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DDMG - Digital Domain Media Group Inc Fourth Quarter Earnings Conference Call

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CORPORATE PARTICIPANTS

John Textor *Digital Domain Media Group - Chairman and CEO*

Shannon Burns *Digital Domain Media Group - VP, IR*

John Nichols *Digital Domain Media Group - CFO*

Jon Teaford *Digital Domain Media Group - CEO Digital Domain Institution*

CONFERENCE CALL PARTICIPANTS

Richard Ingrassia *Roth Capital Partners - Analyst*

Todd Truitt *Luther King Capital - Small Cap Analyst*

John Tinker *Maxim Group - Analyst*

Morley Sankar *Janney Capital - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to the Digital Domain Media Group Fourth Quarter Earnings Conference Call. At this time all participants are in a listen-only mode. Later we will facilitate a question-and-answer session, at which time you may press star one to participate.

(Operator Instructions)

As a reminder, this conference is being recorded for replay purposes. I would now like to turn the call over to Mr. John Textor, Chairman and Chief Executive Officer. You may proceed.

John Textor - *Digital Domain Media Group - Chairman and CEO*

Hi. Thank you, very much. Thank you, everyone, for being on the call. I'm joined here today with both Jonathan Teaford, our outgoing CFO who is now CEO of our Education Division, the Digital Domain Institute. I'm also joined by John Nichols, who is our new Chief Financial Officer, who's going to be delivering the financial results. Both gentlemen, of course, are available for questions and answers.

We are obviously excited to have completed our first full quarter as a public company and today we're going to talk about our financial performance and bring you up to date on some major milestones in what we plan to do going forward.

With regard to our financial performance, obviously we are pleased to have met expectations from an accounting perspective, even beaten expectations, but it's no great surprise to see our fourth quarter numbers when we completed our IPO in the fourth quarter.

So I think what is more relevant are some of the things that we've done in the fourth quarter and in the recent months to position ourselves for growth and for delivery of our plans. We have exceeded expectations in a number of key categories.

We have a business plan that is intended to grow our core business while leveraging that core business and the more lucrative business opportunities. And it's certainly true that we made a lot of promises about what we want to do with this business and how we plan to grow. It's also true that we've really exceeded even our own expectations in the first few months, and I'm going to run through that with you really in detail after John delivers the financial results.

In summary, we're going to talk to you about our Visual Effects business. We have a significant backlog that's grown by 55% over where it was a year ago, so we've positioned that business to grow. Our Education business started classes a few weeks ago. We've strengthened our management team, and we've leveraged the education model into several attractive situations in some of these overseas markets that we'll talk about.

Our Content business -- we've signed some major agreements very early, ahead of expectations, in co-productions, finance, and distribution. That's one of the big questions you get when you are launching a new animation studio, launching a new animation film -- the question you always get is, well, what are you doing for distribution?

And so to have locked down in China, the biggest market outside of the US this far in advance of the film. Bringing on a partner like Galloping Horse for financing distributions is a terrific thing, and that's ahead of schedule by a long shot.

Ender's Games -- Some of you have heard about this film, especially those of you who follow Lionsgate. Certainly a lot of inbound calls regarding Ender's Games have been coming in since Summit Entertainment, our studio partner on that film, was acquired by Lionsgate. And we are obviously thrilled with the early excitement, not really in the financial markets but just in the consumer market, over that very important book finally coming into the theaters.

We've been able to expand our interest in that film while still maintaining a very comfortable position of mitigated risk. I'm going to get granular with regard to Ender's Game and really walk you through what we own and what it means to us at various levels of box office.

And with regard to some of our overseas initiatives, we've had really -- by necessity,-- we've had to pursue government grants and economic incentives to grow our business in the US market when there was no capital to be found in the years 2008 and 2009. But that has really continued nicely as we look to the Middle East and to China.

The opportunities there are proving better than expected, where the support of foreign partners in governments has led to the economic development packages and opportunities of a much grander scale than I think even we expected. We're going to explain exactly what this means to our business. There's a lot of curiosity about this, but there's also a lot of confusion about this.

Is our business taking money in other countries so we can just grow in a new business as well? Really, just the businesses we've already identified.

And what we are going to talk about as we go through the numbers for these grants and opportunities is how they impact our core business, how they allow us to save money as we expand our global footprint of high quality animation at the lowest possible cost, and how these economic incentives flow right down to the bottom line in support of the business model that we've already laid out for you. We'll go into that in some detail.

First, though, the order of business is to run through the financial results for the fourth quarter and now I'll turn it over to John Nichols. I apologize -- first, Shannon Burns, who's with us in investor relations, is going to talk to you about the Safe Harbor Statements and forward-looking statements.

Shannon Burns - *Digital Domain Media Group - VP, IR*

Good morning. Certain statements made during this call will constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements include comments about the company's plans, prospects, strategies, and future performance.

They are made on the basis of our management's current expectations and the belief as well as a number of assumptions regarding the future advance and business performance as of the time the statements are made.

Such forward-looking statements are subject to known and unknown risks, uncertainties, assumptions, and other important factors including those identified in the Safe Harbor Statement that is part of today's earnings press release that is the subject of the conference call and webcast, many of which are outside the company's control.

These could cause actual results to differ from results expressed or implied in the forward-looking statements. Such differences may result from actions taken by the Company as well as developments beyond the company's control.

Further information on factors and risks that could affect our business is included in the filing we make with the Securities and Exchange Commission from time to time, including under the heading Risk Factors on our form 10-K filed March 30. These documents are available on our website at www.ddmg.co.

This conference call and webcast also contain non-GAAP financial measures. A reconciliation of the non-GAAP measures to GAAP measures is provided in today's earnings release. All information provided in this call is as of April 2, 2012, and the Company undertakes no obligation to publicly update the information contained in this call or any forward-looking statements to reflect new information, events, or circumstances or to reflect the occurrence of unanticipated events.

As a last note, please remember that members of the media present on the call are in listen-only mode. Now, I'll turn it over to John.

John Nichols - *Digital Domain Media Group - CFO*

Thank you, Shannon, and thank all of you for joining us today for our update call to discuss recent events in our fourth quarter earnings. Some of you may have already seen the financials released in the 10-K on Friday and the release this morning, so I'm just going to quickly recap the main numbers and then talk about a few key metrics.

The Company reported net income after non-controlling interest of $8.5 million, compared to a loss of $23.6 million in the fourth quarter of 2010, as the non-cash adjustments related to financing instruments swung from a negative to a positive, driven primarily by non-cash debt and warrant-related income of $32.9 million.

This was caused in part by the conversion of $16 million of debt and the exercise of a large number of warrants at the time of our IPO that contributed to a $111 million reduction in our liabilities. Aside from the numbers, we view this as a positive event, as our going-forward financial results will be much less affected by the large non-cash impacts that tend to distract from real operating numbers.

