

# MONEY IN MOVIES

FILM INDUSTRY FINANCING.



Perhaps it is the thought of clinking glasses with Hollywood's current heartthrob at TIFF or, even more exciting, the long-shot prospect of attending the Cannes Film Festival that has you wondering about the opportunity to invest in a feature film. You are quick to realize that the business opportunity is still little more than someone's creative idea wrapped in the glitz that is the glamour and celebrity associated with movie making. The glamour connected with the big screen has always been a strong lure, attracting budding actors and hopeful screenwriters to an industry in which the underlying business principles are still a mystery to most. But feature-film production is a serious business with its own unique and complex financing structures that produce rewards commensurate with the risks.

"People want to be associated with the film industry because of the people related to the industry, the beauty associated with the industry, and the glam factor," explains Lui Petrollini, a partner

at Ernst & Young. Petrollini and partner Neal Clarence lead Ernst & Young's national entertainment practice out of the accounting firm's Vancouver office, serving clients in Vancouver, Toronto, Winnipeg, Los Angeles and New York.

"On the surface, to a certain extent the film industry is glamorous, but in the backroom, with respect to the business operations, it is a cutthroat business. It's not an easy business," says Petrollini.

One of the country's top entertainment lawyers, Arthur Evrensel, who heads up Heenan Blakie's entertainment practice in Vancouver office likens the feature-film industry to horse racing. "It is a hit-and-miss business. Sometimes you have winners."

Evrensel has seen his share of winners in the motion-picture business as a director of Lions Gate Entertainment, which had its start in Vancouver and now extends its reach into Hollywood and diversified entertainment markets around the world. Lions Gate produced the triple Academy Award-winning *Crash* in 2004 and

has carved out a niche for itself in feature films, producing a series of urban horror films, including the third installment of the gory but popular *Saw* series.

"Moviemaking is not just about passion. Real success comes from melding art and business," says Evrensel. "We don't spend more than the film can make on release. It's also all about controlling the cost side. These urban horror films, as a niche product, have production budgets with ceilings of \$20 million." Lions Gate also minimizes its downside risks by bringing in equity partners, usually in the form of film-investment funds based in the United States.

Private equity financing is available from a few private-equity funds in Canada, but individual investors are few and far between. "I've got producers who have been financed by family and friends who are completely unsophisticated, and I've seen others who are more sophisticated, where they really put the producers through their paces before they're willing to provide any cash," Petrollini explains, describing the availability of private financing.

Government also plays a big role in the film industry as a financial supporter. Telefilm Canada, the federal government's arms-length cultural agency, is itself an investor in film production. Telefilm has various forms of financing available at almost every stage of film production, from the earliest stage when only an outline of a script exists, through to distribution and marketing.

Telefilm's John Dippong says the agency expects to see some private financing on the table at the development stage, but is also prepared to take risks at the early stage. "Our programs are producer-driven. The producer has to come to us, ideally with a financing structure with something in place, whether that's funding from a broadcaster or from one of the private-equity funds. Or they can make up their financing structure with their own funds."

William Vince of Vancouver's Infiniti Features risked his own capital in 2005 to produce the highly acclaimed *Capote*. When actor Philip Seymour Hoffman first brought Vince the script, he immediately realized that if he made the film at the right price, the chances of benefitting financially were very high. "I knew that Philip Seymour Hoffman was a great actor. The script was amazing. If I kept the costs below \$7.5 million and I hit the specialty market—the mature audience—then it would do well," Vince says. Infiniti invested \$2.5 million in the *Capote* project, and they brought in MGM Studios as the distributor with \$5 million. Vince's Infiniti was able to structure the deal so that it received 10 per cent ownership in the project. The \$7.5-million production so far has made \$50 million overall.

Vince is a strong advocate for government incentives to attract private capital to the film industry. In fact, his \$2.5-million investment in *Capote* included tax credits he was able to obtain from the Manitoba government, since the film was made in that province. But he also believes government has become too directly involved in financing film production, largely out of necessity since there are few tax incentives remaining to attract private capital. "As soon as the private-sector capital shuts down, more focus is put on subsidies. When government gets too involved in the industry, it takes business sense out of it," Vince contends. "Then when there is no business sensibility, the producer is not accountable and it is hard to attract private capital."

He argues that incentives, such as flow-through losses and generous tax credits, are needed to attract more private capital to a risky business sector. Producers should also provide investors with annual dividends to overcome the fact that, for most feature films,

payback periods span more than a year or two. Investors also need to see true upside potential in the films. This profit-participation potential should not be diluted by commissions, fees or expenses, and Vince contends that experienced producers are capable of structuring such lucrative deals to attract private investors.

Evrensel argues that without the provincial and federal tax credits and without Telefilm Canada's support, few films would be produced in Canada. "These programs go beyond the financial commitment of government. They really help to define, in many ways, who we are as people."

Telefilm has developed a certain rigour to assess the viability of investing at the early stages of a feature film. "In development we look at many things," says Dippong. "It's the quality of the material itself—are the story elements strong? Do we feel that there could be a feature film in this material if it was properly developed? Is there enough skill evident in the writing that you can see your way through to getting this to a final draft? What is the track record of the producer and writer?" Telefilm is willing to take chances on newcomers as well. "We welcome fresh, new voices in the marketplace, but what we like to have them do is perhaps mentor themselves or partner up with more experienced people."

With this kind of support in place at the early development stages and a strong production plan, most experts agree that the "soft money" will be easy enough to find for a good production backed by producers who have a good track record.

Maxime Rémillard, CEO of Montreal's Remstar Corporation, recommends that investors consider films as a higher-risk part of any diversified investment portfolio. Remstar is a production, distribution and finance company with a 10-year track record producing and distributing both English-language and French-language feature films.

"There's demand out there for entertainment content. There's a place for growth in feature films," says Rémillard in describing the impact that new communications technologies are having on the industry. "There are so many outlets for broadcast right now with DVDs, pay-per-view, video-on-demand, and of course the Internet. This creates demand today for entertainment product, and feature film is a big entertainment ticket."

Evrensel offers a brief checklist as advice to investors who might be attracted to the film business:

**Do Your Homework:** Hire someone who has experience in the finance side of the film business, who can determine the real value of the production and who can also assess "how close to the till" you will be as an investor. If you are investing with a distributor, for example, you are closer to the point where revenue flows in than you would be if you were investing with a producer.

**Go With Experience:** Invest with a producer who has a proven track record and has demonstrated relationships with distributors.

**Diversify:** Invest in a proven producer's slate of films. If one film is a hit, one bombs, and two or three do reasonably, you have a chance of seeing a return of at least your capital.

**Build a Team:** Financing films is complicated. The tax rules are complex, and there are many legal considerations. You need to assemble a team of professionals who have expertise in their fields to assist you with due diligence before investing and monitor the project.

"And then there is the other element nobody ever talks about—luck. You have to be lucky," says Dippong in summing up the feature-film business. ☉