INVESTMENT GUIDE

Media
Financiers

Before we begin…

Some key concepts from the world of cinema…

Independent cinema: defines all cinema production outside of the film studio system (in particular the media conglomerates, also called Majors, such as Disney, Sony, Universal or Warner Bros). Independent cinema deals with movies with lower budgets than those of the studios and accounts for more than a third of the market in value. Independent cinema has some autonomy in relation to the production methods, conventions and policies of major production studios.

Content: refers to audiovisual content (mainly feature films, TV series and documentaries)

Minimum Guaranteed (MG): refers to the down payments given in exchange for a mandate by distributors and/or sales agents, which contributes to the financing of the production. The producer (or its financial partner entitled to this right) will keep this amount, whether the movie is a success or not. Distributors or sales agents are not required to invest a MG to acquire a movie; they can also propose to only pay the producer a proportionate share of the revenue earned in a given country.

Backends: refers to any remaining movie and TV series proceeds once all the priority funders (those who have contributed to the financing plan: recoupable grants or subsidies, equity, etc.) have been reimbursed. Usually, backends are paid to producers, cast, technical team and private financiers. Backends give a proportional access to the residual value of the movie, i.e., its long-term proceeds.

Gap financing: private financing consisting in filling the gap of a content's budget. This financing gives the private investor priority rights to any income, and rights to a share of all of the movie's various future receipts, valid for the content's full life.

Greenlight: To greenlight a movie is to authorize its production, once the financing plan is completed. MGs and presales committed before the greenlight enter into the financing plan. MGs and presales paid after the greenlight are part of the proceeds.

Presale: Sale of a content closed with a local distributor on a geographical territory before the end of the film/TV series production. The distributor's MG can be affected to the financing plan.

Waterfall: process for determining the distribution of income for the stakeholders of a film. This important concept is explained in section 3.

HOW CAN AUDIOVISUAL CONTENT BE CONSIDERED AS AN ATTRACTIVE INVESTMENT OPPORTUNITY?

1. The Content Industry

WHY CHOOSE TO INVEST IN THE CONTENT INDUSTRY?

- **A rapidly growing industry with a new paradigm, in particular with the new opportunities brought by streaming platforms (Netflix, Amazon, Disney…)**
- **An investment that combines short-term and long-term returns:**
  - **Fast cash flow generation (around 18-24 months)**
  - **Potential for a substantial residual value (i.e. long-term value) with predictable proceeds**
- **Possibility of limiting the downside more efficiently than with a traditional private equity investment**