Adjusted EBITDA was a loss of $12.2 million, compared to a loss of $9.7 million in the third quarter of 2011 as we continue to invest heavily in our new businesses in Florida, which include our original content Feature Animation Film business and our Education business. Prior to this, the company reported positive EBITDA of $7 million in the fourth quarter of 2010.

Fourth quarter total revenues were $21.1 million, an increase from $16.6 million in the third quarter and a decrease from $31.7 million in the comparable quarter of the prior year. The increase from the third quarter to the fourth quarter is due to our ramp-up of work on existing projects and to the initiation of additional feature film projects.

The decrease from the prior year is due to the fact that the company was working on several large contracts in the fourth quarter of 2010 including Tron - Legacy. While we ramped up our work on several large projects in the fourth quarter of 2011, the schedule of shots completion and related revenue recognition on those new projects it did not equal the timing of revenue recognition of Tron - Legacy.

One of the key metrics for our business is our backlog. This consists of projects for which we have either begun receiving revenue or have reserved capacity as allocated resources. Our backlog was $122.7 million as of March 31, 2012, an increase of 55% from $78.8 million at the comparable time of last year.

This growth reflects an increase in revenue reflected by feature film contracts that we are either currently working on or have been awarded by customers and is an indicator of the type of growth that we expect in our feature film revenue in the current year. We do not disclose backlog for television commercial work, as that business operates with less forward visibility than our Feature Film business. Historically, our Television Commercial business has generated approximately $20 million in revenue annually.

As we look at the efficiency with which we deliver projects to our customers, we break our cost of revenues into three components; direct cost of revenues, unutilized labor and production, and other expenses. Direct cost of revenues reflects the cost of our employees that are producing work for our customers. We monitor our direct cost of revenues as a percentage of revenues, a metric that we refer to as our gross margin.

In the fourth quarter of 2011, our direct cost of revenues included a $3.3 million charge for work performed on a film project that has been declared inactive by its primary production company. Therefore, it was appropriate to write-off this amount. This was an unusual situation. We have never before written off an amount like this for a film project that we stopped working on. John will talk in a bit about the circumstances and the possibility that this film might still go forward. For my part, I'll focus on the financial accounting impacts. When we adjust our direct cost of revenues in the fourth quarter for this one-time write-off, the gross margin in our Feature Film business was 35.7% a drop from 30.6% in the fourth quarter last year.

For the full year 2011, our gross margin in our Feature Film business was 40.7% versus 30.7% from last year after adjusting for this one-time write-off.

The gross margin for our Television Commercial business declined from 44.5% to 35.1% in the fourth quarter of 2011 from the fourth quarter of 2010, and declined from 37.6% in 2010 to 35% for the full year 2011. This is a smaller line of business for us and we are focused on managing this gross margin as we move through 2012. Frankly, we believe anything above 35% in this business represents solid performance and this business performed as expected in the quarter and the year.

Another metric that deserves some explanation is unutilized labor. As was the case in the third quarter, the profitability of the company in the fourth quarter was predictably impacted by charges for unutilized labor, as we built the infrastructure and trained the workforce at our new animation studio in Port Saint Lucie as a brief preamble.

This is exactly what we promised to do when we applied for and received significant grants and incentives to build our business in Florida. The grants were intended to train a workforce that was not yet [trained for] high-end revenue projects, and that's exactly what we've been doing. The cost of unutilized labor peaked at $5.6 million in the recent quarter versus $3.8 million in the third quarter, and versus $1.1 million in the full year of 2010.

This increase is also due to our decision to retain our trained and experienced labor force in anticipation of future projects, including those projects in which we hold an ownership stake. Unutilized labor also includes a substantial amount of our staff in our Florida studio that wasn't trained early in 2011, but now is trained to a sufficient level to deliver projects for customers. We expect these costs will be lower on an annual basis in 2012, as these employees are assigned to revenue producing contracts.

The cost of unutilized labor is substantially funded by grant revenue and economic incentives. However the revenue from those programs must be recognized over the time span of the associated grants and incentives, while the costs are incurred upfront. This timing has had a negative impact on our results for the past few quarters, but in the future we will record the grants and incentive payments (inaudible) and have minimal incremental training costs to offset it.

At the end of 2011, we had over $33 million in grants recorded on our balance sheet as deferred revenue. These reflect grants that we have received and will record on our P&L over the next several years. In addition, our existing grant agreements call for us to receive another $28 million in cash grants as we meet certain milestones over the next four years.

The final component of our cost of revenue is our production and other costs. This amount declined by $0.5 million to $18.8 billion in the full year 2011 from 2010. Production cost in 2011 included a $1.5 million charge related to the production project written off discussed in (inaudible) or effectively the abandoned project that I discussed earlier.

To reiterate what we have described previously, the long-term model that we are working to achieve involves a fully utilized level of revenues such that unutilized labor is close to 0% utilizing box office participation to drive our direct cost of sales to near 50% of sales, and managing our production and other costs efficiently.

In this model, we believe that we can achieve total cost of revenues of less than 70% of sales, representing the total gross profit of more than 30% of sales. In the fourth quarter of 2010, when our unutilized labor was only $0.25 million, we generated $7 million in adjusted EBITDA.

As we grow our sales to support our unutilized labor, we believe that we can generate substantial amounts of quarterly adjusted EBITDA during the second half of this year. We believe that are 55% increase in revenue backlog bodes well for improvements in our profitability.

I would also like to call attention to SG&A, which increased substantially from the prior year given the stock-based compensation expense that was recorded. When stock-based compensation is removed, our SG&A for the fourth quarter increased by only $3.4 million from the fourth quarter of last year, a relatively small increase considering the significant expansion of new business divisions.

Our adjusted EBITDA for the fourth quarter was a negative $12.2 million, compared to a profit of $7 million in the fourth quarter of last year. This decline is primarily due to the drop-off of Tron - Legacy revenues and the Florida-driven increase of unutilized labor, production costs and cash-based SG&A.

A reconciliation of net income to adjusted EBITDA is provided in this morning's press release. Again, we would like to highlight the fact that our grant receipts, which were secured to fund the Florida expansion, have substantially outpaced our adjusted EBITDA losses, which show the upfront expense of this expansion.

For example, our adjusted EBITDA loss for the entire 2011 year was $22.3 million, while we're still holding in deferred grant revenue a total of $33 million. This grant revenue paid for expansion in Florida and will be recognized into income over the coming years.

Comparing the balance sheet at yearend to the balance sheet at the end of the third quarter, the impact of our IPO is obvious. Warrant and other debt-related liabilities were reduced from $138 million to $27 million, while cash and our cash equivalents increased from $10 million to $29 million.

Now I will turn the call back over to John Textor, our Chairman and CEO.

