

FILM INVESTING

PERFORMANCE OPTIMISATION

“Our fund’s micro managed, portfolio approach to film and venture partner selection, affords the ability to avoid the potential pitfalls of revenue participation in film projects and the vagaries of excessive fees and charges - thus enhancing the attraction to this form of investment. The use of guarantees rather than immediate funding provides a greater degree of flexibility for the investors.” **David Tucker**



Film investing: what are the different, and new, sources that could generate revenue streams for an investor?

New sources of revenue will include: Digital distribution, 3D distribution, video on demand, streaming video, digital television, mobile content delivery, handheld content delivery, plus the associated and proportional increase in tie-ins and ancillary revenue streams, such as: merchandising, product placement, spin-offs and video games. Consequently, there has been a dramatic increase in the upside associated with films, whilst affording the opportunities to significantly reduce the downside risks. Our approach, because of its people and processes, is uniquely placed to capitalise on these changes in the marketplace, to ensure profitability for a portfolio of commercially viable films.

How important is it to have a box office hit? How much does it, should it, be contributing to overall performance?

From a performance perspective, a box office hit is nice to have but is not essential, as the market for feature films is changing rapidly and remarkably. With this as backdrop, we believe it is essential to put together a portfolio of venture partnerships directly with the studios and or established production entities. This strategy maximises the benefits from a film investment, whilst minimising the inherent risks. It ensures the correct structure is in place and works best for both the investor and the film industry, to garner this source of alpha.

The “venture partners” for our fund, are drawn solely from the highest echelons of the industry. They are all reputable and well-regarded US-based production companies (some of which are household names), mini-majors and major studios, with established track records.

The production companies are, for the most part, businesses whose talent base and productions are highly sought after by the US studios and world-wide distributors. A box office hit, particularly in the “domestic” market (USA/Canada) is normally the driving force behind a strong worldwide theatrical release. However, in many instances, theatrical performance is increasingly becoming an advert for the DVD, video and ancillary market releases (sound tracks, games, spin off, merchandising etc.). By using this robust and repeatable process to create a diversified portfolio of films, increases the potential to make films that will be successful.

What performance (net annual) can an investor expect?

We are targeting a net return of 15% to 25% per annum over the period of investment with a very low correlation to other asset classes. Going back five years, returns from the domestic box office and initial video rental receipts for some of the venture partners that we are intending to use in our fund were analysed. The numbers fall within our range even without including all the ancillary market returns. Although this is not a guarantee for future performance, reputable film makers do continue to generate profitable films.

Bearing the investor’s interest in mind, what according to you should be an appropriate fee structure?

The fees should be no different than any other alternative investment - 2% per annum management fee with a 20% performance fee paid at the end of the investment term.

What are the loopholes and where do you believe an investor should exercise caution?

The devil is in the detail. The investment returns of each venture will be wholly dependent on the detail of the co-financing and revenue participation arrangements, which historically have not favoured the investor. It is fairly typical to find co-financing/co-production “partners” using complex revenue waterfalls and inequitable fee structures, thereby inhibiting the transparency, accountability and inherent

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profitability of the individual projects and the overall slate.

For example, a fairly typical engagement would see the venture partner taking fees at a number of different levels starting with 20% of the profit until the investor recovers 110% of their capital, then increasing to 40%, 50% and as high as 65%, in some instances, as the venture generates higher profit. Additionally, more often than not, there are management fees that can be as high as 3% per annum plus producer fees, production overheads and miscellaneous expenses that can be an additional 5% to 20%.

The revenue streams are impacted by the studios/distributors charging distribution fees in excess of 20% of the budget, as well as immediately recouping any print and advertising costs and other expenses they may have incurred (which are often hidden), with a margin built in on top. To further compound the investment's potential, the minimum number of projects over the term of the venture can be fairly low in comparison to the requisite capital commitment. Plus, the risk profile of the investment can be severely altered by the fact that these projects can actually be a mere subset of the total production of that studio or producer – “cherry picking” rather than an opportunity to truly co-finance all the products from that source.

Is transparency an issue? Accountability? Solutions?

The industry has a history of frequent litigation, obscure accountancy practices and general obfuscation. Clear, transparent and mutually beneficial terms must be agreed, with on-going monitoring and reporting which ensures that the investment maintains the same risk profile. It is essential to have full right of audit with all parties, across the entire supply chain. The objective is to achieve an alignment of interests: all parties that co-finance a deal must have interests which are aligned as exactly as possible.

Other peculiarities/ observations?

The equity investors are poorly positioned in typical film fund investment vehicles which rely heavily on tax rebates, debt financing and cross collateralisation - with inequitable fee structures, overheads and producer salaries. We believe it is possible to reverse this position by providing a flexible exit strategy at the end of the investment term.

Elaborate on the “unfunded approach” to investing in films?

The investor is providing a guarantee for a fixed term, multiple draw credit facility, or overdraft, for the life time of the fund via our panel of banks. Depending on the nature of these guarantees a small percentage of cash is maintained on account in the fund. The investor continues to manage their portfolio of assets whilst accessing the potentially uncorrelated returns that feature films are capable of generating, with minimal actual cash outlay (the guarantee could be against illiquid assets, such as real estate, or against assets under management). The recycling of revenue in films tends to be remarkably quick. Thus, with well placed, highly controlled film investments across a portfolio of slates, there is a strong chance of our fund generating profits in a relatively short term, which will afford the investor the option of short term liquidity, as the fund's cash surplus proportionally reduces the underlying investor's guarantees.

Why is it particularly well suited to institutional, pension, endowment investors?

These investors tend to have a longer investment horizon; seeking uncorrelated returns in order to diversify their risk. If this investment can be structured in a way, where it can provide the appropriate level of transparency and control, then it is ideally suited to this marketplace. The unfunded approach also allows the investor to better accommodate the investment within their existing risk budget.

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