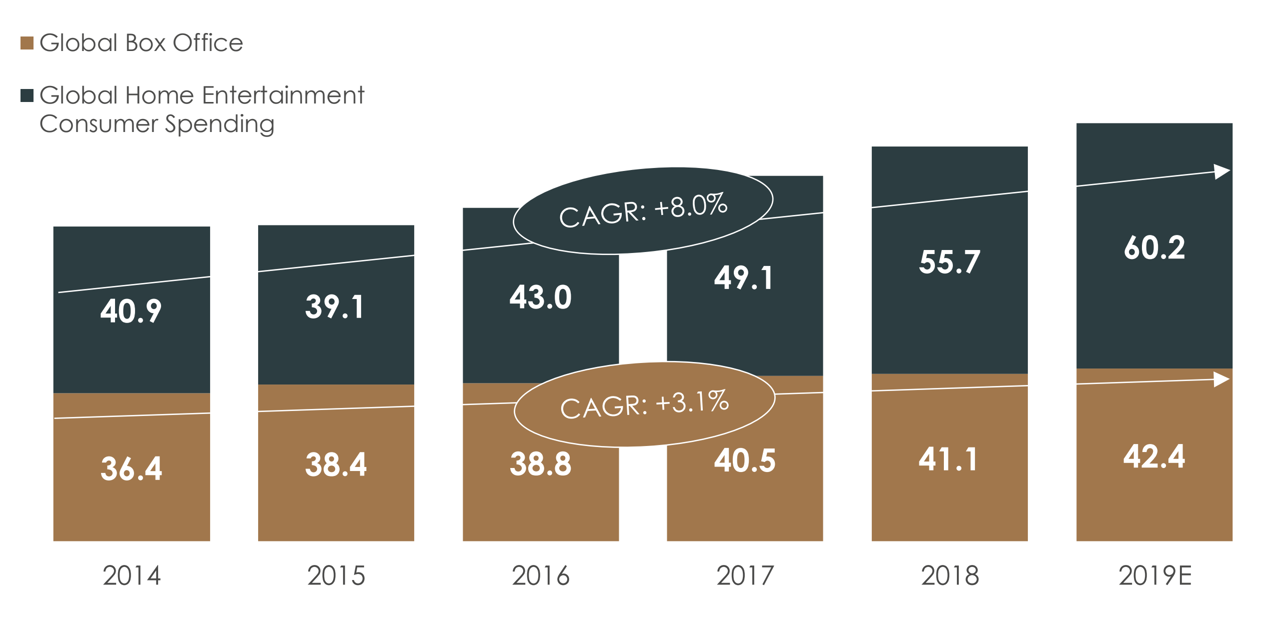
1.1. A growing and resilient industry

More and more high net worth individuals and institutional players are drawn to the content industry by **a compelling macro outlook.** The global entertainment market — consisting of theatrical and home entertainment — has surpassed $100 billion in revenues for the first time in history, with earnings reaching $101 billion in 2019[1]. This figure has increased by a compounded annual **growth rate of 5.8%** over the last five years. This trend can be split into two sub-trends (outside of Covid-struck 2020):

- box office revenues which are increasing by 3.1% (piracy is not a threat anymore)
- home entertainment revenues, including physical (DVD, Blu-Ray) and digital entertainment (EST, VOD and SVOD) which are growing by 8% each year in average, pulled by the hypergrowth of Subscription Video on Demand (SVOD) services like Netflix.

[1] *MPA theme report 2019*

Figure 1: Global Filmed Entertainment (Box Office + Home Entertainment) - In Billion US$



Source 1: 2014-2018 data, "2018 THEME report", Motion Picture Association of America. 2019E estimates made from a linear projection of 2018 data based on the 2014-2018 CAGR

As time goes by, the marketplace has necessarily adapted to this rising consumer demand. Distribution platforms are multiplying and the competition for content acquisition is fiercer than ever. Netflix's content spending was $12 billion in 2018. It will hit $15 billion in 2019 and it is expected to rise to $17.3 billion in 2020[2]. Amazon has an acquisition budget of around $6 billion per year, and new players such as HBO Max and Disney+ launched at the end of 2019/beginning of 2020 with massive spending.

Figure 2: Distribution platforms' spending – In Billion US$

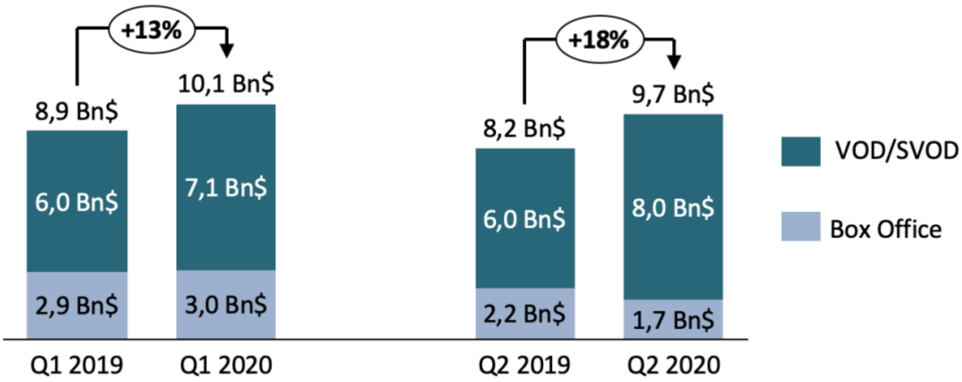
	2018	2019	2020
Netflix	12	15	17.3
Amazon	5	6	7
Apple TV	N/A	0.5	2
Disney +	N/A	0.5	2
Hulu	2.5	2	2.5
HBO MAX		2.5	3.9

Source 2: Variety, Forbes, The Observer

[2] *https://marketrealist.com/2019/09/video-streaming-will-netflix-get-big-break-overseas/*

The recent Covid-19 epidemic has shown that the content industry is also resilient: despite the cinemas' closure, the spending on audiovisual content has been driven by streaming platforms and TV channels purchasing and broadcasting massive volumes of content. As shown in the graphs below, U.S. consumer spending in entertainment increased by 13% in the first quarter of 2020 respectively to the same period in 2019; this figure rose to 18% for the second quarter. The major takeaway observable here is the fact that the increase in VOD/SVOD spending largely compensated the significant drop in box office due to the crisis.