John Textor - *Digital Domain Media Group - Chairman and CEO*

Great. Thank you, John. I do want to reiterate a few things from his financial presentation. Those of you who have heard us talk about this in the past understand that we really tried hard to describe the transition a business is making from private to public -- had to deal with significant amounts of non-cash charges on really the increasing value of our stock price from the earlier days of the private company to the last private round before going public, just a few weeks before going public, at a $9.63 price, and how the rise in that stock price had such a dramatic impact on the non-cash charges.

Obviously, sophisticated investors are used to seeing this. It has made the picture very murky. What's also made it murky historically is the very unique situation we are in -- that there really is not a lot of accounting literature out there for small for-profit companies that are so heavily funded by grants and public incentives.

We, of course, have chosen the appropriate accounting method; it's the conservative accounting method and it shows. We have to show the expansion costs upfront, and when you come to a place like Florida, there aren't just thousands of visual effects and animation people standing at the ready, both from the minor leagues to the major leagues, overnight.

Our business model when we came to Florida, which is what we are telling you now, is consistent with what we told the legislature -- that we are going to have to put people on full salary for many, many, many months to train them to be good enough to do Digital Domain quality work. We're not talking about taking kids out of digital labs and helping them to build websites. We're talking about doing the finest work anywhere in the world -- the kind of work that you see in the top tier of our visual effects industry.

What we asked for were grants from the state of Florida to help pay for this. And what we've done is deliver on our promises to the taxpayers, and we've done so consistent with our business model. But we have to show the expenses of all of this launch upfront, while the revenues from the grants that it helped to offset that we have to show over time.

The good news is now we are at a point where the Florida studio has really been producing some incredible work - 3-D work for Transformers 3, 3-D work for The Smurfs, traditional visual effect work for Girl with the Dragon Tattoo and Rock of Ages. So these people we took right out of local schools, right out of the base-level digital media industry, they've now been trained and they are doing incredibly high quality work.

Some of you up in New York, if you happen to be a New York Mets fans, are going to see incredible in- game visuals that have taken a new step as compared to anything you'll see any ballpark. Well, that's the work of Digital Domain occurring out of this Florida studio, being done by professionals who were students only a year ago.

We've done really high quality work for feature films, and we are now doing really high quality work for special venue projects, as you'll see every single game every few innings at Citi Field this year.

That's kind of where we are. To have gotten through this year with an effective adjusted EBITDA loss in the low 20s and to still have deferred grant revenue of $32 million, close to $33 million, it means that we've actually received more in grants then we have burned in training of these people across 2011.

Now we're at the point where they are revenue-ready. They are extremely high quality and a good part of them also are on The Legend of Tembo, which we are going to talk about in a moment because that's proceeding on schedule, and now it's taking a new step into its first third-party validated co-production agreement.

So, we are happy to have transitioned from private to public. We are happy in the fourth quarter to finally see all those warrants convert and get to a position where we don't have the murkiness and going forward mark-to-market accounting. And we are also thrilled to have gotten through the period of training, where the people here in Florida are now revenue-ready, producing revenues and also commissioned on building assets for original content on films like Tembo.

As far as future grant revenues, let's just say we've gotten a little bit smarter about how to structure these things. What causes difficulty for us right now is that the revenues we brought in from the state of Florida we have to count over a long multi-year period because that tracks the relationship and monitoring that we have with the state of Florida.

But as we look at these grants or economic development packages in other markets, they are really more likely to be recorded either as revenue or contra-expense. So you are already going into a foreign market, you're developing high-quality animation and visual effects capacity for a business that's currently growing. So that's a really good thing because you're going into a lower-cost environment.

And you're doing one better - you're partnering with the local government, making good trades that are good for their efforts to develop industries. And they are helping with these economic incentives to reduce your costs even further, in a market where the labor rate is already substantially lower than it is in Los Angeles or in other places in North America. So, that's just a bit of a wrap-up on his financial discussion.

I do want to talk about our individual business segments, and really what's happening there. The Visual Effects business, at times we've called it the core business, the platform business. One of the analysts on this call actually referred to it -- and I'm happy about this - as the legacy business. Because as much as we love doing incredible visual effects work, a work-for-hire business is really best used as a platform to get into these other markets, frankly, where work is inspiring in the education space, the content creation space.

It's leveraged -- we've leveraged it into co-production opportunities like Ender's Game, and certainly also a military simulation and surgical simulation, as we grow that business in large part in collaboration with the Education business.

So, to call it the legacy business in some sense makes a lot of sense, though the legacy business is still positioned nicely for growth. It does have a stair-stepping pattern to growth, where the flat spots come between big projects and the growth comes with the addition of new projects, but it is growing in importance to the industry.

It's growing for us because we're getting increasingly prominent positions in films and leadership roles in films, and we've got a revenue backlog of $123 million, which is a 55% increase over where it was a year ago at the same time. So, we are happy with where that's going

The Education business -- a couple of updates there. Classes did start just a few weeks ago on schedule. We have strengthened our management team there in two ways. One is the transition of Jon Teaford, our former CFO, over into the role of CEO in the education space.

He's here in the room with me and he doesn't often hear me compliment him, but he was an operating partner with me for so many years. To have him in the CFO position was terrific, he did a great job there, but it really limited his ability to operate and drive the launch of the Education business. So, we are thrilled to have them over there, and obviously thrilled to introduce Nichols in the CFO spot, where he's got great experience in public company accounting.

The other addition to the senior management team there is Ray Dubois. His bio you might have seen in our S-1, He is a member of our Board of Directors. He was known as the mayor of the Pentagon, the guy with senior operating control over the Pentagon. That's a pretty big job. He did that under two Bush administrations very successfully. Prior to that, he had a background in software. He had a background in education. And he's got a Rolodex better than any college president we seen. He has come on full-time in the role of Vice Chairman of the educational initiatives, supporting Jon Teaford as we launch that business.

What's interesting about putting Ray in that spot is we've really looked at military simulation and surgical simulation as research-based initiatives that are, frankly, very well positioned to be nurtured and incubate within the educational institution.

We expect to have our first contract and military simulation in 2012; a relatively small contract in the world of military simulation, but the kind of contract that we think can lead to significant things. And to have that aligned with the educational collaboration, where we have access to research grants and that kind of work, is a really good thing.

So the Education business -- we've also long talked about that it is one of the most predictable growth parts of our business model and one of the most valuable. Keep in mind, there are some comparables in the space, where they are teaching kids to dream about working for companies like Digital Domain and, frankly, their cash flow is greater than our current revenue.

So, we think the entry of Digital Domain in that market with a seasoned team, with a great partner in Florida State University, where the reason we are having early success and acceptance within the educational community is that we've proven we care, frankly, more about the kids and their future than what you're seeing in the for-profit space. And we found a perfect trade-off between the needs of American companies and industries to reduce costs and the needs of students to dramatically increase their experience.

