

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the quarterly period ended September 30, 2016

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the transition period from _____ to _____

Commission file number 001-33468

Point.360

(Exact Name of Registrant as Specified in Its Charter)

California

(State or other jurisdiction of
incorporation or organization)

2701 Media Center Drive, Los Angeles, CA

(Address of principal executive offices)

01-0893376

(I.R.S. Employer Identification No.)

90065

(Zip Code)

(818) 565-1400

(Registrant's Telephone Number, Including Area Code)

**(Former Name, Former Address and Former Fiscal Year,
if Changed Since Last Report)**

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

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

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

Yes No

As of September 30, 2016, there were 12,740,506 shares of the registrant’s common stock outstanding.

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

**POINT.360
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)**

<u>Assets</u>	June 30, 2016 (audited)	Sept. 30, 2016 (unaudited)
Current assets:		
Cash and cash equivalents.....	\$ 49	\$ 40
Accounts receivable, net of allowances for doubtful accounts of \$293 and \$298, respectively.....	4,729	5,408
Inventories, net.....	127	134
Prepaid expenses and other current assets.....	498	776
Total current assets.....	5,403	6,358
Property and equipment, net.....	13,924	14,207
Other assets, net.....	1,215	1,192
Total assets.....	\$ 20,542	\$ 21,757
Liabilities and Shareholders' Equity		
Current liabilities:		
Current portion of notes payable.....	\$ 5,142	\$ 7,800
Current portion of capital lease obligations.....	102	120
Accounts payable.....	838	2,053
Accrued wages and benefits.....	2,057	1,427
Other accrued expenses.....	188	217
Current portion of deferred gain on sale of real estate.....	178	178
Current portion of deferred lease incentive.....	209	209
Total current liabilities.....	8,714	12,004
Capital lease obligations, less current portion.....	79	171
Deferred gain on sale of real estate, less current portion.....	668	624
Deferred lease incentive, less current portion.....	783	731
Notes payable, less current portion.....	5,868	5,980
Total long-term liabilities.....	7,398	7,506
Total liabilities.....	16,112	19,510
Commitments and contingencies (Note 5).....		
Shareholders' equity:		
Preferred stock – no par value; 5,000,000 shares authorized; none issued and outstanding.....	-	-
Common stock – no par value; 50,000,000 shares authorized; 12,630,506 and 12,740,506 shares issued and outstanding on June 30, 2016 and September 30, 2016, respectively.....	22,924	22,978
Additional paid-in capital.....	11,916	12,005
Accumulated deficit.....	(30,410)	(32,736)
Total shareholders' equity.....	4,430	2,247
Total liabilities and shareholders' equity.....	\$ 20,542	\$ 21,757

See accompanying notes to condensed consolidated financial statements.

POINT.360

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended September 30,	
	2015	2016
Revenues	\$ 10,760,000	\$ 8,015,000
Cost of services sold	<u>(7,619,000)</u>	<u>(6,377,000)</u>
Gross profit	3,141,000	1,638,000
Selling, general and administrative expense	<u>(4,617,000)</u>	<u>(3,964,000)</u>
Operating loss	(1,476,000)	(2,326,000)
Interest expense	(110,000)	(178,000)
Gain on bargain asset purchase	4,099,000	-
Other income	<u>161,000</u>	<u>178,000</u>
Income (loss) before income taxes	2,674,000	(2,326,000)
Income tax (expense) - current	(2,000)	-
Income tax benefit - deferred	<u>2,714,000</u>	<u>-</u>
Net income (loss)	<u>\$ 5,386,000</u>	<u>\$ (2,326,000)</u>
Income (loss) per share:		
Basic:		
Net income (loss)	\$ 0.44	\$ (0.18)
Weighted average number of shares	<u>12,341,254</u>	<u>12,677,136</u>
Diluted:		
Net income (loss)	\$ 0.42	\$ (0.18)
Weighted average number of shares including the dilutive effect of stock options	<u>12,790,411</u>	<u>12,677,136</u>

See accompanying notes to condensed consolidated financial statements.

POINT.360

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)**

	Three Months Ended September 30, (in thousands)	
	2015	2016
Cash flows from operating activities:		
Net income (loss).....	\$ 5,386	\$ (2,326)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Gain on bargain asset purchase.....	(4,099)	-
Income tax benefit – deferred.....	(2,714)	-
Depreciation and amortization.....	467	590
Amortization of deferred gain on real estate.....	(44)	(44)
Amortization of deferred lease credit.....	(52)	(52)
Provision for doubtful accounts.....	10	5
Stock compensation expense.....	64	89
Issuance of common stock.....	-	54
Changes in operating assets and liabilities:		
(Increase) in accounts receivable.....	(195)	(684)
Decrease (increase) in inventories.....	1	(7)
(Increase) in prepaid expenses and other current assets.....	(119)	(270)
(Increase) decrease in other assets.....	(214)	7
Increase in accounts payable.....	153	1,216
(Decrease) in accrued wages and benefits.....	(23)	(630)
Increase in other accrued expenses.....	153	29
Net cash used in operating activities.....	<u>(1,226)</u>	<u>(2,023)</u>
Cash flows from investing activities:		
Capital expenditures.....	(148)	(719)
Net cash used in investing activities.....	<u>(148)</u>	<u>(719)</u>
Cash flows from financing activities:		
Borrowings from revolving credit agreement.....	637	2,714
Borrowings of notes payable.....	1,000	104
Repayment of notes payable.....	(56)	(56)
Payment of capital lease obligations.....	(13)	(29)
Net cash provided by financing activities.....	<u>1,568</u>	<u>2,733</u>
Net increase (decrease) in cash and cash equivalents.....	194	(9)
Cash and cash equivalents at beginning of period.....	22	49
Cash and cash equivalents at end of period.....	<u>\$ 216</u>	<u>\$ 40</u>

Selected cash payments and non-cash activities were as follows (in thousands):

	Three Months Ended September 30,	
	2015	2016
Cash payments for income taxes (net of refunds).....	\$ 2	\$ -
Cash payments for interest.....	\$ 96	\$ 83
Assets acquired through capital lease.....	\$ -	\$ 138
Purchase of assets for common stock and warrants.....	\$ 1,417	\$ -
Non-cash deferred interest expense.....	\$ 165	\$ -

See accompanying notes to condensed consolidated financial statements.

Point.360
Notes to Condensed Consolidated Financial Statements (unaudited)
September 30, 2016

Note 1 – THE COMPANY

Point.360 and subsidiaries (the “Company,” “we” or “our”) provides high definition and standard definition digital mastering, data conversion, video and film asset management, distribution and other services to owners, producers and distributors of entertainment and advertising content. The Company provides the services necessary to edit, master, reformat, convert, archive and ultimately distribute its clients’ film and video content, including television programming feature films and movie trailers. The Company’s interconnected facilities provide service coverage to all major U.S. media centers. Clients include major motion picture studios and independent producers. The Company also rents and sells DVDs directly to consumers through its Movie>Q retail stores.

In July 2015, the Company completed the purchase of assets formerly owned by Modern VideoFilm, Inc. by issuing shares of its common stock and warrants to purchase shares of the Company’s common stock. As a result of the transaction, the Company added post-production service capabilities and expanded its client base comprising major studios, broadcast networks, cable outlets, streaming media companies, independent producers and others.

The Company operates in two business segments from three post production and three Movie>Q locations. Each post production location is electronically tied to the others and serves the same customer base. Depending on the location size, the production equipment consists of tape duplication, editing, encoding, standards conversion, and other machinery. Each location employs personnel with the skills required to efficiently run the equipment and handle customer requirements. While all locations are not exactly the same, an order received at one location may be fulfilled at one or more “sister” facilities to use resources in the most efficient manner.