Figure 3: U.S. Consumer Spending



Source 3: DEG Mid-Year 2020 Home Entertainment Report

For illustration, Disney+ direct-to-consumer streaming service has made a huge impact from the first days of its European launch in the midst of the sanitary crisis, with more than 5 million downloads in the United Kingdom, Ireland, Germany, Italy, Spain, Austria and Switzerland altogether[3].

The major beneficiaries of this trend are content producers who are finding themselves with more outlets than ever for selling their products. Furthermore, they can even find themselves in the middle of a bidding war if they manage to produce some of the most iconic cultural products. Netflix reportedly paid $100 million to keep Friends on its service for the year 2019 alone, and the price to obtain the streaming rights of South Park hovers at around $500 million.

1.2. Movies and TV series as an attractive alternative asset class

1.2.A. A new alternative asset class

The "raw materials" on which this industry is built are movies and TV series. Investing in their production budget is the best way to capitalize on the growth of this industry. They could be considered as the constituents of **a new alternative asset class.**

*In finance, an asset class is a category of investments that present similar risk and return characteristics in the marketplace. Movies and TV series present these similar characteristics (which means that they belong to the same asset class), and they are not tightly correlated with other asset classes such as stocks, bonds and real estate. Consequently, investment in filmed entertainment is worth considering for any investors looking to build a **balanced wealth allocation.***

---

[3] https://www.rapidtvnews.com/2020032658256/disney-off-to-a-flying-start-across-europe-with-5mn-downloads.html

1.2.B. Three major advantages of content as an asset

Content offers three major advantages as an asset:

- **The combination of short and long-term returns**

The recovery of cash flows generated by movies and TV series has the following two main features:

- a very long (possibly limitless) life cycle,
- a quick (under 18 months) trend about the potential level/speed of return on investment with first proceed wired fast in (typically 18/36 months).

Intellectual properties on movies are acquired for more than 30 years in most European countries, or even in perpetuity in the UK and the US. As such, even at the end of its first operating cycle, **a movie in a portfolio retains an important residual value** and can therefore remain liquid over a very long period.

Due to the rapidity of the first operating cycle, which usually lasts around 36 months, there is typically **a short payback period for a specific investment.** Strong visibility on future cash flows for a specific project is possible just nine months after the initial investment, and the first paybacks tend to be within 18-24 months of the first investment.

- **The residual value: examples**

The French motion pictures company EuropaCorp showed a deficit of €82.5 million in 2017-2018**,** while the total value of its content portfolio was valued at **€144 million[4].** Mars Films, a French distribution company, filed mid-2019 for bankruptcy (due to its €79 million debt), while its portfolio was still valued at **€107 million[5]**. And the famous studio Miramax founded by the Weinstein brothers in 1979 was bought for its library in 2010, by Colony Capital and the sovereign wealth fund of Qatar, for **$660 million[6].** The Miramax production catalog includes over 700 films which have won a total of 68 Oscars, including *The English Patient*, *Shakespeare in Love* and *No Country for Old Men*.

The global profitability of an investment does not depend solely on the box office: many other distribution channels are likely to generate various forms of revenue over time.

See section 3.3 for a detailed explanation on life cycles and ROI of audiovisual content!

- **Investment profile: a limited downside… and an unlimited upside**

Contrary to corporate equity investments in companies that can lose all value if a portfolio company files for bankruptcy, **the downside of a specific investment in movies and TV series can usually be contained through smart project structuring.**

When the deal terms of an investment are properly negotiated, the loss of capital linked to a failed project can be limited to 50% over the first part of its life cycle and 30% over the long term after taking into account the residual value.