In terms of strategic interests within the Education segment, we are in touch with a number of significant companies, some friendly competitors, some within our industry, close to our industry, within the film industry, the video game industry, that really like what we're doing, and have asked to structure partnerships with us and plug into the University. So, expect to see some activity and significant announcements and major companies giving us a nice third-party validation of our business model over the next quarter.

The Content business -- the key news here is Tembo. As I said at the beginning of this call, it's a really big deal when a film company of great credibility in a market of great size comes along and says not only do we want to co-produce this film, we'd like to invest in this film and we'd like to purchase the distribution rights for a major territory.

And, of course, there are a lot of ways to structure distribution deals, but generally speaking, the deal with Galloping Horse Films which was executed just this last week, is an investment in the film. It is distribution for all of the territories within the People's Republic of China. The timing has really nothing to do with the end of the quarter; it's in anticipation of the very well attended Beijing Film Festival that occurs later in April. It is comprehensive across all exploitation of this film. And we are thrilled because Galloping Horse has a great reputation and great reach in that market. And they are also committed not only to invest and to pay for the initial amounts of the distribution agreement, but they are also committed to provide the P&A, the promotion and advertising, in that market.

So to lock down a territory as large as China this early in the process with The Legend of Tembo, allows us to answer a key question that you get from people you are recruiting to complete the film to other distributors to studio partnerships to the extent that we want to go forward with some of those. The question is always, well, who's distributing it for you? So, that question has been answered in China well ahead of schedule, and we are thrilled with that.

By the way, at the Beijing Film Festival expect to see significant announcements associated with China's support for this, not only with Galloping Horse Films, but with the governments there in China. The Legend of Tembo has a China backdrop to its story so we are looking forward to that.

Ender's Game -- probably this story we are getting most questions about and, again, I think that's probably stems from the fact that our studio partners, Summit Entertainment, which was a private company is now effectively public with this leadership of Summit Entertainment having significant roles at Lionsgate.

So, yes, we are also announcing today and really for the first time that we've executed an amended and expanded investment and production agreement with OddLot Entertainment, who is the primary producer of that project. They've been our co-production partner really since the beginning, and we are thrilled that they invited us to be a part of this at the beginning.

It puts us up at a 37.5% interest in the film. And, of course, that agreement gives us rights to the first film, the sequel, certain gaming rights, and obviously we hope a future that goes well beyond that.

Let's talk about what this actually means to us. It was originally about an $80 million budget for production. I think we are all pleasantly surprised when the casting momentum really became significant. And so, we decided to expand the budget from $80 million to roughly $100 million. It's led by Harrison Ford, Viola Davis, Ben Kingsley, Asa Butterfield, Abigail Breslin, Hailee Steinfeld.

Every one of those individuals are either Oscar winners or Oscar nominated. So that kind of energy, especially led by some of those big names, has really caught the attention of a lot of people, and this film seems to be positioned very well to be a tent-pole production. It will look like one of the biggest films you've ever seen, but at a budget of $100 million, certainly the cost is far less than you would expect from some of the tent-pole films.

We are excited about where we are with Ender's Games. Let me just give you some numbers -- the visual effects budget is roughly $37 million in revenues that will come from the production company back to our company. We did that on a deferred margin basis where our margins recovering that at certain levels of box office can be as much as $13.5 million.

Just to give you a sense -- I hate to project anything, so I'm giving you a range of box office from abject failure to pretty healthy, but not even extremely high. Let me give you a sense for what we would bring in based on those economics of that film. This would include domestic box office rentals, video, television, non-theatrical, and the foreign.

Keep in mind, this film was pre-sold to foreign for about $44 million. So, one of the reasons we got so much energy with the studio is we took a test piece to the Cannes Film Festival, showed it to a roomful of people, and within a very short amount of time had really sold out pretty much every country in terms of foreign distribution. So that brought back a $44 million number that we got to use -- apply to our $100 million budget to reduce the risk of the film.

To the extent the film -- and by the way let me caution you that anything you talk about in rentals, video, TV, this is an ever-changing landscape in the film industry, and so we've taken conservative assumptions on this. And you can't really remind anybody and not that you need to be conservative in the space, as the world that we look forward to a digital distribution is having a dramatic impact on some of the traditional projections of distributions as we see it today.

However, we do think that the net value to filmmakers making films is not really going to decrease, it's just going to change in form. If the film does $60 million at the domestic box office, dare I say a number that low, that is beyond abject failure for a film anticipated like this, we would have total proceeds, that when combined with our initial outlay of $18 million, we'd lose about $6.8 million.

If the film does domestic box office of $80 million, we'd have total proceeds that would come in from these various sources of an amount that is just less than that $18 million, and so we'd lose about $1 million. Now an $80 million domestic box office still, in my opinion, for a property as powerful as this still falls into the category of abject failure.

If it does $115 million domestic box office -- still pretty disappointed. We'd make about $9.5 million. At $150 million of domestic box office - disappointed, but healthy-- we'd make about $22.5 million. At $200 million of domestic box office, we'd make $36 million. At $250 million we'd make $43 million. Both of those numbers I wouldn't say are on the high-end like this, but obviously we'd be very happy.

Why do I go through those numbers? Well, it's the question we get most often. What does this mean? Well, it's important to understand qualitatively it means a few things and quantitatively I just ran through some assumptions for you. Those are obviously just projections.

Qualitatively, what does it mean? Well, this is an example of how you can use Digital Domain as an engine for co-production partnership to dramatically enhance our profitability, while still doing the same kind of work that we've done for years.

This started with a test really early on in story development; the kind of test that looks so good it allowed us to convince foreign distribution arm in arm with the (inaudible) and the people at OddLot that so wonderfully brought this film to us.

It allowed us to demonstrate what the film might look like, to bring in that foreign distribution to develop energy and we've, of course, been active in development with it ever since. So, this is the first example of Digital Domain venturing out into content creation, and what a great example, what a great book, what a great relationship with our co-production partner and what a great opportunity for us going forward.

This is the kind of thing were major filmmakers now come to Digital Domain and say, well gee, I'm having a hard time getting this movie greenlit. And they're asking for the same thing we did for Tron, which started with a test. We took it to the Comic-Con Convention. With Enders Game, started with a test, and we took it to the Cannes Film Festival. And this is how we can end up with a major participation in the film taking very, very little risks.

There was a great article by Seeking Alpha recently that talked about Ender's Game as an opportunity and talked about the risk of it. Look what happened to a major studio, and John Carter didn't do as well as they expected, and what was the size of that loss. Our model doesn't really put us in position for that kind of risk, and we're thrilled to go forward with that model.

Paradise Lost, I do want to talk about that quickly. It's not our property. It's a property that has been developed by Legendary Pictures. They are great friends, and we hope customers and partners in the future. They made a decision to at least delay, if not -- ultimately, they have the right to go forward with the film or not go forward with the film. They have invested a lot in the film. It's one of the most powerful books in history. John Milton's, Paradise Lost is really many, many years before now, one of the first literary anthems to a secular society and it's an incredibly important film.

