A Focal Press & Routledge FREEBOOK

Managing the Money 2.0

New Strategies for Mastering Filmmaking Finance

Routledge
Taylor & Francis Group

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Introduction

In August 2013, the American Film Market® (AFM) and Focal Press, an imprint of Routledge, launched a series of books on the business of motion picture production and distribution. The series, entitled American Film Market Presents, includes books on industry topics such as producing, financing, distribution, pitching, law, marketing, and more. We're excited to be back for our fifth (!) year at the American Film Market and to share this free resource with AFM attendees. Building off the success of the popular Managing the Money resource that we distributed in 2016, we've tapped into our recent film library to bring you *Managing the Money 2.0: New Strategies for Mastering Filmmaking Finance*, featuring all-new content on financing, budgeting and filmmaking, curated from recent Focal Press titles and written by leading industry experts.

Managing the Money 2.0 features from chapters from five of our 2017 titles on producing and the business of filmmaking, and starts with a chapter from the 2nd edition of Paula Landry's *Scheduling and Budgeting Your Film: A Panic-Free Guide,* which offers a nuts-and-bolts introduction to the basics of scheduling and budgeting. Landry presents the fundamentals of line producing in an easy-to-understand style, and includes tips, techniques, checklists, and practical advice that applies to projects of any size and budget, regardless of software.

This is followed by a chapter on production financing, taken from the 4th edition of *The Producer's Business Handbook* by John Lee and Anne Marie Gillen, and this chapter explores the wide range of funding sources available for film productions. The 4th edition – updated to address changing technology and explore the opportunities and impact on the producer of the growth of VR, AR, 360, gaming, and OTT content – is a must-have resource in any producer's toolkit.

The third chapter, from Richard Botto's *Crowdsourcing Your Film,* explores how to make best use of a crowdfunding campaign in support of a film, and how to take fullest advantage of this key platform. Botto's book explains how to put crowdsourcing to use for your creative project, using social media, networking, branding, and an understanding of your audience to build effective crowdsourcing campaigns, sourcing everything from film equipment to shooting

locations.

The fourth chapter comes from the 8th edition of Louise Levison's longstanding *Filmmakers and Financing* and explores the basics of financial forecasting on your film. In the updated edition of this filmmaker's guide, Levison offers easy-to-use steps for writing an investor-winning business plan for a feature film.

Finally, to round out the collection, Joseph Cohen's *Investing in Movies* offers an investor's and producer's perspective on funding in filmmaking, offering an analytical framework to assess the opportunities and pitfalls of film investments. The chapter included here explores the pros and cons of investing in films.

We hope you enjoy *Managing the Money 2.0* and glean some insider tips from the experts featured within. If you like what a certain author has to say about their particular area of expertise, we encourage you to read their entire book. You can browse our website at www.routledge.com/filmmaking for additional titles.

Happy filmmaking!

- The Focal Press Team

CHAPTER

1

SCHEDULE AND BUDGET

This chapter is excerpted from

Scheduling and Budgeting Your Film, 2nd Edition

by Paula Landry.

Learn more

SCHEDULE AND BUDGET BASICS

Excerpted from *Scheduling and Budgeting Your Film*

QUESTION: What is Production Management?

ANSWER: *The planning, organizing and managing of the resources and actions required to successfully create a film from a concept or script.*

Every film is constructed; the result of a combination of resources AKA—places, people and equipment—with the common goal of capturing footage to be edited together to tell a story. Even documentaries and reality television are created and creation requires planning.

Production management is that preparation, representing the business component of show business—answering practical questions such as: When will that scene be shot? Who will shoot it and Where? What role does that actor play and Why does that equipment need to be purchased, rather than rented? Where will we rent these props, How long do we need them and How many of those do we need? Where is the next location? What is all of this going to cost? Why do we need that additional location?

Production management is resource management: effectively

- Identifying
- Organizing and Scheduling
- Locating and Pricing
- Budgeting and Securing

—everything needed to create a film, so that each is available as needed, when required, for the best price possible.

When administrative factors are well managed, they contribute to the artistic process of filmmaking. Actors act, the director directs, the crew concentrates on the task at hand.

Scheduling and budgeting start once there is a project to manage. It assumes that a producer has assembled the basic elements of a film—a script, an end-use plan for the project and possibly a director, key actor—but every project is different.

A Production Manager (PM, or UPM, or Line Producer—we will use these interchangeably) is in a unique position regarding the filmmaking process. They must simultaneously be aware of small details, while maintaining a big picture view. The PM understands the past, present and future of the production—what's currently happening now and what's next.

SCHEDULE AND BUDGET BASICS

Excerpted from *Scheduling and Budgeting Your Film*

Scheduling and Budgeting Your Film: A Panic-Free Guide presents a process to identify each resource needed to create, arrange, and price a film in the most efficient manner. The schedule and budget that you create may be different from someone else's, but there are basic steps and a systematic way to approach them, commonly accepted in the industry, that can be applied to all types of films. This book offers guidelines to understand the process, do it yourself and streamline your process whenever possible.

The Schedule and Budget Relationship

A film's schedule and budget are interdependent, hinging on the script. If one changes, so do the others. Based upon the script, the schedule and budget are the foundation of a film—they determine how quickly and efficiently it can be shot and completed.

For example, if you need a piece of equipment that is typically rented by the day and you add an additional day, your budget will increase.

FIG. 1.1
Extra Tripod George Hodan

SCHEDULE AND BUDGET BASICS

Excerpted from *Scheduling and Budgeting Your Film*

For a shoot in Manhattan, our director and DP have requested an additional tripod. We call several vendors and find one that charges and find out that it will cost $20 per day to rent it, with a small discount if we rent for the entire 6-day week. The schedule below illustrates how renting this equipment for additional days will incur additional costs.