While the short-term upside is usually quite limited – a successful movie traditionally generates returns of 150-200% in the very short term for an equity investor – the residual value, for its part, can be substantial, even in the short term and can increase over time.

---

[4] *https://www.lesechos.fr/tech-medias/medias/en-difficulte-europacorp-cede-une-partie-de-son-catalogue-de-films-a-gaumont-1003915*

[5] *http://ecrannoir.fr/blog/blog/2019/08/28/mars-change-de-strategie/*

[6] *https://www.lesechos.fr/tech-medias/medias/viacomcbs-croque-49-du-studio-americain-miramax-1158457*

For example, the intellectual property rights on Reservoir Dogs, the first movie written and directed by Quentin Tarantino in 1992, have continued to increase in value as Tarantino's career continues to flourish. In addition to the cash flows generated by the monetization of these rights during movie releases in theaters, the frequent TV broadcasting and subsequent addition to SVOD platforms mean that today, some 30 years later, the intellectual property rights still have major market value.

Movies are therefore cash flow generating assets with the potential for long-term appreciation. **There is no limit to the upside of a cultural product and no boundaries in time for its valuation.** Spinoffs[7], prequels[8], sequels[9] are also other kinds of upsides for successful IPs. The same principle applies to TV series, which also offer the additional advantage of the recurring revenues for new seasons. The objective of any content library is to manage diversified portfolio strategies to get a share of one or several of these hits.

[7] *Spin off: content derived from already existing works that focus on more details and different aspects from the original work (e.g. particular topics, characters or events). E.g.: Rogue One is a Star Wars spin-off.*

[8] *Prequel: content whose story precedes that of a previous work, by focusing on events that occur before the original narrative. E.g.: Prometheus is a prequel to the original Alien films.*

[9] *Sequel: content continuing the story of, or expanding upon, some earlier work. E.g.: The Dark Knight is a sequel to Batman Begins.*

2. Investing in content: how does it work?

2.1. The advantages of the content industry for a private investor

Audiovisual scripted content covers mainly movies and TV series. The financing of this industry is based on three premises:

AN **ACYCLIC ECONOMY**	A **SUBSIDIZED SYSTEM**	A **LEVERAGED MARKET**
The content industry is not connected to the financial markets volatility. In times of economic crisis, going to the movies is the cheapest form of amusement. SVOD and TV are also usually thriving in a financial turmoil. It generates a variety of income in multiple forms across multiple regions. It combines short- and long-term income. Recent Covid-19 outbreak showed that content is a resilient market. Even if theaters were closed, film and TV spending were driven by streaming platforms and TV buying large volume of content.	In many countries, content production and distribution are supported by the government, thus bringing free leverage to these private investors: • Automatic subsidies (tax credits, tax shelters in Belgium, etc.) • Selective subsidies This financing is often called “soft money”. In France, soft money can finance anywhere between 30% and 65% of a movie’s budget. US state of Georgia has generated 3 billion tax credit for film incentive from 2013 to 2017 (largest film support program in the USA).	As in LBO private equity, the equity invested into a film is heavily leveraged. But instead of a debt, and further to soft money leverage, it’s also leveraged with pre-financing from distributors or sales agents. Indeed, the movie's stakeholders usually pay a flat fee advance for the right to distribute the movie before production starts in the form of a minimum guaranteed (MG). Once the financing needed for movie production has been collected, the movie is given the green light and production can begin. Additionally, some of the artistic, technical or administrative services may take the form of **deferred compensation** payable to the filmmaker or talents when the movie is released and / or successful.

2.2. How is audiovisual content financed?

Movie and series financing comes from:

- Soft money.
- Pre-buy of distribution rights or minimums guaranteed linked to the sales mandate.
- Private financing (equity): when the two previous sources are not enough to cover the budget of a movie, there is a **gap** which is filled by a private financier. This **gap financing** gives the private investor who's willing to provide financing to the film budget:
    - Priority rights to any income, in order to recoup its investment (plus a risk-taken bonus, usually called the premium).
    - Co-ownership rights to the movie. Rights to a share of all of the movie's various future receipts, valid for the content's full life (usually 99 years or perpetuity): the **backends.**