Typically, a feature film or television show or related material will be submitted to a facility by a motion picture studio, independent producer, advertising agency, or corporation for processing and distribution. A common sales force markets the Company’s capabilities for all facilities. Once an order is received, the local customer service representative determines the most cost-effective way to perform the services considering geographical logistics and facility capabilities.

In fiscal 2010, the Company purchased assets and intellectual property for a research and development project to address the viability of the DVD rental business being abandoned by the closure of Movie Gallery/Hollywood Video and Blockbuster stores. The DVD rental market consists principally of online services (Netflix), vending machines (Redbox) and other video stores.

As of September 30, 2016, the Company had two Movie>Q stores in Southern California. The stores employ an automated inventory management (“AIM”) system in a 1,200-1,600 square foot facility. By saving space and personnel costs which caused the big box stores to be uncompetitive with lower priced online and vending machine rental alternatives, Movie>Q can offer up to 10,000 unit selections to a customer at competitive rental rates. Movie>Q provides online reservations, an in-store destination experience, first run movie titles and a large unit selection (as opposed to 400-700 for a Redbox vending machine). Movie>Q provides the Company with a content distribution capability complimentary to the Company’s post production business.

The accompanying unaudited Condensed Consolidated Financial Statements include the accounts and transactions of the Company, including those of the Company’s subsidiaries. The statements have been prepared in accordance with accounting principles generally accepted in the United States of America and by the Securities and Exchange Commission’s rules and regulations for reporting interim financial statements and footnotes. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. All intercompany balances and transactions have been eliminated in the Condensed Consolidated Financial Statements. Operating results for the three month period ended September 30, 2016 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2017. These financial statements should be read in conjunction with the financial statements and related notes contained in the Company’s Form 10-K for the period ended June 30, 2016.

Earnings (Loss) Per Share

A reconciliation of the denominator of the basic earnings per share (“EPS”) computation to the denominator of the diluted EPS computation is as follows (in thousands):

	Three Months Ended September 30, 2015	Three Months Ended September 30, 2016
Pro forma weighted average of number of shares		
Weighted average number of common shares outstanding used in computation of basic EPS.....	12,341	12,677
Dilutive effect of outstanding stock options.....	<u>449</u>	<u>-</u>
Weighted average number of common and potential Common shares outstanding used in computation of Diluted EPS.....	<u>12,790</u>	<u>12,677</u>
Effect of dilutive options excluded in the computation of diluted EPS due to net loss.....	<u>-</u>	<u>206</u>

The weighted average number of common shares outstanding was the same amount for both basic and diluted loss per share in the three month period ended September 30, 2016. The effect of potentially dilutive securities for September 30, 2016 was excluded from the computation of diluted earnings per share because the Company reported a net loss, and the effect of inclusion would be anti-dilutive (i.e., including such securities would result in a higher earnings per share, or lower loss per share, respectively). There were 2,984,910 and 2,948,725 potentially dilutive shares at September 30, 2015 and 2016, respectively.

Fair Value Measurements

The Company follows a framework for consistently measuring fair value under generally accepted accounting principles, and the disclosures of fair value measurements. The framework provides a fair value hierarchy to classify the source of the information.

The fair value hierarchy is based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value and include the following:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Cash, the only Level 1 input applicable to the Company (there are no Level 2 or 3 inputs), is stated on the Condensed Consolidated Balance Sheets at fair value.

As of September 30, 2016 the carrying value of cash and cash equivalents, accounts receivable, accounts payable, accrued expenses and other current liabilities approximates fair value due to the short-term nature of such instruments. The carrying value of capital lease obligations, notes payable and other long-term liabilities approximates fair value as the related interest rates approximate rates currently available to the Company.

NOTE 2- ACQUISITION OF ASSETS OF MODERN VIDEOFILM, INC.

On July 8, 2015, Point.360 entered into a Sale Agreement Pursuant to Article 9 of the Uniform Commercial Code (the “Sale Agreement”) in a foreclosure sale pursuant to which Point.360 acquired certain assets of Modern VideoFilm, Inc. (“MVF”) including, but not limited to, MVF’s equipment, inventory, and accounts receivable, in a private sale conducted under applicable provisions of the New York Uniform Commercial Code, and assumed no debts, obligations or liabilities except for agreeing to pay a portion of the rent for each facility of MVF to its landlord on a per diem basis based on the number of days post-closing, if any, that we occupy such facility to complete the relocation of certain acquired assets, and paid time off owed to former MVF employees employed by the Company in

connection with the closing to the extent (i) accrued and unused as of the closing, and (ii) such employees have not requested such paid time off to be paid by MVF.

As consideration for the assets described in the preceding paragraph, we issued 2,000,000 shares of our common stock, and five-year warrants to purchase an aggregate of 800,000 shares of our common stock at an exercise price of \$0.75 per share. We also issued to Medley Capital Corporation and Medley Opportunity Fund II LP (the “Lenders”) warrants to purchase an aggregate of 500,000 shares of our common stock under the same terms as in the previous sentence in consideration for the Term Loan Agreement described below.

In connection with the Acquisition, on July 8, 2015, the Company entered into a Term Loan Agreement (the “Loan Agreement”) with the Lenders. The Loan Agreement is comprised of a five-year term loan facility in the amount of \$6.0 million, \$1.0 million of which was funded on the July 8, 2015 closing date. Under the Loan Agreement, we may request one or more additional advances in an aggregate amount not to exceed the remaining \$5.0 million, until the third anniversary of the closing date. The fair value assigned to the common stock and warrants issued as consideration for the purchase of assets and the Term Loan was \$1,417,000 and \$165,000, respectively. The fair value of the consideration for the Term Loan was recorded as a reduction in the total amount of the Term Loan, and will be amortized over the five-year life of the Term Loan.

The condensed consolidated balance sheet reflects the allocation by Point.360 management of the MVF purchase price to identifiable tangible and intangible assets and liabilities acquired, and a credit to retained earnings for \$6.8 million representing the difference between (x) the aggregate fair values assigned to the tangible and intangible assets acquired (less liabilities assumed), and (y) the fair value of the common shares and warrants given as consideration for the purchase (see table below). The excess of the net asset value purchased over the purchase price has been recorded as other income in the three months ended September 30, 2015.

Under the acquisition method of accounting, the total estimated purchase price is allocated to MVF’s tangible and intangible assets and liabilities based on their estimated fair values at the date of the purchase date. The following table summarizes the allocation of the purchase price for MVF:

Current assets	\$ 3,173,000
Property and equipment	5,359,000
Other assets	118,000
Acquired intangibles:	
Trade name	150,000
Customer relationships	<u>200,000</u>
Total fair value of assets acquired	9,000,000
Total liabilities assumed	<u>(770,000)</u>
Net assets acquired	8,230,000
Common stock and warrant consideration	<u>(1,417,000)</u>
Gain before deferred income tax benefit	6,813,000
Income tax benefit – deferred	<u>(2,714,000)</u>
Gain on bargain asset purchase	<u>\$ 4,099,000</u>

ASC 805 requires that when fair value of the net assets acquired exceeds the purchase price, resulting in a bargain purchase of assets, the acquirer must reassess the reasonableness of the values assigned to all of the net assets acquired, liabilities assumed and consideration transferred. The Company performed such assessment and concluded that the values assigned for the acquisition are reasonable. The gain on bargain purchase was primarily attributable to the fact that this was a foreclosure sale.