Table 1.1

Equipment	Vendor	Days	Cost
Tripod	DCTV	1	$20.00
		2	$40.00
		3	$60.00
		Entire Week (6 day)	$80.00

This situation brings up questions: in how many scenes will it be used? Can we group those scenes together to rent it for the shortest amount of time? Should we just pay a little more and rent it by the week for $80 and not worry about when in the schedule the tripod will be used? Going down a checklist: cost, personnel required, insurance, safety, transportation, storage; the convenience of having the extra tripod on hand outweighs any inconvenience for a relatively low cost. Working in production management raises questions with recurring themes: how will this new factor affect our power resources, human resources, time and monetary resources and constrictions of physical space and safety issues?

TIP*: One of the fastest ways to reduce your budget is to cut entire script pages or shooting days from your schedule. These decisions aren't made in a vacuum; you need the input of your team. Practical considerations require that the director agree that required scenes can be shot in the time allotted to do so.*

For example, if you have scheduled one full day to shoot scene 23 and for some reason the shooting must be extended into the next day—this may impact your budget—paying for an additional day at that location, extending permits if necessary, equipment rental agreements, and employing extras or crew.

It's cause and effect; additional time, locations, equipment or people generally increase time needed to shoot—impacting the schedule and, correspondingly, the

SCHEDULE AND BUDGET BASICS

budget. The reverse is true; shave time off of your schedule and the budget should go down.

Without a script or detailed concept, creating a film shooting schedule is dif.cult. And a budget doesn't exist in a vacuum; it is a result of that schedule— when you need certain equipment or people, and for how long.

Film production works on a project basis. Crew and cast are freelancers; they must always plan the next job and may have employment scheduled immediately after your shoot. Extending their planned work time on your project may be out of the question, or tricky to arrange. Together the schedule and budget set the framework of possibilities for a film and resources required to create that film.

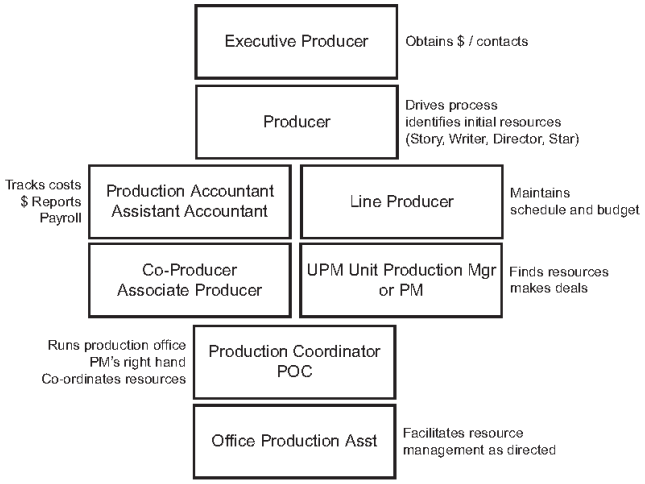
Who Manages the Schedule and Budget

There are many producer titles and ultimately one job: get the best film made, on time and on budget! The producer's unit organizes time and money to make the film's creation possible.

At the macro level, a producer plans a film project. Regardless of title, Line Producer (LP), Production Manager (PM), or Unit Production Manager (UPM), the person managing the schedule and budget oversees the execution of that plan. The bigger the budget, the larger the producer's unit. The line between a credit and a job description varies from film to film, but the task of managing the schedule and budget rests upon one person.

A producer's unit may have one or more of the following players.

FIG. 1.2
Producer's Unit



SCHEDULE AND BUDGET BASICS

Excerpted from *Scheduling and Budgeting Your Film*

Big Hollywood films with multimillion-dollar budgets may employ many people in the producer's unit. On films with modest budgets of a million dollars and under (way under for many of us), the Producer and the PM may be one and the same person, assisted by the Production Coordinator and Production Assistant (PA).

The distinction between the UPM and LP credit rests with the DGA. A UPM is an official credit for DGA members (AKA PM), while a LP is not affiliated with a union or guild. On films employing both a LP and a PM, generally, the LP maintains the schedule and budget and the PM locates resources and makes deals. The bottom line is to **know exactly what is expected of you**, what credit you will be given and to put it in an employment contract.

The job of the person managing the schedule and budget involve some mix of:

- Breaking down the script
- Creating, then adjusting the schedule
- Collaborating with the Director, Assistant Director (AD) and Production Designer
- Budgeting the film and possibly securing locations
- Facilitating the hiring of crew and cast
- Execution of contracts, permits, releases, banking, and accounting
- Arranging travel and housing
- Coordinating communication with film commissions, studio and/or distribution and/or banking, .financiers, insurance people, and any other stakeholders and
- Initiating and tracking all the paperwork—production and status reports.

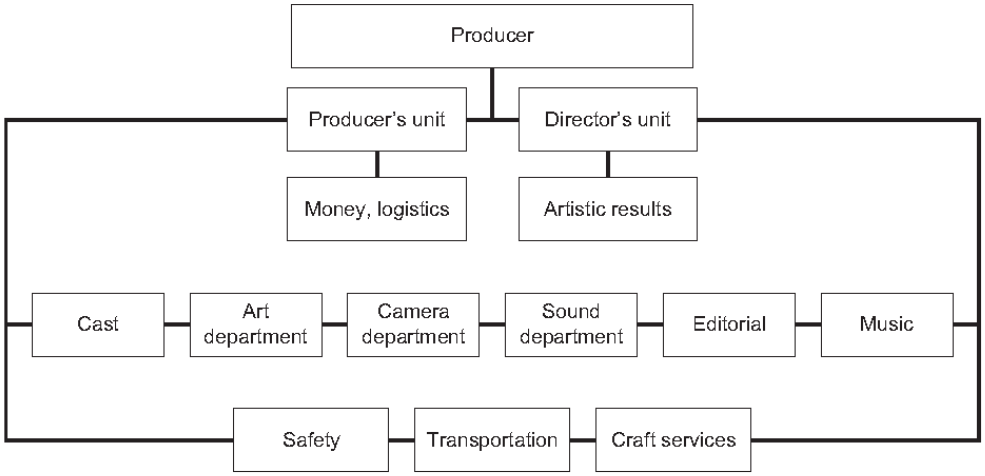
A Little History

Many norms in filmmaking go back to the studio system. Prior to the 1950s, studios employed a full-time staff of actors, crew, technicians, definite "units" responsible for specific duties, reporting to a department head. This makes life simple. Give people clear things to do and empower them to carry out those duties. Who does what depends on the film's intended end-use, crew experience and the availability of resources. On small films, many people wear several hats.