We thought it was very well positioned somewhere between 300 and Passion of the Christ. I believe in my heart that that film is going to get made. I believe that Legendary is going to make it. We have a financial interest in that film if it goes forward equal to effectively the amount that we chose to take in the write-off. But the manner in which to account for these things when they are substantially delayed is very clear.

The conservative approach and the right approach is to write it off, but I don't think that film has gone away. If anything, I think that it's an even greater opportunity for Digital Domain to be more involved in co-production with Legendary and expanding our relationship there.

We chose the write-off now, but I believe very strongly that that film will get made, and I believe will be a partner in it. We already have a financial interest in its future outcome, so we will see what happens there. To be clear, it is Legendary's decision and we will continue to talk to them about what they expect to do there.

In terms of overseas expansion -- the last major category of the things that I'm going to touch on. We did announce the execution of a non-binding memorandum of understanding to establish a production studio and the Digital Domain Institute in Abu Dhabi. This represents a material step. Some of you might have noticed, we do have significant shareholders from Abu Dhabi that are well established in Abu Dhabi, with the ruling family of Abu Dhabi of course. And this is a relationship that has been important to us.

We have looked at various other countries around the Gulf and the execution of this memorandum of understanding basically represents that we have a pretty darn good understanding of what the economic incentive and partnership package is going to be, that we know that we want to go to Abu Dhabi based on, not only that, but the relationships that we have there in the common vision we have for that country.

But setting up a digital production studio in Abu Dhabi is not just going there because it's a neat exploding economy with a whole bunch of neat stuff; it's frankly a better alternative than India. The growth plan of Abu Dhabi in their 2030 plan is to go from say 1 million residents to 6 million residents. Many of those, obviously, inbound workers that come from countries like India. One of the problems we have in developing a stronger studio in terms of quality in India is that many of the best people in our industry don't necessarily want to commit to long-term stint in India. We find Abu Dhabi is a little more attractive there. It's much more open to expatriates especially in nearby Dubai and also increasingly in Abu Dhabi.

So, this is not some wild new idea to go starting a new business in Abu Dhabi. This is the pressure we put on ourselves to expand our global footprint, a footprint of high quality animation at the lowest cost imaginable, whether it's accessing India labor up in Abu Dhabi, or labor in China, that's part of our business model.

So, to the extent a foreign government or a foreign partner makes it attractive for you to show up, then your already established mission of growth and reduced cost has become even more attractive in terms of reducing cost.

So, what we are allowed to say at this point is that sort of past comments that we have made about the scale of -- an economic incentive package, we continue to stand by, and that for the most part, we are going to suppress public commentary about this in anticipation of significant announcements that we intend to make at the Cannes Film Festival in May 2012.

They take MOUs very seriously over there. So, do we. We wouldn't announce this if we didn't think it was happening. We've spent many, many months pressing forward with this, and we are looking to the Cannes Film Festival for the introduction of more specifics in the major ideas there with a joint announcement in partnership with the people of Abu Dhabi.

In China, which is the other part of the agreement that we finished off this last week, and they were somewhat related to Tembo mainly just because of the relationship with Galloping Horse, we have executed a definitive agreement technically referred to as the Amended and Restated Formation and Joint Venture Agreement with Beijing Galloping Horse Films. This is something that we announced back in December as an agreement that is expanded in scope. This is the construction of a visual effects facility, the construction of a motion capture facility, the early platform that can lead to an expanded relationship, obviously likely with Beijing Galloping Horse in other parts of our business including education.

Their commitment is a little different. It's not like a government grant as you might get from the US or other countries, it's an expected $50 million investment by Beijing Galloping Horse in what we expect will be a remarkable studio with a government land contribution and, of course, the facilities I just described. And that will be made available at zero cost to the joint venture, which will be owned 50/50. So, it's as if somebody handed you just a remarkable facility to open up in China; the largest film of market in the world outside of the United States growing at 35% per year for the last nine year, 44% last year. Those are my estimates, and I believe those are supported by the industry's view of China.

As our company grows, whether it's growing our core business in the foreign markets, or growing our business into new businesses like animation or education, we've been very successful at making good trades with governments and partners that have encouraged them to contribute significant capital, some on the balance sheet, some off the balance sheet to grow our business.

We expect, that by the time you count up our Florida ground, our China off-balance-sheet financing and our Gulf Coast regions economic incentives, the economic incentives that we brought into this company in the last two years outpaced the capital we brought in from the IPO by seven to one. So, that's terrific leverage through partnerships, and partnerships where our partners are benefiting as much as we are.

In terms of the overall picture, I'd say as I said at the onset of the call, it's no great surprise when you deliver on your fourth-quarter earnings when you just went public in the fourth quarter. Where we are ahead of schedule is in education. Not only have we opened up on time there, but the interest that has come into this company from strategic folks at -- friendly competitors and other related industry companies that is moving far better than we expected.

Also, far better than expected is how the Digital Domain Institute has been our calling card overseas. If you go to a foreign country and you say, well, I'm going to build a film studio quite selfishly because I want to make money in your country, maybe they will introduce you to a realtor. But if you show up with the Digital Domain Institute say we are going to educate your people and lift up the industry that you targeted as important to you and therefore help your nation, then the discussion of partnership and the benefits that come from that are really remarkable. So, the Education business is way ahead of schedule in terms of importance there.

The Content business, as I said, Tembo -- we've got through our first cut reel. We'll move through the third cut reel, which is a very watchable form of the film, by the time we get to September. That film, which is due in release toward the end of 2014, it's remarkable to have the kind of co-production and finance and distribution support and interest, not only from China, but from other places we already have in that film, and Ender's Game, we are thrilled there as well.

I guess that's probably it. In summary, we are excited with our start as a new public company. We know that being public is about making promises and keeping them. We think we're doing a good job of that so far. And as we go forward, obviously we need to do a much better job of communicating the fundamental value of the components of our business with these growth opportunities, but we really think that's just a matter of time and execution.

So, with that, I would love to break. And, Francis, our operator, if you wouldn't mind seeing what questions are in the queue. We see the queue in front of us and there's a question from Rich Ingrassia, Analyst at Roth Capital Partners.

If you are ready to go, we'd love to hear from Rich.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

Your first question is from Richard Ingrassia from Roth Capital Partners. You may proceed.

Richard Ingrassia - *Roth Capital Partners - Analyst*

Thanks. Good morning, guys. John, can you comment on any progress towards a distributor in North America or other foreign territories for Tembo, or is it too early to say?

Can you hear me? Hello?

Richard Ingrassia - *Roth Capital Partners - Analyst*

The question, John, was about Tembo again, and progress that you may have had with potential other finance partners or maybe more specifically distributors in North America or other foreign territories.