NOTE 3- NOTES PAYABLE AND CAPITAL LEASE OBLIGATIONS

In August and September of 2012 (subsequently modified on December 18, 2013, September 5, 2014, and January 27, 2015), the Company entered into revolving credit, equipment financing and two mortgage agreements with a bank, as follows:

Revolving Credit Facility. The revolving credit facility previously provided up to \$2 million of credit. The revolving credit agreement was canceled by the bank in December 2014 due to the Company’s failure to meet minimum financial covenant requirements described below.

Equipment Financing Facility. The equipment financing facility previously provided up to \$1.25 million of financing for the cost of new and already-owned or leased equipment. All amounts due under the facility (approximately \$0.2 million) were paid off in February 2015.

Hollywood Way and Vine Street Mortgages. The Company entered into two real estate term loan agreements with respect to its Hollywood Way and Vine Street locations for \$5.5 million and \$3.1 million, respectively. The Vine mortgage was paid off upon sale of the building in June 2014. The remaining Hollywood Way loan provided for interest at Libor plus 3% (3.53% as of September 30, 2016). Repayment is based on monthly payments with a 25-year amortization, with all principal due in 10 years. The real estate loan is secured by a first trust deed on the property. As of September 30, 2016, the Company owed approximately \$4.6 million under the mortgage. The Hollywood Way mortgage was paid off upon sale of the building in October 2016 (see note 11.).

Amounts due under the mortgage were secured by the related real estate. Until January 27, 2015, while amounts were outstanding under the credit arrangements described above, the Company was subject to minimum tangible net worth (TNW), EBITDA, and fixed charge ratio financial covenants. See below for changes in the covenant requirements occurring on that date.

As of September 30, 2014 the Company did not meet the TNW, the minimum quarterly EBITDA, and the minimum quarterly and TTM fixed charge ratio covenants. Availability under the revolving credit facility was canceled in December 2014. On January 27, 2015, the bank waived the Company's breach of financial covenants as of September 30, 2014. Concurrently, the bank eliminated the previously mentioned financial covenant requirements effective with the quarter ended December 31, 2014 and imposed a new covenant requiring that, effective June 30, 2015, the Company shall maintain a ratio of EBITDA (as defined) to the sum of interest expense and the current portion of long term debt of not less than 1.0 to 1, to be measured semi-annually. EBITDA and interest expense will be measured at the end of each calendar half-year on the basis of the preceding twelve months. On June 30, 2016, the Company did not meet the new fixed charge ratio covenant.

In July 2016, the Company entered into a three-year credit agreement which, as amended in September 2016, provided for \$4 million of borrowings based on 85% of acceptable accounts receivable as defined. The loan and security agreement as amended provided for interest at prime rate plus 1.0% (4.50% as of September 30, 2016). In addition, the Company will pay a monthly "collateral management" fee of 0.55% of the outstanding daily loan balance (an equivalent annual fee of 6.6%), and an annual commitment fee of 0.5% and 0.4% of the commitment on the first and second anniversary dates, respectively. Amounts outstanding under the agreement are secured by all of the Company's personal property. As of September 30, 2016, the Company owed \$3.1 million under the credit agreement.

Due to the Company's failure to meet financial covenants, the balance owed for the mortgage debt has been classified as a current liability in the condensed consolidated balance sheet as of September 30, 2016. The mortgage was paid off upon sale of the building in October 2016.

In connection with the purchase of the assets of Modern VideoFilm, Inc. on July 8, 2015, the Company entered into a Term Loan Agreement (the "Loan Agreement") with the Lenders. The Loan Agreement is comprised of a five-year term loan facility in the amount of \$6,000,000, \$1,000,000 of which was funded on the July 8, 2015 closing date. As of September 30, 2016, the Company had borrowed the \$6,000,000 under the Loan Agreement.

We must pay monthly interest in arrears on the unpaid principal balance of the Term Loan at a rate per annum equal to three-month LIBOR plus 6.00% (6.85% as of September 30, 2016). At the Company's election, interest may be paid as payment in kind ("PIK") by adding such accrued interest to the unpaid principal balance of the Term Loan. During the quarter ended September 30, 2016, the Company elected the PIK method which increased the total amount outstanding under the Term Loan by \$104,000. The outstanding principal balance and all accrued and unpaid interest on the Term Loan are due and payable on July 8, 2020. We may voluntarily prepay outstanding Term Loan from time to time in whole or in part without penalty or premium.

Annual maturities for debt under term note and capital lease obligations as of September 30, 2016 are as follows (excluding the mortgage loan which was paid off in October 2016):

2016	\$	3,259,000
2017		71,000
2018		38,000
2019		29,000
2020		6,136,000
Thereafter		-
Total:	\$	9,533,000

NOTE 4- PROPERTY AND EQUIPMENT

In March 2006, the Company entered into a sale and leaseback transaction with respect to its Media Center real estate. The real estate was sold for approximately \$14.0 million resulting in a \$1.3 million after tax gain. In accordance with the Accounting Standards

Codification (ASC) 840-40, the gain will be amortized over the initial 15-year lease term as reduced rent. Net proceeds at the closing of the sale were used to pay off the mortgage and other outstanding debt. A \$250,000 security deposit related to the lease has been recorded as a deposit in "other assets, net" in the Condensed Consolidated Balance Sheets as of June 30, 2016 and September 30, 2016.

The lease is treated as an operating lease for financial reporting purposes. After the initial lease term, the Company has four five-year options to extend the lease. Minimum annual rent payments for the initial five years of the lease were \$1,111,000, increasing annually thereafter based on the Consumer Price Index change from year to year.

In June 2011, the Company entered into a lease amendment with respect to the Company's Media Center facility. The amendment provided that the landlord would reimburse the Company up to \$2 million for the leasehold improvements to be made by the Company to the premises. The leasehold improvements would be recorded as a fixed asset and amortized over the remaining term of the lease (until March 2021). Pursuant to the lease amendment, the Company's monthly lease costs increased by approximately \$27,000 on April 1, 2012. The Company incurred \$2.1 million of costs for construction, of which \$2.0 million was reimbursed by the landlord. A deferred lease incentive has been recorded for the total amount reimbursed by the landlord in accordance with ASC 840-20. The lease incentive is being amortized over the remaining lease term as an offset to rent.

Property and equipment consist of the following as of September 30, 2016:

Land.....	\$	2,405,000
Buildings		6,892,000
Machinery and equipment.....		43,856,000
Leasehold improvements		9,086,000
Computer equipment.....		8,274,000
Equipment under capital lease.....		1,221,000
Office equipment, vehicles, CIP		<u>980,000</u>
Subtotal		72,714,000
Less accumulated depreciation and amortization.....		<u>(58,507,000)</u>
Property and equipment, net.....	\$	<u>14,207,000</u>

NOTE 5- COMMITMENTS AND CONTINGENCIES

From time to time, the Company may become a party to legal actions and complaints arising in the ordinary course of business, although it is not currently involved in any such legal proceedings.

NOTE 6- INCOME TAXES

The Company reviewed its Accounting Standards Codification ("ASC") 740-10 documentation for the periods through September 30, 2016 to ascertain if any changes should be made with respect to tax positions previously taken. In addition, the Company reviewed its income tax reporting through September 30, 2016. Based on Company's review of its tax positions as of September 30, 2016, no new uncertain tax positions have been identified; nor has new information become available that would change management's judgment with respect to tax positions previously taken.

During the three months ended September 30, 2015, the Company recorded a deferred tax benefit in the amount of \$2.7 million equal to the Company's effective federal and state tax rate (approximately 40%) times the \$6.8 million gain recorded in connection with the purchase of MVF's assets. For financial statement purposes, the MVF purchase transaction was a bargain purchase. Therefore, the assets were recorded at their fair value determined under ASC 805, and the bargain element of the transaction was recorded as other income (ASC 805-30-25-2). The differences between the book and tax bases of the net assets acquired result in the recognition of deferred tax liabilities of \$2.7 million (\$6.8 million x 40% tax rate). The amount of the deferred tax benefit was recorded as a reduction of the \$6.8 million gain on the statement of operations.