SCHEDULE AND BUDGET BASICS

Excerpted from *Scheduling and Budgeting Your Film*

FIG. 1.3
Working Together, Filmmaking Units are Responsible for Explicit Tasks



Historically, the line producer produced "below the line" which, if you look at the budget following, has two parts, Above The Line—initial creative costs such as Writer, Director, Star Cast, Producer and Below The Line—the cost of making the script. Thus the title, Line Producer.

Modern-day filmmaking dictates that you get your film made any way possible, with whatever resources you can muster. Lean and mean can generate creativity and speed.

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Excerpted from *Scheduling and Budgeting Your Film*

Table 1.2

Account Numbers	Category	Total		
Above The Line			The Producer launches and drives the process, starting with Above the Line costs	
1100	Story and Screenplay	$10		
1300	Producer	25		
1400	Direction	25		
1500	Cast	45		
	Total Above the Line	**105**		
Below The Line			The Line Producer (short for "**Below the Line**" producer) facilitates the making of the film, through budget and schedule management.	
2000	Production Staff	$15		
2100	Extra Talent	55		
2200	Sets	10		
2300	Props	15		
2400	Wardrobe, Makeup/Hair	25		
2500	Electrical	12		
2600	Camera	25		
2700	Sound	25		
2800	Locations/Food	150		
	Total Below the Line: Production	**332**		
4000	Editing	25		
4100	Music	15		
	Total Below the Line: Post	**40**		
	Total Above the Line	**105**		**105**
	Production	332		
	Post	40		
	Total Below the Line	**372**		**+ 372**
	GRAND TOTAL	**$477**		**= 477**

Helpful Tools and Software

Scheduling and budgeting can be accomplished with, or without, computers and software. The steps are similar and the relationship between a script, schedule and budget remain the same, no matter what tools you use. There are advantages and trade-offs either way.

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Excerpted from *Scheduling and Budgeting Your Film*

A Manual and Computer Approach

Computers were heralded to launch a paper-free work environment, but that hasn't yet happened! Production management breeds a lot of paper, so it helps to get organized.

The process is similar, whether you use a computer or not. The beauty of breaking down a script manually is that you become familiar with the story because there's so much physical interaction. Literally. When using a computer, the process isn't necessarily easier, but the automation, duplication and rearranging saves time. That's why it has become the standard.

If the entire process will be managed in the computer, it is helpful to print and read the script at least once, to become acquainted with the story and characters.

Tools for the non-computer approach:

- Pencils, colored pencils, ruler and breakdown sheets
- Calculator
- Production board

Production boards—cardboard or wooden charts displaying the schedule, scene by scene, on colored strips of paper—were traditionally used to easily visualize and rear-range the schedule. With the widespread use of computer-based scheduling tools, a production board, while still useful, is only necessary if you find it useful.

With a computer, you have several choices and many programs provide demos for you to test out the software. Increasingly, online components, collaborative features and mobile compatibility are offered so that you can view and sometimes work on your breakdowns, schedules and budgets on a tablet or Smart phone.

Tools You Will Need

- Entertainment Partners software, Movie Magic Scheduling and Movie Magic Budgeting are powerful tools and the industry standard. www.entertainmentpartners.com

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• WattWenn offers production-scheduling tools with robust functions for multi-episodic and complex productions, offering tools to compare multiple schedules. Easy script import, keeps the script in a window as you work on the breakdown. www.wattwenn.com

• Showbiz makes a robust budgeting, payroll, accounting and scheduling software. www.showbizsoftware.com

• Studio Binder is a cloud-based production management suite of tools, offering budgeting, scheduling and a variety of customizable forms, including syncing and sharing information for teams online. www.studiobinder.com

• Scenios is a cloud-based production management suite incorporating tools for writing, scheduling, post production logging and tracking deliverables, and works on mobile devices. www.scenios.com

• Final Draft software is an industry standard for screenplay writing, with features for importing into other film production software. www.. naldraft.com

• Fade In is an additional screenwriting software offering that generates breakdowns for scheduling and budgeting purposes. www.fadeinpro.com

• Jungle Software offers a variety of software integrating the breakdown, scheduling and budgeting process, available at different price points. www.junglesoftware.com

• Celtx software assists with script writing, collaborative scheduling, budgeting, preproduction, cost reporting, resource management process and storyboards. www.celtx.com

• Fuzzlecheck is a relative newcomer in scheduling software that is available in English, German and Spanish. www.fuzzlecheck.com

• Yamdu is an online production management suite of tools for online collaboration and organization from development through delivery. www.yamdu.com

• Microsoft Word and Excel, or word processing and spreadsheet software, like Open Office, facilitate the production management process, if set up correctly, but lack the automated features contained in specialized software designed for media production.

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All of these programs are available for sale online and from the software manufacturers themselves. Try out the trial periods in the software to give some a test run. Check out the websites listed or www.writersstore.com. If you're going to use the computer approach, you'll definitely need a printer (preferably color) with lots of ink.

Trends to Consider

Thanks to advances in technology and human innovation, the production process continues to evolve and become more streamlined. Over the past several years, film production has changed primarily to digital production, which does not change the process of scheduling and budgeting a film. New trends are emerging and these may affect the process.

• Mobile platforms offer the opportunity for filmmakers to manage their productions from smart phones and tablets. A variety of production software products now offer mobile platforms for your convenience, so that no matter where you are, you can adjust your schedule and budget without a computer. Visually this can be difficult due to the size of the screens on these devices. An additional point to consider relating to mobile platforms is where the files you are working on are stored (in Internet cloud storage on a service like Dropbox, or on a company server, for example). The reason this issue could be relevant depends on the reliability of your access and connection to the Internet; so for instance, if your device goes offline at some point, it's important to know how that may affect your work, as well as the security of the platform.

• Filmmaking is inherently team-based and in response to that, many providers of software for the scheduling and budget process offer collaborative tools, such as the ability for multiple users to log into a film's schedule or budget and work on different parts of the same file.

