

ENTERTAINMENT

Investing in entertainment backed assets



C. Mead Welles, CEO and Senior Portfolio Manager, Octave Entertainment Fund

What made you want to invest in the entertainment space?

The opportunity to invest in the entertainment space was driven by our experience structuring complex financial transactions around commodities and international trade. We were approached by a number of entertainment companies who had similar financing needs, and we recognised that we could apply our model to the entertainment and media space as we had historically applied to commodities and agriculture. Specifically, we try to use some combination of receivables and inventory to secure our transactions. In the case of media, the receivables are the distribution contracts that exist between any given seller of content and the companies that distribute that content to the end viewer. The inventory is the media library in question; it could be a film library, or a television series, or even a music catalogue.

Who should invest, and what would be the benefits?

The benefits of investing in an entertainment fund are high yields with low volatility and low correlation to other asset classes. The strategy is best suited for sophisticated institutional investors, who are seeking investments with this risk return profile.

Would you say entertainment-based investing is unique, when compared with other assets?

Investment in the entertainment space in and of itself is not new. With weightless assets, there are a number of risks that are quite different from other, more conventional industries that may not be as easily mitigated, like technology changes. One example is the change in home video standards from VHS to DVD to VOD. These landscape shifts can render the initial due diligence and models for any given transaction obsolete in a short period of time. The approach we take is designed to mitigate the risks as best as we can.

Why are such investments synonymous with higher risk, uncertainty, longer gestation periods ... from your experience would you say that is indeed the case? If yes, are the rewards commensurate? Elaborate.

The entertainment sector is perceived to have higher risk because of the many “unknowns” on how profits are generated. The industry has always looked at profit from a pre and post tax standpoint which by its nature makes the financing risks more unclear for an outsider. Furthermore, some of the perceived risk stems from the fact that cash flows in the entertainment sector are not as linear as they are in other industries. For instance, when a seller of content (eg. an owner of a film library or a studio) signs a contract with a cable channel for distribution, the cable company is typically not required to air the movie on a set schedule. Since most contracts call for payment after the film has been aired, the seller has no control or visibility on when the payment will come in. Although the gross contract value is visible upfront, the realisation of those cash flows is unpredictable, which makes it difficult not only for the seller to plan its cash flows, but for traditional lenders to as well.

Of course, the rewards for accepting this higher perceived risk is a higher expected return. In the case of our fund, we try to mitigate this perceived risk, as the science of our structuring process is to secure our position while at the same time allowing the obligor access to sufficient cash flow to manage its business.

How do you break down the scope of investing in this space ... how do you identify investment prospects, what sort and why?

The scope of investing in the entertainment and media space is quite broad. There are opportunities globally in the financing of film libraries, television series, music catalogues, and live concerts, among other areas. Our method of identifying prospects is driven by referrals and by proactive sourcing; we have developed an extensive network of relationships within the entertainment space, so that we can maintain a diverse pipeline of transactions.

What skills would you say an investor must possess if one were looking at investing in this space?

Knowledge of the risks inherent in the entertainment sector and familiarity with structured finance are important.

Is now a particularly opportune time to invest ... when is?

We do not advocate a “market timing” approach to investing in the entertainment space. In the case of our fund, we structure transactions so that the security underlying each transaction and the relative ability of any obligor to repay tend to be independent of economic cycles. We do watch trends and we do not like to be trend setters in this arena. In that regard, we are always happy to wait around to “pick up the pieces.”

What are the different investment vehicles available to an investor looking to invest in the entertainment space?

There are a variety of investment vehicles that we know of available to investors. Vehicles include debt funds that lend against libraries or cash flows, equity funds that invest in entertainment companies and individual productions, and hybrids that are more opportunistic.