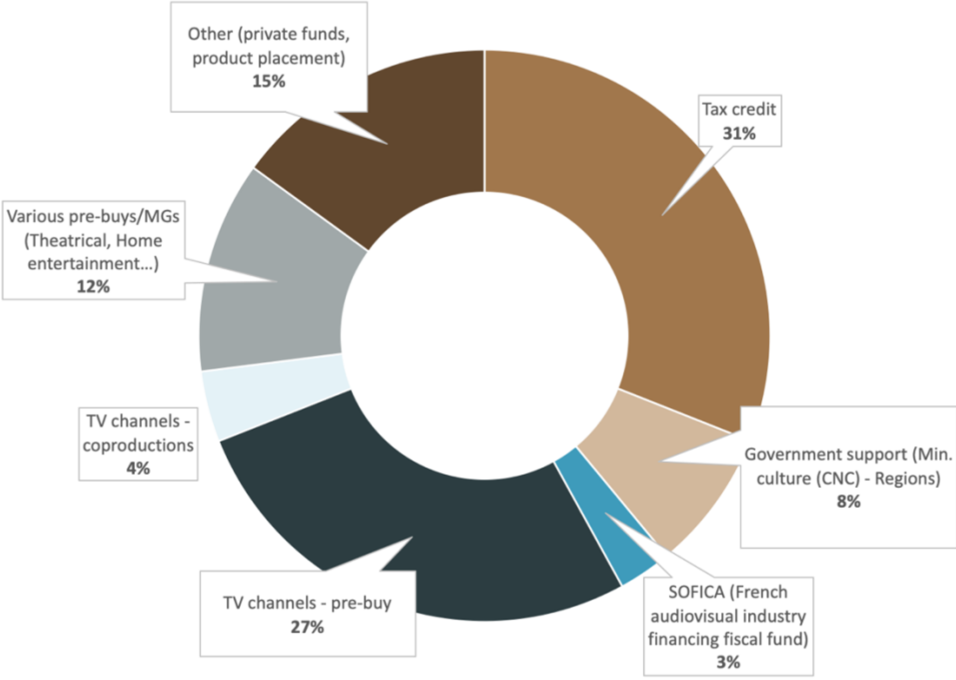
Sources of movie financing

	SOFT MONEY		PRE-BUYS AND EQUITY					
	Automatic subsidies	**Selective subsidies**	**Producer**	**International sales agent**	**Distributor – Domestic**	**Distributor – Other**	**Audience output (B to C)**	**Financier**
ROLE	• Subsidies with no conditions precedent. Example: Tax credits: tax exemptions for expenses incurred in a specific item or area (e.g., 65% tax credit in Manitoba (Canada)	• Grants (common in Europe, rare in the United States) such as regional or national grants (certain grants from the CNC in France)	• Organizes the financing and production of the movie • Has the long-term rights for the movie	• Intermediary (optional) assigned by the producer to find distributors in each country, particularly outside of their domestic region.	• Purchases all the rights of a movie (cinema, TV, etc.) in the producer's domestic region. • Uses these rights by selling them to different media outlets in the domestic region (see audience output).	• Purchases all the rights of a movie (cinema, TV, etc.) in their region. • Uses these rights by selling them to different media outlets in the region (see audience output).	• Cinema (independent or chains) • Channels (free or subscription, e.g., Canal+) • VOD (video on demand, the viewer pays for the movie when they want to watch it) • SVOD (platform with subscription, e.g.: Netflix)	• Invests in content to bridge the gap between financing collected by the producer (soft money, MG) and the movie's budget.
Financial participation			• Can offset their salary and expenses against the future revenues of the movie.	• Carries out international sales, receiving a commission for each sale. The agent can give the producer a MG (optional) at the start, therefore participating in the movie's financing.	• Distributes the movie in the domestic region, receives sales commissions. Can give the producer a MG (optional) at the start, therefore participating in the movie's financing.	• Distributes the movie in a geographic area, receives sales commissions. • In exchange, the distributor can give the producer a MG (optional), therefore participating in the movie's financing.	• Purchases (from the distributor or sometimes directly from the agent or producer) the right to distribute the movie for a fixed period (generally a few years).	• A financial advance in the form of equity, which is often reimbursed in priority to other financial stakeholders. This investment gives way to backends.