John Textor - *Digital Domain Media Group - Chairman and CEO*

We think it's way too early to have that conversation. Our model as we showed in Tron and our model as we showed in Ender's Game is a little different. We think, given the ability to generate high-quality visual and early looks at what a film might look like in an animation form, that's really kind of what you want to have complete before you go out and seek distribution. That has been very effective for us.

In China the reason -- well, let me back up on the United States. For a film that comes out in the end of 2014 in a world where digital distribution is quickly changing the paradigm of distribution, where with a push of a button out of the studio of Digital Domain I can distribute to big screens, little screens, handheld PDAs and get to 80% of the market just out of our own studio, the question is really not one of distribution, it's one of marketing support.

Because the only benefit you are really seeking to get [now] is either production capital, they say distribution, but that really just means P&A. So, we think it's way too early for a film like Tembo to start auctioning itself to the major studio backers within North America. China is a little different, and when I finish discussing North America will cover that. But in the United States, it is -- there are assumptions that we are relying o, which is that major filmmakers that have never had a failure always get studio support.

So when you look at our team, whether it's Pam Coats, who was head of Creative Development at Disney for 20 years, or you look at Aaron Blaise and Chuck Williams, the director team that prior to that had heavy involvement in some of the great Disney Classics like Lion King and, of course, directed Brother Bear, and with story artists that are coming out of Pixar and Blue Sky another great companies in great numbers, we have no doubt that by the time we get to the appropriate time to call in studio support or marketing support, will be able to do that for Tembo.

We think that the excitement in China is sort of validation of that, because this is a group that paid upfront for the rights to Tembo, and along with other sources in China is very likely to come up with full production investment to support the film. That's why we jumped early into a distribution and P&A agreement well ahead of schedule because it also comes with production capital and relationship to more production capital. So, the fact that we don't have it in the US means that we haven't looked for it yet in the US, not because we've been more successful in one region or another.

And I do think, again, we are huge believers in the world of digital distribution. We think that the studios are going to have to be very aggressive to continue to refine and define their business models in a world of digital content distribution. And I think it's a major mistake for a content creator to assign a distribution agreement too early when in the manner in which we distribute is a technology evolution cycle not a business model cycle.

And with the push of a button if I can get to 90% of the screens in North America two years from now, why would I want to strike my distribution agreement now, giving somebody 11% to 20% of the box office for a push of the button?

Richard Ingrassia - *Roth Capital Partners - Analyst*

Fair enough. Okay. On Ender's Game, can you just walk us through the steps of the process there that got you to the incremental 12.5% stake and how exactly -- how does he get financed per se?

John Textor - *Digital Domain Media Group - Chairman and CEO*

Well, that film, as you know from our past conversations, we were invited to be a part of that property. We were involved early. Gigi Pritzker is a wonderful producer and partner and all of the people at OddLot -- how we got here is they invited us to be a part of this early.

This work that occurred with the Director Gavin Hood occurred at Gigi's direction and partnership with the folks at Digital Domain in Venice. And we set out very early on because we were so involved in the development of this picture to do two things.

One, give them the best contract with transparency into our costing model with a fair margin, and then defer that margin to the early stages of box office recovery. The film does not need to do extraordinarily well for us to recover that margin, but nonetheless, that deferred margin deal is how we sort of secured an initial producer role in the film.

We also chose to take an amount of money that was, frankly, a little less than that deferred margin and invest that as a direct investor in the film. So, that's what secured the initial 25% that you remember us talking about before. We also due to producer fees that don't add up to a lot, but are material as compared to our earnings level today.

And how we moved to 37.5% is that at that time -- and I don't really want to openly communicate the percentage breakdown between OddLot and Lionsgate. That's really for them to speak about, whereas we're, frankly, obligated to share that information about us. But, there was a 25% stake that was available that we took initially.

There was another 25% stake that had a number of discussions and bidders looking at it. And then the remaining percentage was really the people at OddLot and up to them to determine knew what they were ultimately going to offer to a studio (inaudible). And what ultimately allowed us to increase our position from 25% to 37.5% is that we were so excited about this film all, along with Gigi and the people at OddLot, that we decided to step up and share that remaining 25% piece.

So we increased our investment from the $12 million level up to the $18 million level. And that was funded, and has been entirely funded, out of core capital of the company, keeping in mind that we still have this significant revenue item and this gross margin in profit item on the visual effects work (inaudible).

There was a second part of your question that I'm not sure I covered.

Richard Ingrassia - *Roth Capital Partners - Analyst*

No, that pretty much covers it, but I think maybe just to wrap that up and then I'll make way here further questions. I think there's some confusion on the street just regarding how exactly the company's financials will reflect the visual effects work on co-produced projects.

You touched on it earlier when you mentioned the deferred margin basis but maybe just give us a little bit of clarity or do a compare on how the accounting is going to work on Ender's Game versus your straight work-for-hire business that everyone is much more familiar with.

John Textor - *Digital Domain Media Group - Chairman and CEO*

Well, Teaford, why don't I have you explain the accounting of co-production?

Jon Teaford - *Digital Domain Media Group - CEO Digital Domain Institution*

Sure. In terms of the visual effects work, we -- there are a couple components to it. We booked revenue for the work we do on a current basis, so as -- on a percentage of completion basis, the same way that we do for our other projects.

That work is done, and we earn a margin on that along the way and it's a relatively thin margin while we are in production. There's a fairly large catch-up that occurs once the film releases into the theaters, where we get an amount that's equal to what more of a normalized margin would have been out of the box office receipts.

So that will flow through after the market releases in the theaters as largely a profit-based item, without much if any cost against it. So it will be -- there's revenue in percent of completion mode, and then it will -- with a fair and usual margin, and then we've got a catch-up margin once the film releases in the theaters.

And then, in addition, we get box office based compensation or 37.5% ownership stake of the profits on the film.

Richard Ingrassia - *Roth Capital Partners - Analyst*

Okay, perfect. Thank you, very much.

Operator

Your next question comes from the line of Tony Wible from Janney Capital. You may proceed.

Morley Sankar - *Janney Capital - Analyst*

It's Morley Sankar actually standing in for Tony. I wanted to focus on a couple of things relating -- looking forward to the backlog of the pipeline of work. The first thing is really to understand a little bit better over what time period you expect to realize the backlog. And the second is in terms of pipeline.

When do you think you're going to be announcing your second co-production film, and when you think you're going to be starting production for the first animated film sort of post-Tembo?

John Textor - *Digital Domain Media Group - Chairman and CEO*

I will take those first -- those last two questions first, if you don't mind. Thanks for standing in for Tony, by the way. After Ender's Game, I -- look I think we know with some reasonably likelihood what our next co-production film is going to be. I think that we will announce our next live-action co-production film before the close of the second quarter.