• New types of production are emerging and maturing; 3-D movies and Virtual Reality, which shoots video in 360-degrees and augmented reality productions, are currently available in varying degrees. Most of us are familiar with 3-D films, which require special glasses in order to see the additional "dimension" that pops out. Smart-glasses are required for 360-degree video, virtual reality and augmented reality. Virtual reality immerses the audience in a 360-degree film and augmented reality adds new visual information into the present visual landscape. The

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widespread adaptation of these formats depends on the widespread acceptance (and price) of the headgear. Working on any of these types of film requires input from the Producer (Post Production Supervisor and Visual Effects Supervisor if there is one) from the outset about the special time and expense considerations for these effects. Virtual and augmented reality are popping up in music videos, commercials, as well as the marketing and gaming sector, but may become a permanent format in movies, TV and episodic video on the web.

• As digital cameras become more refined there are more formats to contend with, from High Definition, 2K, 4K to 8K and beyond. The scheduling and budgeting processes remain the same; however, with increased formats, more planning and storage for files (additional hard drives and cards) are required and the camera equipment may be more expensive.

• Advances in technology demand more than ever that filmmakers ask good questions before we begin.

• Production incentives are government-funded programs to help filmmakers save money on their productions; they may not affect your scheduling, but often require a specific budget form. Incentive rules vary (how much one must spend and so forth) and in the U.S., differ from one state to the next. These programs are also referred to as tax rebates, tax incentives, film incentives or production incentive schemes. A typical requirement for receiving the benefit is that your production uses a specific budget form (usually on that film commission's website) to help that state or governing body account for how the money was spent.

Basic Steps and Stages

Establishing a system for film scheduling and budgeting helps in several ways; you get to know the project, find opportunities to condense the schedule—creating time efficiencies, saving money on the production by experimenting with different budget scenarios.

Basic steps establish a starting point—assigning numbers to scenes and characters that will remain constant, transforming the script into shorthand documents (like production board strips, call sheets and production reports)—so that it is not necessary to read the script through every time to find essential information.

Scheduling

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Excerpted from *Scheduling and Budgeting Your Film*

Without breaking down a script into a schedule, it is easy to miss essential scenes, props, characters and equipment. Without a schedule, there is really no plan and the resulting budget bears little connection to reality. The initial scheduling process maintains the integrity of data from the script, like a GPS leading you toward the completed film. Each day gets you closer. A schedule is the foundation of a production.

Depending on the script, a film shoot can last weeks, or months. Mentally compare the production of the Angelina Jolie-starring, video game-inspired action film, *Tomb Raider*, to an iconic indie film like *The Blair Witch Project*. Actors, costumes, sets, stunts and locations aside, the Tomb Raider shoot lasted 100 days while the duration of The Blair Witch Project shoot was approximately eight days. That is not the only reason that Tomb Raider was a more expensive film to make, but it is a major indicator. Complicated films take longer to shoot; each additional shooting day costs more. Once every single person, place, or thing in the script is identified in the breakdown process, assembling them in an efficient order creates a schedule that helps to save money. Think of it as a really great puzzle.

This scheduling process allows you to combine scenes based on similar characteristics (set, time of day, INT/EXT, combinations of cast or equipment), for efficiency.

1. **Read the script completely through** to become familiar with the story and characters. Note questions if you must, but try to give the screenplay your full attention. This .first, unbiased impression is similar to how an audience will see the finished film.

2. **Identify each scene with a number**—one scene at a time, digitally in the computer, or by lining the script on paper, at each SCENE HEADING showing changes in location. Each numbered scene is a complete unit unto itself. As you insert scene numbers, mark the page into eighths—to show how much of a page the scene takes up.

3. **Breakdown the script**, one scene at a time, marking every resource; Set, Cast Member, Sound, Prop, Vehicle, as well as any Stunt, Effect, potentially expensive shot and all questions, on the script.

4. **Complete one Breakdown Sheet** for each scene, either in the computer or on paper.