As of September 30, 2016, the Company had no net deferred tax assets because future realizability of such benefit was not considered to be more likely than not.

The ASC prescribes a recognition and measurement of a tax position taken or expected to be taken in a tax return and provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition.

The Company files income tax returns in the U.S. federal jurisdiction, and various state jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal state or local income tax examinations by tax authorities for years before 2008. The Company has analyzed its filing positions in all of the federal and state jurisdictions where it is required to file income tax returns.

The Company's provision for, or benefit from, income taxes has been determined as if the Company filed income tax returns on a stand-alone basis.

NOTE 7- STOCK OPTION PLAN, STOCK-BASED COMPENSATION

In May 2007, the Board of Directors approved the 2007 Equity Incentive Plan (the "2007 Plan"). The 2007 Plan provides for the award of options to purchase up to 2,000,000 shares of common stock, appreciation rights and restricted stock awards.

In November 2010, the shareholders approved the 2010 Incentive Plan (the "2010 Plan"). The 2010 Plan provides for the award of options to purchase up to 4,000,000 shares of common stock, appreciation rights and restricted stock and performance awards.

Under the 2007 and 2010 Plans, the stock option price per share for options granted is determined by the Board of Directors and is based on the market price of the Company's common stock on the date of grant, and each option is exercisable within the period and in the increments as determined by the Board, except that no option can be exercised later than ten years from the grant date. The stock options generally vest in one to five years.

The Company measures and recognizes compensation expense for all share-based payment awards made to employees and directors based on estimated fair values. We also estimate the fair value of the award that is ultimately expected to vest to be recognized as expense over the requisite service periods in the Condensed Consolidated Statements of Operations.

We estimate the fair value of share-based payment awards to employees and directors on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's Condensed Consolidated Statements of Operations. Stock-based compensation expense recognized in the Condensed Consolidated Statements of Operations for the three month period ended September 30, 2016 included compensation expense for the share-based payment awards based on the grant date fair value. For stock-based awards issued to employees and directors, stock-based compensation is attributed to expense using the straight-line single option method. As stock-based compensation expense recognized in the Condensed Consolidated Statements of Operations for the periods reported in this Form 10-Q is based on awards expected to vest, forfeitures are also estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. For the period being reported in this Form 10-Q, expected forfeitures are immaterial. The Company will re-assess the impact of forfeitures if actual forfeitures increase in future quarters. Stock-based compensation expense related to employee or director stock options recognized for the three month periods ended September 30, 2015 and 2016 was as follows:

Three months ended September 30, 2015	\$ 64,000
Three months ended September 30, 2016	\$ 89,000

The Company's determination of fair value of share-based payment awards to employees and directors on the date of grant uses the Black-Scholes model, which is affected by the Company's stock price as well as assumptions regarding a number of complex and subjective variables. These variables include, but are not limited to, the expected stock price volatility over the expected term of the awards, and actual and projected employee stock options exercise behaviors. The Company estimates expected volatility using historical data. The expected term is estimated using the "safe harbor" provisions provided by the SEC.

During the three month period ended September 30, 2016 the Company granted awards of 130,000 stock options at an exercise price of \$0.60 per share.

The following table summarizes the status of the 2007 and 2010 Plans as of September 30, 2016:

	<u>2007 Plan</u>	<u>2010 Plan</u>	<u>Total</u>
Options originally available	2,000,000	4,000,000	6,000,000
Stock options outstanding	1,832,650	1,116,075	2,948,725
Options available for grant	22,160	2,760,350	2,782,510

Transactions involving stock options are summarized as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value
Balance at June 30, 2016	2,961,350	\$ 0.72	\$ 0.57
Granted	130,000	\$ 0.60	\$ 0.55
Exercised.....	(110,000)	\$ 0.49	\$ 0.41
Cancelled	(32,625)	\$ 0.91	\$ 0.80
Balance at September 30, 2016.....	2,948,725	\$ 0.72	\$ 0.57

As of September 30, 2016, the total compensation costs related to non-vested awards yet to be expensed was approximately \$0.7 million to be amortized over the next four years.

The weighted average exercise prices for options granted and exercisable and the weighted average remaining contractual life for options outstanding as of September 30, 2016 were as follows:

	Number of Shares	Weighted Average Exercise Price (\$)	Weighted Average Remaining Contractual Life (Years)	Intrinsic Value (\$)
Employees – Outstanding	2,806,225	\$0.72	2.71	\$ 255,000
Employees – Expected to Vest	2,525,603	\$0.72	2.71	\$ 229,000
Employees – Exercisable	1,082,850	\$0.77	1.51	\$ 61,000
Non-Employees-Outstanding	142,500	\$0.75	2.27	\$ 17,000
Non-Employees- Expected to Vest	142,500	\$0.75	2.27	\$ 17,000
Non-Employees-Exercisable	142,500	\$0.77	2.27	\$ 17,000

The aggregate intrinsic value in the table above is the sum of the amounts by which the quoted market price of the Company's common stock exceeded the exercise price of the options at September 30, 2016, for those options for which the quoted market price was in excess of the exercise price.

Additional information with respect to outstanding options as of September 30, 2016 is as follows:

<u>Options Outstanding</u>			<u>Options Exercisable</u>		
<u>Options Exercise Price Range</u>	<u>Number of Shares</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Weighted Average Exercise Price</u>	<u>Number of Shares</u>	<u>Weighted Average Remaining Contractual Life</u>
1.07	22,500	0.17 years	1.07	22,500	0.17 years
1.04	30,000	4.12 years	1.04	30,000	4.12 years
1.00	50,000	3.94 years	1.00	12,500	3.94 years
0.95	226,425	0.45 years	0.95	226,425	0.45 years
0.88	618,250	4.42 years	0.88	-	4.42 years
0.81	806,900	1.35 years	0.81	605,175	1.35 years
0.80	22,500	1.10 years	0.80	22,500	1.10 years
0.74	22,500	2.10 years	0.74	22,500	2.10 years
0.64	15,000	2.12 years	0.64	15,000	2.12 years
0.60	130,000	4.87 years	0.60	-	4.87 years
0.57	5,000	2.94 years	0.57	5,000	2.94 years
0.50	415,350	2.35 years	0.50	132,675	2.35 years
0.48	554,300	3.37 years	0.48	101,075	3.37 years
0.23	30,000	3.10 years	0.23	30,000	3.10 years

In addition to the above 2007 and 2010 Plans, the Company issued 10,000 shares of restricted stock during fiscal year ended June 30, 2010 with a weighted average fair value of \$0.58 per share.

We use the detailed method provided in ASC 718 for calculating the beginning balance of the additional paid-in capital pool (APIC pool) related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and the Condensed Consolidated Statements of Cash Flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of ASC 718.

NOTE 8- STOCK RIGHTS PLAN

In July 2007, the Company implemented a stock rights program. Pursuant to the program, stockholders of record on August 7, 2007, received a dividend of one right to purchase for \$10 one one-hundredth of a share of a newly created Series A Junior Participating Preferred Stock. The rights are attached to the Company's Common Stock and will also become attached to shares issued subsequent to August 7, 2007. The rights will not be traded separately and will not become exercisable until the occurrence of a triggering event, defined as an accumulation by a single person or group of 20% or more of the Company's Common Stock. The rights will expire on August 6, 2017 and are redeemable at \$0.0001 per right.

