stores is better in the long term. Thus, we initially expected few sales that would teach the model. **In fact, from September through December 1999 the company had a total of 960 sales that generated $3,179 in gross revenue.**

Mr. Sander's summer long pursuit yielded titles to jumpstart the September relaunch of our website and inroads with all of the major studios. While negotiations with most of the major studios appeared to progress well it was also clear that we would not receive compelling studio produced content for quite some time.

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