The agent and domestic distributor's MG, and potential gap financing enable the movie to be greenlighted.

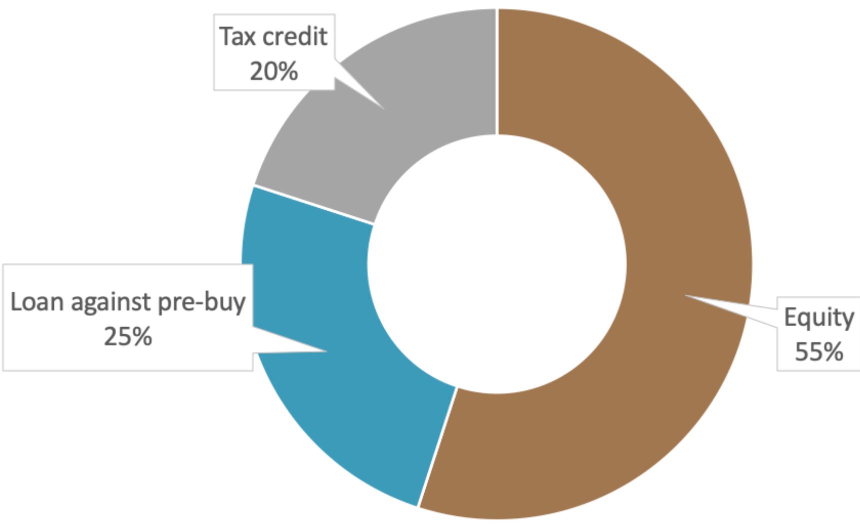
Here are two examples of the typical breakdown of various types of movie financing structure:

Figure 4: Average proportion of different financing sources for French-led movies (2008-2017)



Source 4: "Report on the private financing of movie and audiovisual production and distribution", Dominique Boutonnat, December 2018.

Figure 5: Average breakdown of financing sources for US indie movies financed by equity investors