After a triggering event, the rights will detach from the Common Stock. If the Company is then merged into, or is acquired by, another corporation, the Company has the opportunity to either (i) redeem the rights or (ii) permit the rights holder to receive in the merger stock of the Company or the acquiring company equal to two times the exercise price of the right (i.e., \$20). In the latter instance, the rights attached to the acquirer's stock become null and void. The effect of the rights program is to make a potential acquisition of the Company more expensive for the acquirer if, in the opinion of the Company's Board of Directors, the offer is inadequate.

No triggering events occurred in the three months ended September 30, 2016.

NOTE 9- SHAREHOLDER'S EQUITY

The following table analyzes the components of shareholders' equity from June 30, 2016 to September 30, 2016 (in thousands):

	Common Stock	Paid-in Capital	Accumulated (Deficit)	Shareholders' Equity
Balance, June 30, 2016	\$ 22,924	\$ 11,916	\$ (30,410)	\$ 4,430
Exercise of stock options	54	-	-	54
Stock-based compensation expense	-	89	-	89
Net loss	-	-	(2,326)	(2,326)
Balance, September 30, 2016	<u>\$ 22,978</u>	<u>\$ 12,005</u>	<u>\$ (32,736)</u>	<u>\$ 2,247</u>

NOTE 10- STOCK REPURCHASE PLAN

In February 2008, the Company's Board of Directors authorized a stock repurchase program. Under the stock repurchase program, the Company may purchase outstanding shares of its common stock on the open market at such times and prices determined in the sole discretion of management. No shares were acquired pursuant to the repurchase program during the three months ended September 30, 2016.

NOTE 11- SUBSEQUENT EVENT

On October 11, 2016, Point.360 (the "Company") sold to HWAY LLC, a California limited liability company ("HWAY"), all of its right, title and interest in and to certain land and improvements located at 1122 and 1133 North Hollywood Way, Burbank, CA (the "Property") pursuant to a Standard Offer, Agreement and Escrow Instructions for Purchase of Real Estate (the "Purchase Agreement"). Concurrently, the Company leased the Property from HWAY pursuant to a Standard Industrial/Commercial Single-Tenant Lease (the "Lease Agreement", and together with the Purchase Agreement, the "Sale and Leaseback"). Haig Bagerdjian, Chief Executive Officer, director and majority shareholder of the Company, holds a 99% membership interest in HWAY.

Pursuant to the Purchase Agreement, the Company sold the Property to HWAY for a purchase price of \$9.8 million in cash (the "Purchase Price"). The Company received approximately \$4.8 million in cash after payment of approximately \$4.6 million to Bank of the West in full payment of indebtedness secured by a first lien mortgage on the Property, approximately \$0.3 million paid to HWAY for a security deposit and rent under the Lease Agreement, and other closing costs.

Under the Lease Agreement, the Company will continue to occupy the Property consisting of 31,259 square feet in a two-story office building with a basement and a 3,732 square foot parking lot (the "Lease"). The Lease is for an initial term of 11 years, commencing on October 11, 2016 (the "Commencement Date"). The Lease may be extended for two five-year option periods; however such options may not be exercised if (i) the Company is sold to another person, or (ii) if Mr. Bagerdjian and/or his affiliates cease to be a controlling shareholder of the Company. The term of the Lease expires on October 31, 2027, unless it is extended under the Company's option rights. Beginning with the Commencement Date, the monthly base rent under the Lease will be \$65,644 which base rent is subject to an annual increase of 3%. The Company is responsible for paying utilities, operating expenses and real estate taxes for the Property.

NOTE 12- SEGMENT INFORMATION

In its operation of the business, management reviews certain financial information, including segmented internal profit and loss statements prepared on a basis consistent with U.S. generally accepted accounting principles. Our two segments are Point.360 and Movie>Q. The two segments discussed in this analysis are presented in the way we internally managed and monitored performance for the three month periods ended September 30, 2015 and 2016. Allocations for internal resources were made for the periods. The Movie>Q segment tracks certain assets separately, and all others are recorded in the Point.360 segment for internal reporting presentations. Cash was not segregated between the two segments but retained in the Point.360 segment.

The types of services provided by each segment are summarized below:

Point.360 – The Point.360 segment provides high definition and standard definition digital mastering, data conversion, video and film asset management and other services to owners, producers and distributors of entertainment and advertising content. Point.360 provides the services necessary to edit, master, reformat, convert, archive and ultimately distribute its clients' film and video content, including television programming feature films and movie trailers. The segment's interconnected facilities provide service coverage to all major U.S. media centers. Clients include major motion picture studios and independent producers.

Movie>Q – The Movie>Q segment rents and sells DVDs directly to consumers through its retail stores. The stores employ an automated inventory management ("AIM") system in a 1,200-1,600 square foot facility. By saving space and personnel costs which caused the big box stores to be uncompetitive with lower priced online and vending machine rental alternatives, Movie>Q can offer up to 10,000 unit selections to a customer at competitive rental rates. Movie>Q provides online reservations, an in-store destination experience, first run movie and game titles and a large unit selection.

Segment revenues, operating loss and total assets were as follows (in thousands):

Revenue	Three Months Ended September 30,	
	2015	2016
Point.360	\$ 10,699	\$ 7,967
Movie>Q	61	48
Consolidated revenue	<u>\$ 10,760</u>	<u>\$ 8,015</u>

Operating loss	Three Months Ended September 30,	
	2015	2016
Point.360	\$ (1,342)	\$ (2,151)
Movie>Q	(134)	(175)
Operating loss	<u>\$ (1,476)</u>	<u>\$ (2,326)</u>

Total Assets	June 30,	September 30,
	2016	2016
Point.360	\$ 19,920	\$ 21,222
Movie>Q	622	535

Consolidated assets	\$ 20,542	\$ 21,757
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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Except for the historical information contained herein, certain statements in this quarterly report are "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995, which involve certain risks and uncertainties, which could cause actual results to differ materially from those discussed herein, including but not limited to competition, customer and industry concentration, depending on technological developments, risks related to expansion, dependence on key personnel, fluctuating results and seasonality and control by management. See the relevant portions of the Company's documents filed with the Securities and Exchange Commission, including the Risk Factors section of the Company's most recent annual report on Form 10-K, and Risk Factors in Item 1A of Part II of this Form 10-Q, for a further discussion of these and other risks and uncertainties applicable to the Company's business.

Overview

Point.360 is one of the largest providers of video and film asset management services to owners, producers and distributors of entertainment content. We provide the post production services necessary to edit, master, reformat and archive our clients' film and video content, including television programming, feature films and movie trailers using electronic and physical means. Clients include major motion picture studios and independent producers. The Company also rents and sells DVDs and video games directly to consumers through its Movie>Q retail stores.

We operate in a highly competitive environment in which customers desire a broad range of services at a reasonable price. There are many competitors offering some or all of the services provided by us. Additionally, some of our customers are large studios, which also have in-house capabilities that may influence the amount of work outsourced to companies like Point.360. We attract and retain customers by maintaining a high service level at reasonable prices.

The market for our services is primarily dependent on our customers' desire and ability to monetize their entertainment content. The major studios derive revenues from re-releases and/or syndication of motion pictures and television content. While the size of this market is not quantifiable, we believe studios will continue to repurpose library content to augment uncertain revenues from new releases. Uncertain economic conditions can negatively impact the ability and willingness of independent producers to create new content.

The demand for entertainment content should continue to expand through web-based applications. We believe long and short form content will be sought by users of personal computers, hand-held devices and home entertainment technology. Additionally, changing formats from standard definition, to high definition, to Blu-Ray and perhaps to 3D will continue to give us the opportunity to provide new services with respect to library content.