SCHEDULE AND BUDGET BASICS

Excerpted from *Scheduling and Budgeting Your Film*

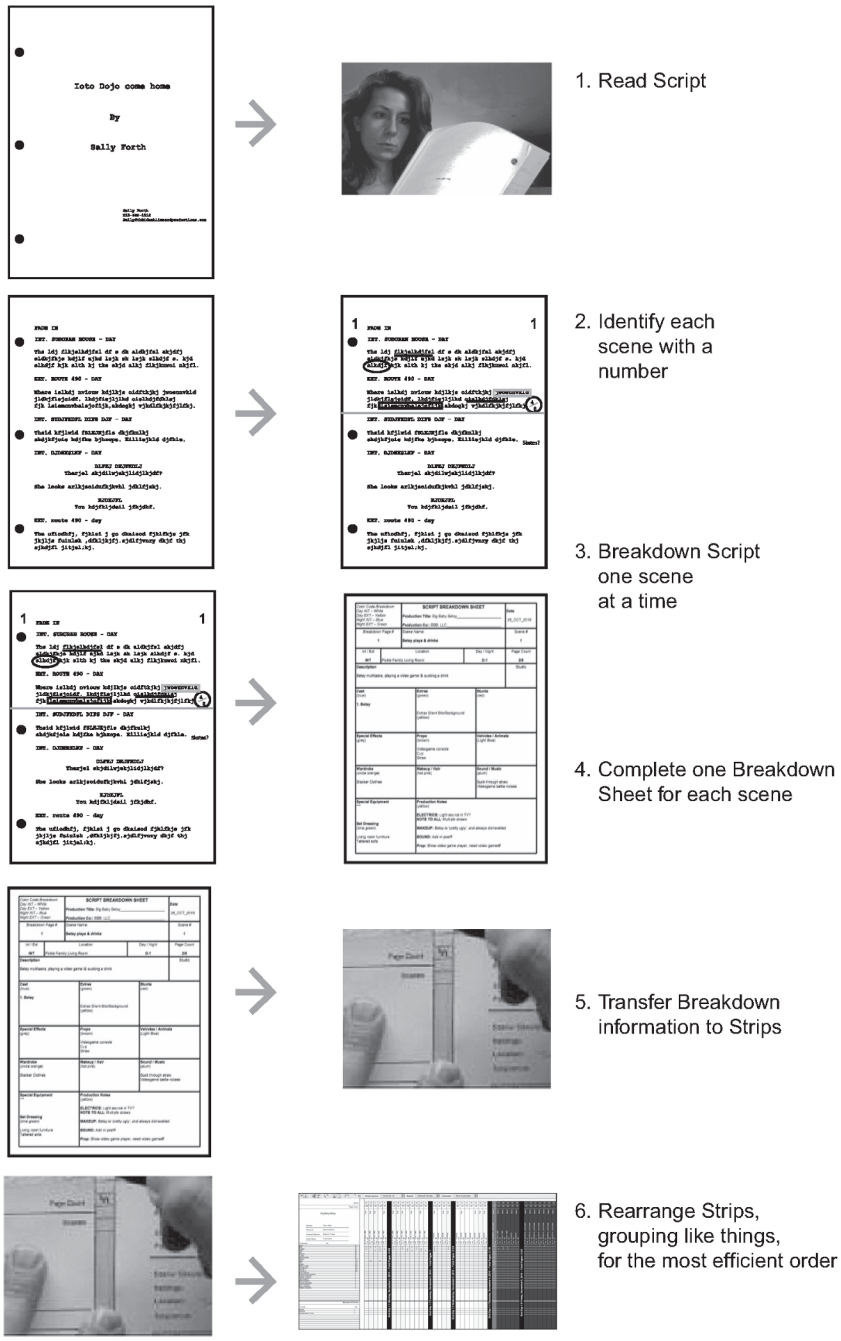

FIG. 1.4

Basic Scheduling Steps

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5. **Transfer Breakdown Sheets** to colored Strips for the Production Board. (In a film scheduling computer program, this will happen automatically.)

6. **Shift Strips** around to combine scenes based on identical characteristics, sets, INT/EXT, time of day, cast.

Budgeting

Like scripts, good budgets are created and rewritten. As a practical matter, the budgeting process begins with the script, your schedule and questions for the producer.

• What format will the film be captured on? Completed on?

• Is it union or non-union? Estimated length?

• Does the film rely heavily on stunts, special effects, animals, kids, huge crowds, specific weather, exotic locations?

• Have any specific resources for the film already been identified?

Answers to many questions will point you in a specific direction.

Budgeting is a 3-stage process:

1. **Identify and Obtain prices** (from multiple sources) in writing from film commissions (for vendors and locations), post production labs (post services), equipment rental houses (shoot), department heads and unions (cast and crew).

2. **Negotiate** potential deals and present data to your team.

3. **Lock-in** your deals with signed contracts (employment contracts, location contracts, permits).

Budgets are structured in layers. The top sheet is an overview, with each successive layer providing more in-depth details. Every item in a budget is assigned an account number, to allow items to be tracked and organized.

SCHEDULE AND BUDGET BASICS

Excerpted from *Scheduling and Budgeting Your Film*

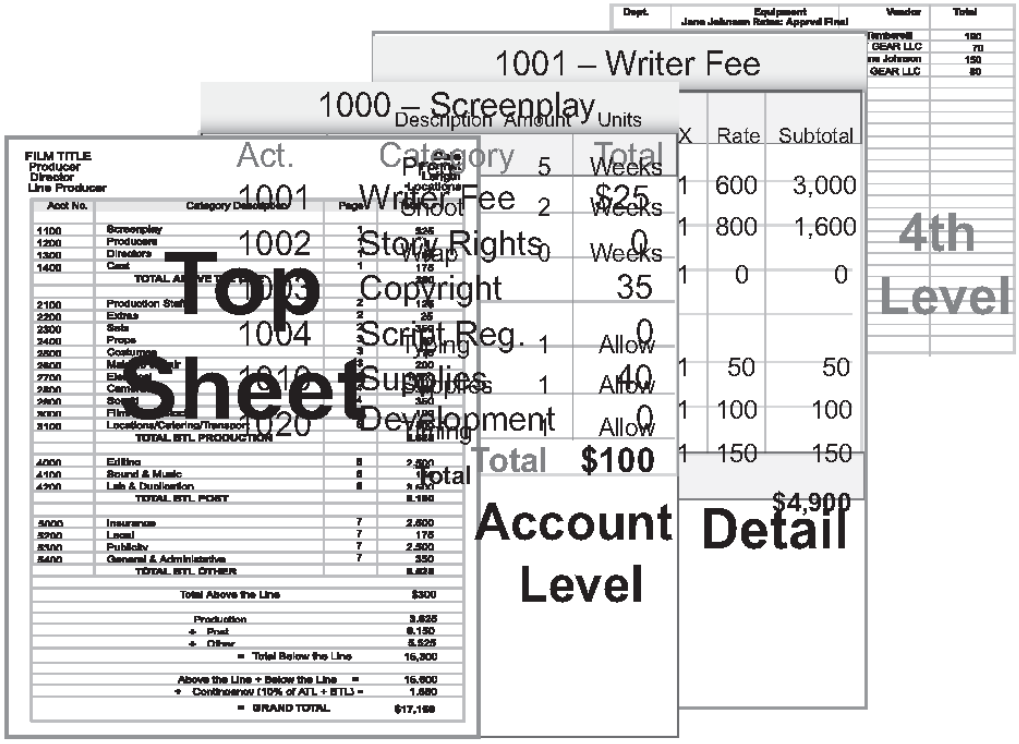

FIG. 1.5

Budgets Evolve with New Information, Until Locked

Without a completed script, the budget is more of an estimate. The process tends to be fluid. It is important to approach a budget realistically; don't cut it too close! Estimate upwards, giving yourself the flexibility to borrow between accounts later.

End Uses of the Schedule and Budget

Depending on your relationship with a production, you may not know what this particular schedule and budget will be used for. An obvious answer is fundraising, but discovery may be the result as well. Often, the scheduling and budgeting process is a fact-finding mission, revealing the feasibility of a project.