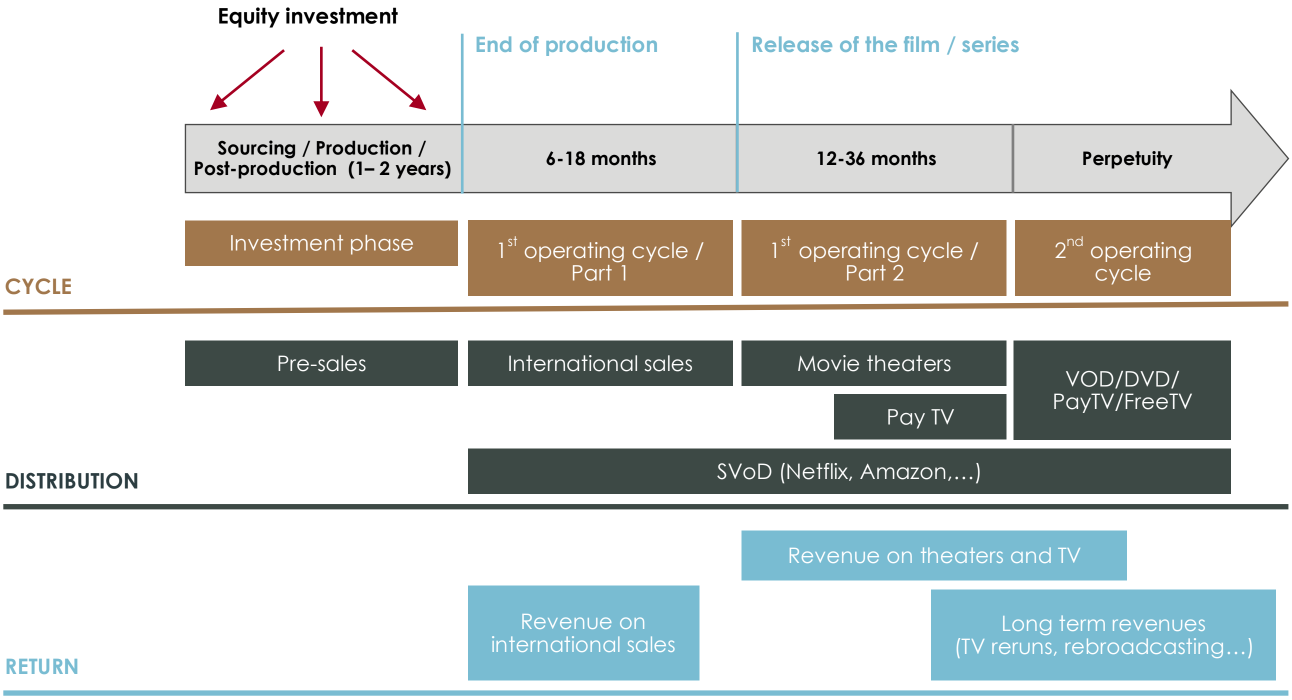
Source 5: Logical Pictures

As shown in the graphs above, European movies usually benefit from stronger financing leverage, thanks to various support mechanisms less frequent in the US.

2.3. The life cycle of a movie and the revenue hereby generated

As shown in the diagram below, the global profitability of a film investment does not depend solely on the theatrical box office: many other distribution channels are likely to generate various forms of revenue over time.

Figure 6: The life cycle of content and revenue



2.4. The waterfall – making investments in the audiovisual sector profitable for private financiers

All revenue generated by the movie globally (distributor MGs around the world, theater tickets and TV royalties, DVD and streaming revenues, remake rights, merchandising, etc.) flows through **the income waterfall** for the whole term of the rights.

Negotiations between the financing stakeholders determine who will recover their investment (called investment recoupment) and when. Income is gradually accumulated and distributed among the movie's financiers based on the agreements made between them.

A simplified fictional example to help the understanding

In this example:

- The equity investor is the only financier of a movie:

- Investment: €100,000.
- Premium of 20% (= additional priority recoupment of 20% of the investment ticket, i.e., €20,000) The investment and premium are recoupable "from the first euro" (i.e., priority is given to the equity financier. Only the sales agent recovers their commission and expenses before)
- 10% share of any further income (backends pool)

- An international sales agent
- has a 15% commission on sales
- did not provide any Minimum Guaranteed MGs (thus no MG to recoup for the sales agent)
- And can be reimbursed for up to €10,000 of marketing expenses (festivals, travel, etc.).

Figure 7: First sale: The international sales agent sells the movie for €100,000 to an Italian distributor.