To meet these needs, we must be prepared to invest in technology and equipment, and attract the talent needed to serve our client needs. Labor, facility and depreciation expenses constitute a majority of our costs. Our goals include maximizing facility and labor usage, and maintaining sufficient cash flow for capital expenditures and acquisitions of complementary businesses to enhance our service offerings.

We have an opportunity to expand our business by establishing closer relationships with our customers through excellent service at a competitive price and adding to our service offering. Our success is also dependent on attracting and maintaining employees capable of maintaining such relationships. Also, growth can be achieved by acquiring similar businesses that can increase revenues by adding new customers, or expanding current services to existing customers. For example, in July 2015, we completed the purchase of assets formerly owned by Modern VideoFilm, Inc. ("MVF"). As the result of the transaction, the Company added post-production service capabilities and expanded its client base comprising major studios, broadcast networks, cable outlets, streaming media companies, independent producers and others.

Our business generally involves the immediate servicing needs of our customers. Most orders are fulfilled within several days, with occasional larger orders spanning weeks or months. At any particular time, we have little firm backlog.

We believe that our interconnected facilities provide the ability to better service customers than single-location competitors. We will look to expand both our service offering and geographical presence through acquisition of other businesses or opening additional facilities.

Three Months Ended September 30, 2016 Compared to Three Months Ended September 30, 2015

Revenues. Revenues were \$8.0 million for the three months ended September 30, 2016, compared to \$10.8 million for the three months ended September 30, 2015. Sales decreased \$2.8 million principally due to decline in feature and TV post work associated with the renovation of our facilities and the elimination of MVF's Santa Monica facility at the end of the prior year quarter. There is a risk that negative sales fluctuations may occur in the future for customers with larger project-based orders depending on the size of the order and the length of time needed to perform the required services. Additionally, sales to continuing MVF customers may be negatively impacted due to employee turnover and customer reaction to facility changes and ongoing transition activities resulting from the MVF transaction. We continue to have excellent relations with our major customers.

Cost of Services. Costs of services consist principally of wages and benefits, facility costs and depreciation of physical assets. During the three months ended September 30, 2016, total costs of services decreased \$1.2 million (\$1.2 million due to lower MVF wages and benefits and facility costs), and were 80% of sales compared to 71% in the prior year. In the current period, depreciation costs increased \$0.1 million due to the addition of MVF assets.

Gross Profit. In the three months ended September 30, 2016, gross margin was 20% of sales, compared to 29% for the same period last year. The decrease in gross profit percentage is due to the factors cited above. From time to time, we will increase or decrease staff capabilities to satisfy potential customer service demand. We expect gross margins to fluctuate in the future as the sales mix changes.

Selling, General and Administrative Expense. SG&A expense was \$4.0 million (50% of sales) in the three months ended September 30, 2016 as compared to \$4.6 million (43% of sales) in the same period last year. SG&A for the three month period ended September 30, 2015 included approximately \$0.3 million of legal, accounting and other expenses related to the MVF purchase transaction.

Operating Loss. Operating loss was \$2.3 million in the three months ended September 30, 2016 period compared to a \$1.5 million loss in the same period last year.

Interest Expense. Net interest expense was \$0.2 million in the three months ended September 30, 2016 compared to \$0.1 in the prior year period. The increase was due to interest associated with additional term loan and line of credit borrowings.

Other Income. Other income in both periods includes sublease income. Other income in the three months ended September 30, 2015 also includes \$4.1 million representing the difference between (x) the aggregate fair values assigned to the tangible and intangible MVF assets acquired (less liabilities assumed), and (y) the fair value of the common shares and the warrants given as consideration for the purchase.

Income Taxes. During the quarter ended September 30, 2015, the Company recorded a deferred income tax benefit in the amount of \$2.7 million related to the MVF assets acquired.

Net Income (Loss). The net loss in the three months ended September 30, 2016 was \$2.3 million, compared to net income of \$5.4 million in the prior year period.

LIQUIDITY AND CAPITAL RESOURCES

In August and September of 2012 (subsequently modified on December 18, 2013, September 5, 2014, and January 27, 2015), the Company entered into revolving credit, equipment financing and two mortgage agreements with a bank, as follows:

Revolving Credit Facility. The revolving credit facility previously provided up to \$2 million of credit. The revolving credit agreement was canceled by the bank in December 2014 due to the Company's failure to meet minimum financial covenant requirements described below.

Equipment Financing Facility. The equipment financing facility previously provided up to \$1.25 million of financing for the cost of new and already-owned or leased equipment. All amounts due under the facility (approximately \$0.2 million) were paid off in February 2015.

Hollywood Way and Vine Street Mortgages. The Company entered into two real estate term loan agreements with respect to its Hollywood Way and Vine Street locations for \$5.5 million and \$3.1 million, respectively. The Vine mortgage was paid off upon sale of the building in June 2014. The remaining Hollywood Way mortgage provided for interest at Libor plus 3% (3.52% as of September 30, 2016). Repayment was based on monthly payments with a 25-year amortization, with all principal due in 10 years. The real estate loan was secured by a first trust deed on the property. As of September 30, 2016, the Company owed approximately \$4.6 million under the mortgage. The Hollywood Way mortgage was paid off upon sale of the real estate in October 2016.

In July 2016, the Company entered into a three-year credit agreement which, as amended in September 2016, provided for \$4 million of borrowings based on 85% of acceptable accounts receivable as defined. The loan and security agreement as amended provided for interest at prime rate plus 1.0% (4.50% as of September 30, 2016). In addition, the Company will pay a monthly “collateral management” fee of 0.55% of the outstanding daily loan balance (an equivalent annual fee of 6.6%), and an annual commitment fee of 0.5% and 0.4% of the commitment on the first and second anniversary dates, respectively. Amounts outstanding under the agreement are secured by all of the Company’s personal property. As of September 30, 2016, the Company owed \$3.1 million under the credit agreement.

Due to the Company’s previous failure to meet financial covenants, the balance owed for the mortgage debt has been classified as a current liability in the condensed consolidated balance sheet as of September 30, 2016. The mortgage was paid off upon sale of the building in October 2016.

In connection with the purchase of the assets of Modern VideoFilm, Inc. on July 8, 2015, the Company entered into a Term Loan Agreement (the “Loan Agreement”) with the Lenders. The Loan Agreement is comprised of a five-year term loan facility in the amount of \$6,000,000, \$1,000,000 of which was funded on the July 8, 2015 closing date. As of September 30, 2016, the Company had borrowed the \$6,000,000 under the Loan Agreement.

We must pay monthly interest in arrears on the unpaid principal balance of the Term Loan at a rate per annum equal to three-month LIBOR plus 6.00% (6.85% as of September 30, 2016). At the Company’s election, interest may be paid as payment in kind (“PIK”) by adding such accrued interest to the unpaid principal balance of the Term Loan. During the quarter ended September 30, 2016, the Company elected the PIK method which increased the total amount outstanding under the Term Loan by \$104,000. The outstanding principal balance and all accrued and unpaid interest on the Term Loan are due and payable on July 8, 2020. We may voluntarily prepay outstanding Term Loan from time to time in whole or in part without penalty or premium.

Amounts Borrowed. As of September 30, 2016, the Company had outstanding borrowings of \$3.1 million of under the revolving credit facility, \$0.3 million of equipment financing, \$4.6 million of mortgage debt, and \$6.1 million under the Term Loan. The mortgage was paid off upon sale of the building in October 2016.

Monthly and annual principal and interest payments due under the capital leases and Term Loan balances outstanding as of September 30, 2016 are approximately \$47,000 and \$0.6 million, respectively, assuming no change in interest rates.