Keep in mind that live-action co-production films do move much quicker. That film is either going to be a film in the -- let's just call it the patriotic, military, we love our soldiers who do great things kind of space, or it's going to be a co-production with a major studio.

We do not have infinite bandwidth to be able to announce two co-productions at the same time, so we are really evaluating out of a group of roughly five studio partnership co-productions, and out of a group of, say, two in-house development productions, which by the way also come with studio partners, but the order is sort of reversed, where we recruit the studio partner as happened in Ender's Games.

Expect the next co-production to be announced in the second quarter, and expect that to be the kind of film that could potentially see a window into the end of 2013, and the very early part of 2014 in terms of a release date.

In terms of our next animation film, we have already identified the film internally. It's a film developed as original content here at Digital Domain by our new director Brad Lewis, who some of you may remember the press release Brad came over from Pixar after co-directing Cars 2 and producing Ratatouille. We are not releasing the concept of the story on that film yet, but it's nicely positioned to drop in almost exactly a year maybe a little less after The Legend of Tembo.

We do have a film that we developed here internally which we've also not released the title, but it's one of the great stories that came out of the early development work as we were looking at alternatives -- ultimately, having chosen Tembo.

There's a film we developed internally here that the entire story team really fell in love with. It is not of the scale, the big, epic, coming-of-age Pixar like film that we think is Tembo, and so it's a smaller film and a smaller budget that we will likely develop here, and drive from Tradition Studios, but partner with an animation studio on an outsourced basis to deliver that more quickly.

And without saying too much in terms of forward-looking guidance, we seen you're model, we've seen Rich's model and we still support the placement of those films within those models.

Jon Teaford - *Digital Domain Media Group - CEO Digital Domain Institution*

To answer the rest of your question in terms of when we would expect to recognize the revenues that are included in our backlog, of the backlog we reported our current balance right now of $122 million, about $90 million of that relates to revenue we expect to recognize in 2012 and the balance relates to next year.

At this point last year, that $90 million was -- the equivalent number was about $60 million. So we were at $60 million this time last year; we're at $90 million right now for revenues we expect to recognize in the current fiscal year. That's some very significant growth for this year -- we think shows the effects of the work we've been doing to grow the scale of our company and improve our reputation in the industry.

Morley Sankar - *Janney Capital - Analyst*

Thank you.

Jon Teaford - *Digital Domain Media Group - CEO Digital Domain Institution*

No problem.

John Textor - *Digital Domain Media Group - Chairman and CEO*

Is that all?

Morley Sankar - *Janney Capital - Analyst*

Yes. Thank you.

John Textor - *Digital Domain Media Group - Chairman and CEO*

Great. Well, Thank you for being on the call. In the order of the queue, Todd from Luther King. Hi, Todd, how are you?

Todd Truitt - *Luther King Capital - Small Cap Analyst*

How are you doing? Great quarter.

John Textor - *Digital Domain Media Group - Chairman and CEO*

Great. Thank you.

Todd Truitt - *Luther King Capital - Small Cap Analyst*

My question, I don't want to get on valuation too much on these calls, but I just want to make sure that I'm understanding this correctly and thinking about this on the right lines. Last year, but a year ago, correct me if I'm wrong, but The Mill is a competitor of yours base out of England.

John Textor - *Digital Domain Media Group - Chairman and CEO*

Yes, they are a visual effects company that did a fair amount of feature film work, and started to orient board towards television commercials, visual effects as we have both sides of that business. But, yes, they are a good quality company.

Todd Truitt - *Luther King Capital - Small Cap Analyst*

And so, it's fair to say they're somewhat of a comp and they were taken out last year by Barclays at approximately two times revenue which valued the business at about $190 million. Is that right?

John Textor - *Digital Domain Media Group - Chairman and CEO*

Well, that was pretty widely reported and we've had a good relationship with Barclays and we feel pretty [credible] that's a confirmed number.

In answer to the first part of your question, yes, I would say they were a direct comp to the visual effects services businesses. They don't do original content creation, so you would comp them to Digital Domains productions, our visual effects services subsidiary.

Todd Truitt - *Luther King Capital - Small Cap Analyst*

So if I look at the legacy business, the visual effects, if we look at the $90 million kind of 2012 revenue it will be recognized. If we put a 2X multiple on that, and I know it's not a perfect, but it's a pretty good comp of The Mill, you get you get to about $180 million valuation. That's just for the legacy business. That doesn't include education, it doesn't include co-production, it doesn't include animation. Am I thinking about this the right way?

John Textor - *Digital Domain Media Group - Chairman and CEO*

Yes, except my bias on this, because I think when you say they are a comp, they are a comp business model, The Mill does not have our track record. They haven't won eight Academy Awards. They do not represent to strategic investors what we represent, frankly, which is a seat at the table in the inner circle of Hollywood with the top directors and producers of our industry.

And what we found -- we believe that was the financial -- a financial investor, a financial buyer valuation. We believe, frankly, that our value metrics to be stronger because strategic -- major companies in India, major companies in China, they show up with a ton of capital in Hollywood, and invest in big slates. And they may drive the -- they may pay for the film but often times they don't even have the ability to work on the film, if these are visual effects companies or animation companies or strategic film companies from these other markets.

I think that's a good comp. I think that we would have a strategic premium that's greater than that of The Mill because of who we are and who we work with. I think there is a time -- some time off in the future, well down the road, where it might be attractive to consider the independent valuation of our visual effects subsidiary.

Right now we are very happy with -- it's worth more to us in driving these other businesses. I do think, though, you are probably looking at the right way, we believe our company -- our visual effects subsidiary would probably be valued more highly than that by some of these major players in China that are trying to really get the attention of those Hollywood, but that's obviously theoretical.

But, yes, we saw the transaction for The Mill, thought it was in attractive financial market valuation. We think that ours would go at either that multiple or a higher multiple because of our strategic significance.

Todd Truitt - *Luther King Capital - Small Cap Analyst*

That's great, John. Thanks. I appreciate the color. Can you also talk a little bit about the valuation around your patents?

John Textor - *Digital Domain Media Group - Chairman and CEO*

The patents we've been talking a lot about like the 3-D patent?

Todd Truitt - *Luther King Capital - Small Cap Analyst*

Correct.

John Textor - *Digital Domain Media Group - Chairman and CEO*

Yes. That's a tough conversation because you have companies like RealD that have patents on a 3D projector, though, in our opinion, don't really have the fundamental patents that allow them or anybody else within the distribution paradigm to even handle or convert or distribute or exhibit or project a 3D image.

So, to think that the guys that the guys with a very smart business model to build a projector have developed a greater than $0.5 billion market cap off of that projector technology when, in our opinion, they don't have the right to touch an image that is converted from 2D to 3D, that maybe speaks to the value of our patents.

If we were to continue to develop our business model to take advantage of that patent portfolio, I would say that the high end of what they're worth would be the market valuation of somebody like RealD that is a pure 3D player.