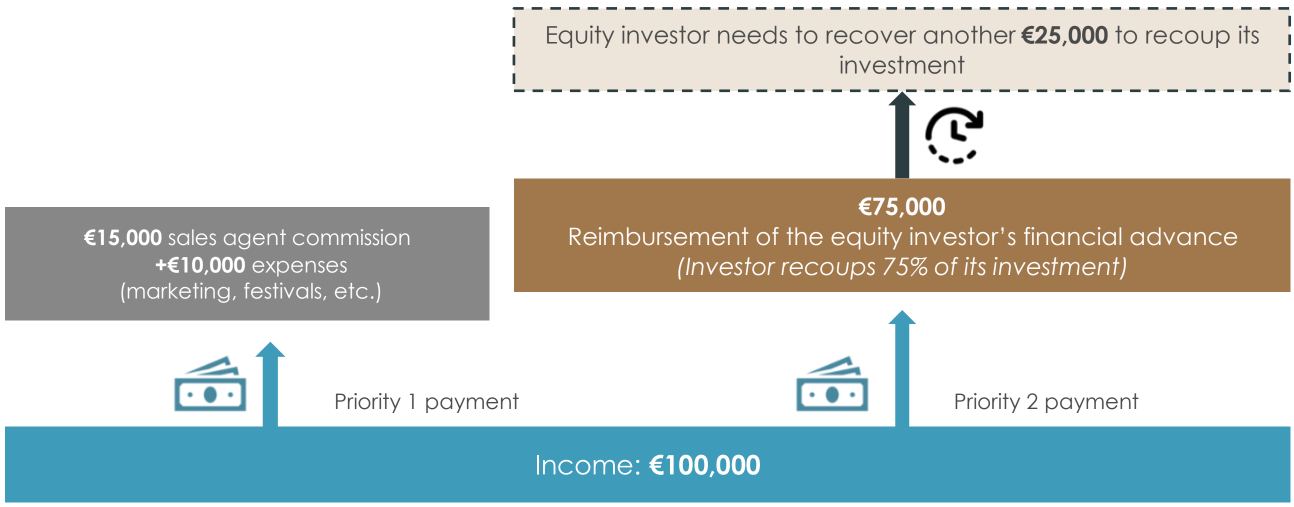
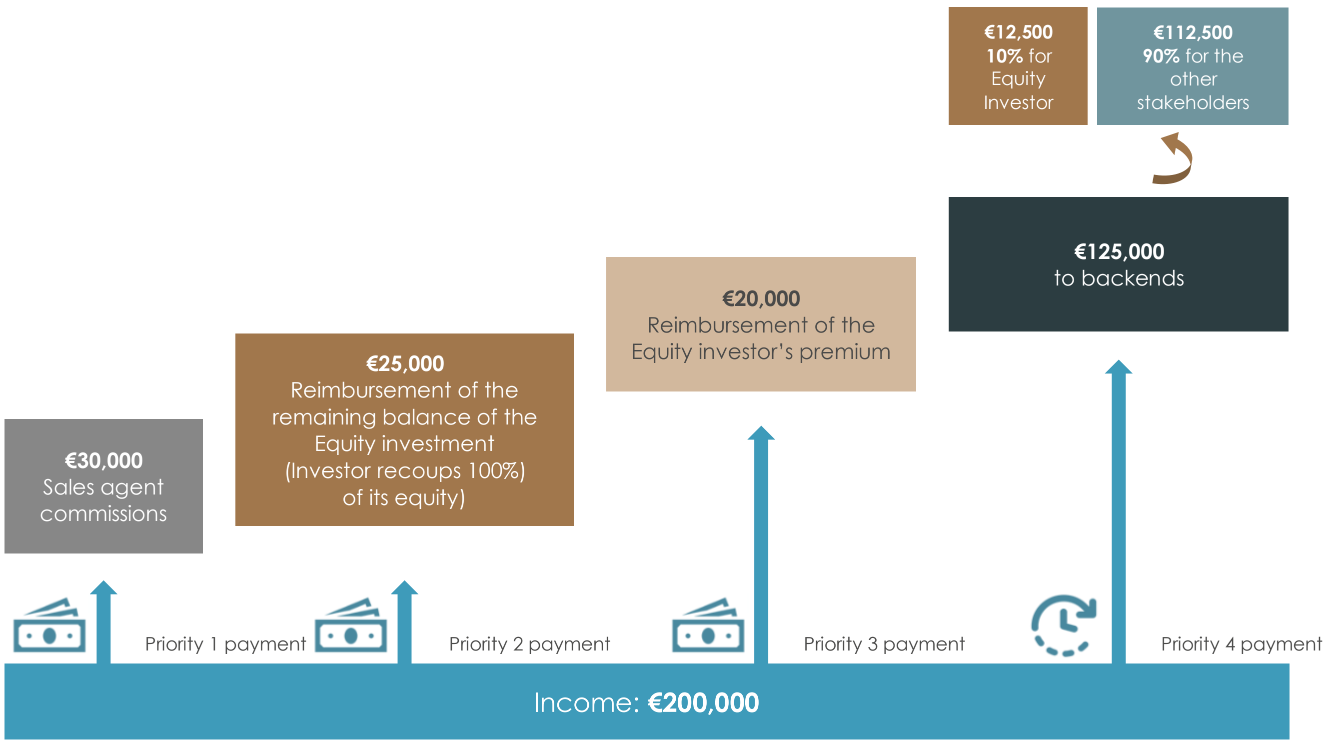


Figure 8: Second sale: The international sales agent then sells the movie for €200,000 to a German distributor.



Content can generate various sources of revenue: MG of distributors around the world, theater tickets, DVD and streaming revenues, TV rights, remake rights, merchandising, etc.

Generated around the world, these revenue flows pass through the income waterfall, which determines the conditions for revenue distribution for each stakeholder.

The financial engineering is key. The profitability of an investment primarily depends on the position negotiated by the investor in the waterfall. As a result, for the same project, the profitability of an investor may be very different depending on its position in the waterfall.