The following table summarizes the September 30, 2016 amounts outstanding under our line of credit, capital lease obligations and mortgage loans (excluding the mortgage loan which was paid off in October 2016):

Line of credit	\$	3,139,000
Current portion of notes payable and capital leases.....		120,000
Long-term portion of notes payable and capital leases.....		170,000
Term Loan.....		<u>6,104,000</u>
Total.....	\$	<u><u>9,533,000</u></u>

The Company’s cash balance decreased from \$49,000 on July 1, 2016 to \$40,000 on September 30, 2016, due to the following:

Balance July 1, 2016	\$	49,000
Increase in accounts receivable.....		(684,000)
Increase in prepaid expenses & other assets.....		(270,000)
Borrowing from revolving credit facility.....		2,714,000
Capital expenditures for property and equipment		(719,000)
Increase in accounts payable.....		1,216,000
Net loss.....		(2,326,000)
Changes in other assets and liabilities		<u>60,000</u>

Balance September 30, 2016..... \$ 40,000

Cash generated by operating activities is directly dependent upon sales levels and gross margins achieved. We generally receive payments from customers in 30-90 days after services are performed. The larger payroll and facilities components of our cost structure must be paid currently. Payment terms of other liabilities vary by vendor and type. Fluctuations in sales levels will generally affect cash flow negatively or positively in early periods of growth or contraction, respectively, because of operating cash receipt/payment timing. Other investing and financing cash flows also affect cash availability.

In fiscal 2016 and 2017, the underlying drivers of operating cash flows (sales, receivable collections, the timing of vendor payments, facility costs and employment levels) have been consistent. Sales outstanding in accounts receivable have increased from approximately 57 days to 65 days within the last 12 months. We do not expect days sales outstanding to materially fluctuate in the future.

The following table summarizes contractual obligations as of September 30, 2016 due in the future, excluding the mortgage that was paid off in connection with the sale of real estate in October 2016, and including the operating lease obligations associated with the lease of the sold real estate:

Contractual Obligations	Payment due by Period				
	Total	Less than 1 Year	Years 2 and 3	Years 4 and 5	Thereafter
Term Debt Principal Obligations	\$ 6,104,000	\$ -	\$ -	\$ 6,104,000	\$ -
Term Debt Interest Obligations ⁽¹⁾	2,030,000	406,000	812,000	812,000	-
Capital Lease Obligations	290,000	120,000	109,000	61,000	-
Capital Lease Interest Obligations	35,000	15,000	15,000	5,000	-
Operating Lease Obligations	19,215,000	3,853,000	5,225,000	4,156,000	5,981,000
Line of Credit Obligations	<u>3,139,000</u>	<u>3,139,000</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	\$ 30,813,000	\$ 7,533,000	\$ 6,161,000	\$ 11,138,000	\$ 5,981,000

⁽¹⁾ Interest on variable rate debt has been computed using the rate on the latest balance sheet date.

During the past year, the Company generated sufficient cash flow to meet operating, capital expenditure and debt service needs and its other obligations. When preparing estimates of future cash flows, we consider historical performance, technological changes, market factors, industry trends and other criteria. Cash flows from operations were \$(1,266,000) and \$(2,023,000) for the 3-month periods ended September 30, 2015 and September 30, 2016, respectively. Cash flows from operations will vary from period to period, depending on cash receipts and payment timing with respect to current assets and current liabilities. The sale/leaseback of real estate in October 2016 generated additional working capital to support the Company's cash needs in the fiscal year ending June 30, 2017.

We occasionally consider the acquisition of businesses which complement our current operations and possible real estate transactions. Consummation of any acquisition, real estate or other expansion transaction by the Company may be subject to the Company securing additional financing, perhaps at a cost higher than our existing line of credit and term loans. In the current economic climate, additional financing may not be available. Future earnings and cash flow may be negatively impacted to the extent that any acquired entities do not generate sufficient earnings and cash flow to offset the increased financing costs.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates and judgments, including those related to allowance for doubtful accounts, valuation of long-lived assets, and accounting for income taxes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions and conditions. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Critical accounting policies are those that are important to the portrayal of the Company's financial condition and results, and which require management to make difficult, subjective and/or complex judgments. Critical accounting policies cover accounting matters that are inherently uncertain because the future resolution of such matters is unknown. We have made critical estimates in the following areas:

Revenues. We perform a multitude of services for our clients, including film-to-tape transfer, video and audio editing, standards conversions, duplication, distribution, etc. A customer orders one or more of these services with respect to an element (movie, television show, etc.). The sum total of services performed on a particular element (a “package”) becomes the deliverable (i.e., the customer will pay for the services ordered in total when the entire job is completed). Occasionally, a major studio will request that package services be performed on multiple elements. Each element creates a separate revenue stream which is recognized only when all requested services have been performed on that element. At the end of an accounting period, revenue is accrued for un-invoiced but shipped work.

Certain jobs specify that many discrete tasks must be performed which require up to four months to complete. In such cases, we use the proportional performance method for recognizing revenue. Under the proportional performance method, revenue is recognized based on the value of each stand-alone service completed.

In some instances, a client will request that we store (or “vault”) an element for a period ranging from a day to indefinitely. The Company attempts to bill customers a nominal amount for storage, but some customers, especially major movie studios, will not pay for this service. In the latter instance, storage is an accommodation to foster additional business with respect to the related element. It is impossible to estimate (i) the length of time we may house the element, or (ii) the amount of additional services we may be called upon to perform on an element. We do not treat vaulting as a separate deliverable in those instances in which the customer does not pay.

The Company records all revenues when all of the following criteria are met: (i) there is persuasive evidence that an arrangement exists; (ii) delivery has occurred or the services have been rendered; (iii) the Company’s price to the customer is fixed or determinable; and (iv) collectability is reasonably assured. Additionally, in instances where package services are performed on multiple elements or where the proportional performance method is applied, revenue is recognized based on the value of each stand-alone service completed.

Allowance for doubtful accounts. We are required to make judgments, based on historical experience and future expectations, as to the collectability of accounts receivable. The allowances for doubtful accounts and sales returns represent allowances for customer trade accounts receivable that are estimated to be partially or entirely uncollectible. These allowances are used to reduce gross trade receivables to their net realizable value. The Company records these allowances as a charge to selling, general and administrative expenses based on estimates related to the following factors: (i) customer specific allowance; (ii) amounts based upon an aging schedule and (iii) an estimated amount, based on the Company’s historical experience, for issues not yet identified.

Valuation of long-lived assets. Long-lived assets, consisting primarily of property, plant and equipment, comprise a significant portion of the Company’s total assets. Long-lived assets are reviewed for impairment whenever events or changes in circumstances have indicated that their carrying amounts may not be recoverable. Recoverability of assets is measured by comparing the carrying amount of an asset to its fair value in a current transaction between willing parties, other than in a forced liquidation sale.

Factors we consider important which could trigger an impairment review include the following:

- Significant underperformance relative to expected historical or projected future operating results;
- Significant changes in the manner of our use of the acquired assets or the strategy of our overall business;
- Significant negative industry or economic trends;
- Significant decline in our stock price for a sustained period; and
- Our market capitalization relative to net book value.

When we determine that the carrying value of long-lived assets may not be recoverable based upon the existence of one or more of the above indicators of impairment, we measure any impairment based on comparing the carrying amount of the asset to its fair value in a current transaction between willing parties or, in the absence of such measurement, on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our current business model. Any amount of impairment so determined would be written off as a charge to the statement of operations, together with an equal reduction of the related asset. Net long-lived assets amounted to approximately \$14.5 million as of September 30, 2016.

Accounting for income taxes. As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves us estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items, such as deferred revenue, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax provision in the consolidated statements of operations.