We have been very careful, and we have to be very careful, about how we prosecute those patents because we don't like the idea of prosecuting infringement against our friends and our partners, and that specifically means the studios. They are our customers now in the visual effects business, they are our friends in the co-production and co-development of original stories, and they are partners when we talk about marketing and distribution.

So, we have a strategy, which has been to assure the six major studios and really anybody else that might be a customer in the studio environment, that we will not take advantage of our patent portfolio to inhibit their business in any way. But we do reserve the right to go down the chain of distribution because we don't think it's possible to get a 3D conversion movie onscreen anywhere in the world without violating our patents.

We bought this patent portfolio because we knew we were violating the patents. We saw other companies -- publicly traded exhibition and projector and screen companies -- sue this predecessor company that owned the patents to invalidate the patents and they failed.

We ourselves were contacted by Samsung over the summer, and we hadn't written a letter to them or threatened them, we didn't even know them, and they paid us $3.5 million to not sue them when we had never called them.

So I think the value of our patent portfolio, the authenticity of it and the strength of it are quite remarkable. We do know that if we were to sell it into the patent troll market, if we just saw it adds value, the numbers that we hear there are an easy $30 million to $50 million.

But for an industry that is growing so quickly, not just in the theater, but in television sets, if Samsung, the guy that makes the TV set doesn't even think that they can handle a 3D image without violating our patents, then what does that say about the distributors, exhibitors, and projection companies in the industry, as well as the other TV sets guys?

If one television set guy pays you $3.5 million to someone not to sue when you didn't even call them, I'd say the value of the patents is substantially more than that $50 million if we were to fully develop the licensing and infringement model.

Todd Truitt - *Luther King Capital - Small Cap Analyst*

That's very helpful, John. I appreciate it. And congratulations on a fantastic first quarter as a public company.

John Textor - *Digital Domain Media Group - Chairman and CEO*

Great. It's nice to get it done. Thank you, Todd.

Okay, and it looks like we have a question from John Tinker, Analyst at Maxim. John, thanks for being patient in the queue with our technical problems.

John Tinker - *Maxim Group - Analyst*

Not at all, thank you. Two brief questions. One, when you went through the Ender's Games numbers, that was just domestic theatrical box office, that didn't include DVDs or any other ancillary sales.

John Textor - *Digital Domain Media Group - Chairman and CEO*

I'm sorry, John, I missed the first half of your question --

John Tinker - *Maxim Group - Analyst*

When you went through the Ender's Game numbers, that was just the domestic theatrical box office. I'm assuming that didn't include any ancillary revenue such as DVD sales or Netflix or whatever.

John Textor - *Digital Domain Media Group - Chairman and CEO*

Well, it did include domestic box office. It included an assumption -- obviously assumptions that are geared off of box office based on predictable (inaudible) ratios to rentals, to video, television for non-theatrical.

It also included at a flat rate that $44.8 million assumption we were paid in foreign advances and deposits. And a certain of those foreign relationship do allow for upside, but for our purposes across every one of those box office assumptions, as I read before, we assumed it was entirely flat out of foreign.

Of course, if Ender's Game the movie does as well as Ender's Game the book has and there is a sequel, then we have the ability to go into foreign distribution with considerably more upside, whereas the first film we did we really took the conservative approach of pre-selling that first film to all those territories.

John Tinker - *Maxim Group - Analyst*

Okay. And just a last quick question. If you could just clarify the amount of cash on the balance sheet and the amount of debt on the balance sheet.

John Textor - *Digital Domain Media Group - Chairman and CEO*

To clarify those numbers off of the fourth quarter financials?

John Tinker - *Maxim Group - Analyst*

Yes.

John Textor - *Digital Domain Media Group - Chairman and CEO*

Okay, John -- he's got the schedule in front, so I'm going to hand the --

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Jon Teaford - *Digital Domain Media Group - CEO Digital Domain Institution*

At December 31, 2011, our cash and cash equivalents were $29.4 million and then we had cash held in trust of $6.6 million. In terms of debt, we had on the balance sheet the -- there are several warrant-related (inaudible) liabilities which are non-cash; those are mark to market accumulations, at December 31, that was $20 million. The principal balance of our debt outstanding was $27 million at the end of the year.

John Textor - *Digital Domain Media Group - Chairman and CEO*

That's [in] two pieces. The senior position with Comvest is -- correct me if I'm wrong, John -- it's roughly [$19.4 million] and the increase above that, that John just quoted, is convertible note held by Comvest that is tied into the same kind of security interest. It is substantially in the money.

So you could look at it as a debt, or you could look at it as an in the money convert, although they do have a put that comes at the end of the year which gives them some conditional ability to put it back to us depending on share prices. That put value is at $6 a share, so it's kind of even money right now.

And I'm being corrected by somebody that passed me a note in terms of I guess that's the primary cash and cash equivalents here -- I'm sorry. The first note is 21 -- I'm sorry, that convertible debt position and warrant position of Comvest is worth about 25 in total.

So did we get to your question in terms of clarifying the debt, or --

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John Tinker - *Maxim Group - Analyst*

So it's 25 to Comvest and then 20 is part of the warrant liability.

John Textor - *Digital Domain Media Group - Chairman and CEO*

Starting from the top, it's a $19.4 million senior position, so there's an $8 million convertible note. Let's just forget now what it's worth. That's what gets to that roughly $28 million senior debt number that Teaford described to you which was on the balance sheet at the end of the year.

They do have a put on that convert at $6 a share that comes at the end of the year. We've got a long list of alternatives that have been offered to us to refinance that debt and that's something we will be considering. So, we feel very comfortable with it, especially given the fact that that convert is really share-based and in the money.

So whether you think that are real debt is $19.5 million or $28 million or if it's the value of the put, understand that variability depends on the value of the stock and right now it substantially in the money as a convert.

John Tinker - *Maxim Group - Analyst*

Okay, thanks.

John Textor - *Digital Domain Media Group - Chairman and CEO*

Great, all right. Thanks, John. Francis, we do not have visibility of the queue at this time.

Operator

There are no other questions, sir.

John Textor - *Digital Domain Media Group - Chairman and CEO*

Okay. Terrific. For everyone that has had the patience to stay on this long, certainly we appreciate you being a part of our fourth quarter earnings call, again our first full quarter as a public company.

We do think that you'll see us a lot more. We think it's incumbent upon us to do a better job of communicating the fundamental value of our business as a whole not just the components, but how we are leveraging our history and our platform as a company to go into these more lucrative business models.

So look forward to seeing us on the road and in a number of non-deal road show formats and at conferences. And, of course, we really do like a telephone contact and questions, so feel free to call and any time and we will make sure we get your questions answered.

Thanks again, and we look forward to talking to you again.

Operator

Ladies and gentlemen, this concludes your presentation. You may now disconnect.