Common uses for the schedule and budget:

- To determine the cost in time and money for a production
- To share the information with potential partners

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• To decide whether it makes sense to do this project with this team at this time

• To discover the information and present it in crowdfunding campaigns and to potential funders for purposes of raising money

• To create the financial information needed to format into the specific template required by a film commission for the governing body to apply for a production incentive.

The movie you are scheduling and budgeting may have a definite start date, or may be something that might happen; so your schedule and budget may be used to draw sup-port, resources and ultimately, financing.

End of Chapter One Review

1. Production management is composed of the business tasks to ef. ciently plan the organization and use of resources in making a film.

2. Systematic scheduling and budgeting ensures that all of the elements in a script will make it into the film.

3. Regardless of the credit or title given to the person performing the vital task of creating the schedule and budget, production management process is a set of established steps.

4. Many factors play a role in the final schedule and budget of a film: script changes, crew and cast input, preferred team collaboration method, the final format and end-use of the film, as well as the shooting process itself. All of these rest upon the foundation of the primary schedule and budget.

5. The basic scheduling work. ow consists of reading the script, lining it, breaking it down and completing breakdown sheets, then converting those to scene strips and rearranging those strips for the best schedule.

6. The basic budgeting work. ow consists of identifying and obtaining prices for each resource, negotiating deals and locking-in the deals by executing signed legal contracts.

7. The systems of scheduling and budgeting have evolved over a century of filmmaking, but the basics, covered here, remain largely unchanged. It is helpful,

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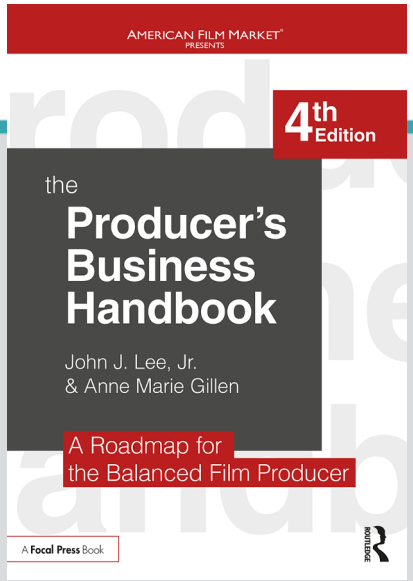
but not necessary, to pinpoint the end use of the budget and schedule before starting. The tasks can be done with or without a computer; however, software designed specifically for this purpose can save time and effort.

CHAPTER

2

PRODUCTION FINANCING



Learn more

PRODUCTION FINANCING

Excerpted from *The Producer's Business Handbook*

Introduction

This chapter reviews the primary processes of production financing. It explores the many sources actively participating in this funding. Further, it demonstrates how balanced producers develop and use these relationships that include state and national production funding, production incentive programs, licenses, presales, third-party co-branding relationships, private equity, as well as international territory gap/estimate financing, to determine the funding that will provide each project the most benefits, including funding cost. Further, this chapter examines the use of a Production Financing Worksheet that leads producers through careful consideration and selection of these production funding sources, automatically calculating interest and other costs, simplifying setting up each project's optimal financing architecture.

PLANNING IS ESSENTIAL TO FUNDING

Beginning with the end in mind is a life practice of many successful people. This is especially true in assessing, planning, and engaging each project's production funding. Most investors participate only in industries they understand by their own experiences in them. If they do make exceptions, it is most likely they would do so as a minor partner, relying on other investors experienced in entertainment.

Establishing a fully functional independent production entity involves:

1. understanding the formidable benefits related to selecting each project's unique funding partners

2. having a working knowledge of and access to these production financing sources that include a relationship with a bank or alternate financial institution with an entertainment department able to aggregate each project's funding from cash investors, collateral and guarantee providers, and

3. fulfill the investment return objectives expected by all partners.

Development and Production Funding

Although it is less expensive, the development of each project is often more sophisticated, takes longer, and is a less predictable process than its production. Consequently, development is typically financed separately from production

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financing. This process is reviewed in Chapters 11 and 12.

Production Funding's Present Global Bullish Condition

Perhaps not since the beginning of the motion picture industry has content been in greater global demand, more old-line and new funding sources active in entertainment financing, and, consequently, has there been such abundant production and distribution funding resources available to producers. The following two lists review the primary causes for this pleasant condition. As you review these lists, consider not only related funding sources, but also current and coming content creation opportunities.

The Internet has and/or is bringing:

• The steady growth of streaming audiences on all screens (the global infrastructure delivery to whom is currently being dominantly assured by Netflix, Google, and other major global players)

• The advent of almost every person having a small screen with them all the time, in major and medium territories

• Content's ubiquitous availability on all screens

• Audiences steady content consumption growth

• Interactivity that gives distributors the ability to feed each audience member their own preferred content and ads

• Social networks that assure almost immediate audience-branding, after each project's premier (though media-sophisticated and expensive advertising and promotion are still crucial to each project's branding before it is released)

• The conversion of cable/satellite/telco television to OTT systems, that deliver audiences both linear programming and VOD

• VOD audience viewing selection, rather than scheduled programming, that will clearly become the dominant audience program selection process

• Global audiences' inter-connectivity that enables dynamic new forms of global content branding

• The radical reduction in distributors' content delivery costs (and able to deliver almost everywhere the Internet reaches, on every screen)

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• The ability for producers to distribute directly to each audience member (beneficial if their content is sufficiently branded).

Other big items, not directly linked to the internet:

• Production's technological advancements continue to allow filmmakers to create their projects at increasingly lower costs—growing profits, reducing risk, to the delight of all producer partners.

• More major territories are producing projects for global territory release.

• China commenced its serious global content creation and distribution presence by overhauling and radically expanding its production infrastructure, using top global production and distribution talent and acquiring distribution/production/exhibition/transmission operations within other major global territories.

• United States studios continue to produce fewer independent budgeted projects, focusing on massive budgeted tent-poles, franchises, and comic book heroes; providing further opportunities for Indy producers to create a greater number of more story-reliant projects with comparatively modest budgets.

• The global middle class is growing entertainment's audiences by tens of millions per year.