At September 30, 2016, the Company has no uncertain tax positions. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. The deferred tax assets are fully reserved at September 30, 2016.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk. The Company had borrowings of \$14.1 million on September 30, 2016 under note payable, Term Loan and mortgage agreements. Our line of credit, equipment financing, Term Loan and mortgage loan are subject to variable interest rates. The weighted average interest rate paid during the three months ended September 30 2016 was 6.4%. For variable rate debt outstanding at September 30, 2016, a .25% increase in interest rates will increase annual interest expense by approximately \$36,000. Amounts outstanding or that may become outstanding under the credit facilities provide for interest primarily at the LIBOR plus 3.0 – 6.0% (3.52% to 6.82% as September 30, 2016). The Company’s market risk exposure with respect to financial instruments is to changes in LIBOR or the prime rate.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934 (the “Exchange Act”), the Company’s management, with the participation of the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company’s disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company’s disclosure controls and procedures were effective as of September 30, 2016.

Changes in Internal Control over Financial Reporting

The Chief Executive Officer and President and the Chief Financial Officer conducted an evaluation of our internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) to determine whether any changes in internal control over financial reporting occurred during the quarter ended September 30, 2016 that have materially affected or which are reasonably likely to materially affect internal control over financial reporting. Based on the evaluation, no such change occurred during such period.

Internal control over financial reporting refers to a process designed by, or under the supervision of, our Chief Executive Officer and Chief Financial Officer and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- Provide reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and members of our board of directors; and
- Provide reasonable assurance regarding the prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on our financial statements.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, the Company may become a party to legal actions and complaints against the Company arising in the ordinary course of business, although it is not currently involved in any material legal proceedings.

ITEM 1A. RISK FACTORS

In our capacity as Company management, we may from time to time make written or oral forward-looking statements with respect to our long-term objectives or expectations which may be included in our filings with the Securities and Exchange Commission (the “SEC”), reports to stockholders and information provided on our web site.

The words or phrases “will likely,” “are expected to,” “is anticipated,” “is predicted,” “forecast,” “estimate,” “project,” “plans to continue,” “believes,” or similar expressions identify “forward-looking statements.” Such forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. We wish to caution you not to place undue reliance on any such forward-looking statements, which speak only as of the date made. We are calling to your attention important factors that could affect our financial performance and could cause actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements.

The following list of important factors may not be all-inclusive, and we specifically decline to undertake an obligation to publicly revise any forward-looking statements that have been made to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events. Among the factors that could have an impact on our ability to achieve expected operating results and growth plan goals and/or affect the market price of our stock are:

- Recent history of losses.
- The need to raise additional operating capital.
- Changes in credit agreements and breaches of related covenants and ongoing liquidity.
- Our highly competitive marketplace.
- The risks associated with dependence upon significant customers.
- Our ability to execute our expansion strategy.
- The uncertain ability to manage in a changing environment.
- Our dependence upon and our ability to adapt to technological developments.
- Dependence on key personnel.
- Our ability to maintain and improve service quality.
- Fluctuation in quarterly operating results and seasonality in certain of our markets.
- Possible significant influence over corporate affairs by significant shareholders.
- Our ability to operate effectively as a stand-alone, publicly traded company.
- The consequences of failing to implement effective internal controls over financial reporting as required by Section 404 of the Sarbanes-Oxley Act of 2002.

Specific risk factors related to our July 2015 acquisition of the assets of Modern VideoFilm, Inc. include

- difficulty in realizing anticipated financial or strategic benefits of such acquisition.
- diversion of capital and potential dilution of stockholder ownership,
- the risks related to increased indebtedness, as well as the risk such financing will not be available on satisfactory terms or at all,
- diversion of management’s attention and other resources from current operations, including potential strain on financial and managerial controls and reporting systems and procedures,
- management of employee relations across facilities,
- difficulties in the assimilation of different corporate cultures and practices, as well as in the assimilation and retention of geographically dispersed personnel and operations,
- difficulties and unanticipated expenses related to the integration of departments, systems (including accounting systems), technologies, books and records, procedures and controls (including internal accounting controls, procedures and policies), as well as in maintaining uniform standards,
- difficulties and unanticipated expenses related to the integration of departments, systems (including accounting systems), technologies, books and records, procedures and controls (including internal accounting controls, procedures and policies), as well as in maintaining uniform standards,
- assumption of known and unknown liabilities, some of which may be difficult or impossible to quantify,
- inability to realize cost savings, sales increases or other benefits that we anticipate from such acquisitions, either as to amount or in the expected time frame,
- non-cash impairment charges or other accounting charges relating to the acquired assets, and
- maintaining strong relationships with our and our acquired companies’ customers after the acquisitions.

Other factors not identified above, including the risk factors described in the “Risk Factors” section of the Company’s June 30, 2016 Form 10-K filed with the Securities and Exchange Commission, may also cause actual results to differ materially from those projected by our forward-looking statements. Most of these factors are difficult to anticipate and are generally beyond our control. You should consider these areas of risk in connection with considering any forward-looking statements that may be made in this Form 10-Q and elsewhere by us and our business generally. Except to the extent of any obligation to disclose material information under the federal securities laws, we undertake no obligation to release publicly any revisions to any forward-looking statements, to report events or to report the occurrence of unanticipated events.

ITEM 6. EXHIBITS

(a) **Exhibits**

- 31.1 Certification of Chief Executive Officer Pursuant to 15 U.S.C. § 7241, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer Pursuant to 15 U.S.C. § 7241, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. § 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. § 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

- 101 The following unaudited financial information from our Quarterly Report on Form 10-Q for the quarter ended September 30, 2016, formatted in XBRL (eXtensible Business Reporting Language): (1) Condensed Consolidated Balance Sheets as of September 30, 2016 and June 30, 2016; (2) Condensed Consolidated Statements of Operations for the three months ended September 30, 2015 and 2016; (3) Condensed Consolidated Statements of Cash Flows for the three months ended September 30, 2015 and 2016; and (4) Notes to Condensed Consolidated Financial Statements.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DATE: November 10, 2016

POINT.360

BY: /s/ Alan R. Steel

Alan R. Steel

Executive Vice President,

Finance and Administration

(duly authorized officer and principal financial officer)

CERTIFICATION PURSUANT TO
15 U.S.C. § 7241
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Haig S. Bagerdjian, certify that:

1. I have reviewed this report on Form 10-Q of Point.360;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 10, 2016

/s/ Haig S. Bagerdjian
Haig S. Bagerdjian
Chairman of the Board of Directors,
President and Chief Executive Officer

CERTIFICATION PURSUANT TO
15 U.S.C. § 7241
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Alan R. Steel, certify that:

1. I have reviewed this report on Form 10-Q of Point.360;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 10, 2016

/s/ Alan R. Steel
 Alan R. Steel
 Executive Vice President, Finance and
 Administration, and Chief Financial Officer

CERTIFICATION PURSUANT TO
18 U.S.C. § 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Report of Point.360 (the “Company”) on Form 10-Q for the period ended September 30, 2016, as filed with the Securities and Exchange Commission (the “Report”), I, Haig S. Bagerdjian, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- (1) The Report fully complies with the requirements of Section 13 (a) or 15 (d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Haig S. Bagerdjian
Haig S. Bagerdjian
Chief Executive Officer
November 10, 2016

CERTIFICATION PURSUANT TO
18 U.S.C. § 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Report of Point.360 (the “Company”) on Form 10-Q for the period ended September 30, 2016, as filed with the Securities and Exchange Commission (the “Report”), I, Alan R. Steel, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- (1) The Report fully complies with the requirements of Section 13 (a) or 15 (d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Alan R. Steel

Alan R. Steel
Chief Financial Officer
November 10, 2016