• In the United States a big change came in 2016 when the JOBS (Jumpstart Our Business Startups) Act made available to independent producers a significant provision—Title III crowdfunding for non-accredited investors—opening film investment to the average person. Many independent investors have shifted at least part of their investments from large companies/projects to smaller companies/projects.

These favorable entertainment industry conditions are and will continue the entertainment industry's boom as new, well-funded entrants lay their claims to content distribution turf that is just being forged. The battle for global audience dominance led by the long preparing, strategy-keen, well capitalized YouTube, and by the most high-profile-content-creation-active Netflix and Amazon, also includes each territory's cable/telco/satellite entities that are certain to lose the overall game by nature of their fatally flawed technologies, but that are prime to win at

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least the near-term battle for each home's fundamentally needed high-speed Internet.

This battle will continue until audiences choose their sweet-spot for the new distribution system(s) and their content preferences from the unprecedented content glut that is beyond the audience's ability to consume and, what continues to be the biggest conversion-prevention in the United States: big licensing fees paid from cable/satellite/telco systems, the terms for which have prevented some of the highest profile content to be available via the Internet.

Most importantly for producers, the winners of these battles will largely be determined by those who license/acquire the most audience-favored content. As always, the producers delivering this content will be the most long-term rewarded.

Because the market is positive and hyperactive, independent producers may be tempted to produce without regard to distribution. This remains a disastrous course, unless there is high-probability-engagement plan for branding and distribution.

For project financing, successful producers are especially looking for their share from those sources spending the most on programming, have extraordinary global branding power, and offer producers a fair profit participation. Globally, these sources are Netflix and Amazon. Their basic production relationship structure may be reviewed on their websites. Production relationships with them is clearly material-centric. Even knowing Jeff Bezos or Reed Hastings will have little effect on getting a project greenlit. Powerhouse content and highly marketable talent attachments are the exclusive head-turners.

If you are outside the United States, especially in any of the leading 30 territories, find out who is the chief for Netflix and the chief for Amazon in your territory. Today there are mostly ground-floor opportunities, each potentially very beneficial for Indy producers. Their game is to produce audience-engaging, universal stories from that territory and release them to most all other territories. This is the key to their dynamic brand establishment in that territory and provides the greatest benefits to related content.

Consider how Netflix launched their first original series in Brazil. While first necessarily focusing on building Brazil's Internet infrastructure, they then also secured what appeared was a Brazil story that would be huge there and potentially well received in their other 180 territories. They cast major Brazil stars, launched a

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major Netflix branding campaign ("Change Everything"), produced the first eight episodes of the first Netflix Brazil original series (entitled 3%) and the day after the launch were mobbed with overwhelming positive audience response, many of them having binge-watched all eight episodes overnight!

These indicators of where audiences already are show us where the entertainment industry is heading. Successful producers are developing stories to fill that space.

Private Equity Funding

Each year, an increasing number of entertainment projects are entirely financed by private investors. Some of these projects are from solid independent producers who smartly prepare their projects' branding/release, as well as their production. However, private financing is:

(1) often the most expensive cost of money

(2) provides no creative or marketplace check and balance for the

producer or investor(s), and

(3) is often a sign of the producer's lack of business connectivity to less costly and more beneficial industry capital sources.

Where private investors can be smart for the investor and producer is in providing a minority portion of production funding. This allows these investor(s) the stability of partnering with entertainment industry funding partners, and could allow the producer to license certain rights more favorably, reducing production cost-of-money by increasing the project's income.

ENTERTAINMENT INDUSTRY FUNDING AND FINANCING SOURCES

Fortunately, today's producers have a broad array of production financing sources available to them than ever before in motion picture history.

In addition to private investors, these sources include the following:

- **Government Funding Programs**

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Excerpted from *The Producer's Business Handbook*

Like other government grants, these media funding programs have qualifying criteria necessary to be met to qualify for funding that usually become only a portion of, but occasionally provide 100 percent of a project's budget. Requirements typically include the producer being a native-born citizen of the granting country, but some allow co-productions with non-granting-citizen partners. Applications usually have 1 to 3 submission deadlines each year and many now require a signed distribution agreement, discovering the failure of most projects that do not have at least some distribution set-up before its production. The cost of these funds in equity and profit participation is often very reasonable, yet the creative restrictions are often narrow. If your government offers this funding, we recommend thoroughly understanding compliance, as these can be highly beneficial.

- **Production incentive programs**

- **International territory presales**

A presale is a contract whereby a distributor agrees to buy or license certain project rights in a specific territory, for a pre-agreed amount, of which typically 10 percent to 20 percent is payable upon signing and the remainder upon acceptance of delivery and first release window.

- **Ancillary presal**e

Like an international presale, but with an ancillary participant such as premium television or electronic game.

- **Gap/estimate financing**

A bank or other lender, lends the producer an amount equal to a discounted amount, typically 50 percent, of the value of the unsold international territories, based on their estimated value provided from a qualified/bankable international sales agent. Some banks have a lending limit for this facility of $2.5 million or 20 percent of the budget, whichever is less.

- **Talent profit/equity**

This is all or a portion of a key talent's compensation converted to picture profits participation that could result in their being compensated much more than otherwise.

- **Vendor profit/equity**

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Commonly referred to as "contra deal," in which key vendor compensation is converted to project profits participation providing opportunity for higher earnings.

- **Crowdfunding and Crowdfinancing**
- **Corporate sponsorship or brand tie-ins**

As producers use multiple funding facilities to finance each project, their bank, or alternative funding source, becomes the crucial aggregating and participating financing participant.

Regardless of the combination of financing sources, the bank or alternative source is almost always used for each project's depository, cash disbursements, and loans against the broad variety of collateral and guarantee instruments. It must be stressed that banks provide loans, not equity capital. They take "no risk," charge interest as well as fees for their services, and expect full repayment within specified terms. Every bank financing arrangement requires a completion bond and a collection account. The two main U.S.-based bond companies are Film Finances and UniFi Completion Guarantors. The two main collection account managers are Freeway Entertainment and Fintage House. Completion bonds and collection accounts are necessary for producers to convert presales, gap financing, or other bank collateral sources into production capital.

Balanced producers typically receive and exercise most their production financing through their bank. Knowing that a project's production financing is managed through a bank's full-service entertainment department indicates that the project's financing has likely been derived from sources that provide the greatest creative and marketplace benefits.

THE BANKING BUSINESS

Banks are often referred to as institutions. They are certainly governed by more agencies than most other businesses, but banking is a business. Banking decisions are profit motivated and predicated on sound business principles.

Every time the trade papers carry a story stating that a specific bank has supplied production funding to an independent producer, that bank's entertainment

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department receives calls from naive producers. They set up appointments and arrive, armed with a script and a budget, ready to pitch to the bank as if it were a studio or equity financier. But banks make decisions with different criteria than those used by studios.

Knowing someone at a bank, like knowing someone at a studio, is helpful, but it has little effect on the bank's lending decisions. The similarity between banks and other financing sources is that to obtain their support, it is critical to understand their unique criteria for making decisions and the way they operate.

Every bank's inventory is its money. Banks principally earn profits by lending this money at interest. Like most businesses, banks sometimes have shortages or excesses of inventory. Though lending decisions have limited elasticity, when a bank's lending reserves are low, its lending decisions become more restrictive. When lending reserves are high, its lending decisions are more relaxed. It is an important question, and proper form, to ask your loan officer the status of the bank's current lending reserves.

Banks with strong entertainment divisions will always have the capacity to lend, even if they are not primarily lending their bank's funds. If the division is making "good" loans, then their loss ratio is low, the loans serviced according to terms are high, and overall profits are high. With a strong loan portfolio, these divisions can perform as the lead (syndicating) bank with other participating banks, as well as engage other outside lending-capital scenarios.

When choosing the lead bank that will manage your production borrowing, select one that has a sound, experienced entertainment banking team. Bank lending in most markets is very conservative, as banks typically lend only on premium collateral. Producers' funding planning and documentation are thoroughly reviewed in this chapter.

There are several major banks with entertainment departments active in motion picture financing including: Comerica, Union, Bank Leumi, East West Bank, First Republic Bank, and MUFG Union Bank. All these are active in the United States. There are also numerous funds that do entertainment lending as well, including: 120dB Films, Aperture Media partners, and VX119 Media Capital.

Each bank has loan amount preferences. There are small banks seeking loans in the six- to low-seven-figure amounts, midrange banks seeking loans in the seven- to low-eight-figure amounts, and more sophisticated banks seeking loans in the

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mid-eight- to low-nine-figure amounts. It is important to know a bank's loan size criteria.

BASIS OF LENDING DECISIONS

Banks make their lending decisions based on a combination of elements that must be represented clearly and completely in the loan package presented in this chapter. For loan approval, the loan package must demonstrate that the bank has collateral assurance for its return of principal, fees, and interest and that the loan can be reasonably debt-serviced through the production company's regular course of doing business.

The ultimate assurance of repayment to the bank loan is the strength of the producer's pledged collateral. Collateral alone, however, is not sufficient for loan approval. Banks do not want to lend if there is even a modest probability that they will be forced to call on collateral to recover a remaining amount due. Producers must demonstrate their ability to produce on budget and on schedule as assured by a completion bond, which is part of the loan package.

Each loan memorandum submitted to a bank should include, and its approval is substantially determined by, the following items.

Cover Letter

This letter provides a summary of all elements in the bank package. It describes the production company, a brief description of the project being produced, the requested production loan amount, the expected interest rate, the production timing and loan term, and the plan and timing for loan processing. The collateral is summarized and may include

(1) production incentive program(s) and their portion of production budget contribution

(2) writer, director, or actor payment offset for profit participation or project (special effects) equity ownership

(3) SFX (special effects) entity or other production participant payment offset for larger payment from profits, profit participation, or project equity ownership

(4) presales and their entities, amounts, and terms

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(5) major brand participants and their amounts and terms

(6) gap or other funding requested by the bank and these amounts and terms

(7) private equity participants and their amounts and terms.

Table of Contents

The pages of the bank memorandum should be numbered, and there should be a table of contents following the cover letter, which will assist the bank in reviewing the completeness of the package and in easily locating information in the memorandum.

Application

The bank's loan application should be filled out, signed, and made a part of the memorandum. Some parts of the application may be referenced by "see page number" if the information is completely set forth in another section of the package.

Activity and Cash Flow Projections

Each of these projections should be month-to-month for the first year and cover at least six months beyond the anticipated active loan period. Each of these projections should have narrative "Notes to Projections," which describe important characteristics about the projections that are not self-evident. The cash flow projection must include the loan proceeds and debt servicing, calculated at the rate represented in the cover letter.

Distribution Sectors and Liquidation

Breakdown Summary

This section reveals the project's planned distribution arenas and a conservative version of the liquidation breakdown estimate, including the producer's share of gross receipts. This is especially important, in backup to international sales estimates, if the bank is requested to provide gap or related financing.

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Collateral

In the initial loan memorandum, this is a descriptive list of the license agreements, international sales estimates, production incentives or equity, brand tie-in relationship(s), talent or vendor offset relationships, private equity relationships, and any other parties associated with providing collateral or direct investments in the project. Even if the bank is not managing these elements, it and the completion guarantor will need to verify that the production entity has access to the project's complete production budget.

Conditional Documents

The bank will not take any substantial risk. If the license agreements used as collateral specify any conditions not satisfied by the completion bond, these further conditions must also be satisfied. The most common additional condition in international presale or domestic ancillary license agreements is that the project must be released in a specific territory (for instance, the United States) by any one of a specified list of distributors. If this is a condition, a copy of the distribution agreement or a binding commitment letter acceptable to the bank must also be included in the loan package.

Collection Account Commitment

The bank will require that a collection account manager (CAM) be secured to protect all parties. The collection account manager monitors the revenue collection process, the allocation and payment of revenue, and the exploitation of all potential revenue streams. There are two companies whose services we recommend: Freeway Entertainment and Fintage House. Both have been the collection account manager for hundreds of film and television productions, and 99 percent of the independent world works with them: Woody Allen, Annapurna Pictures, Lionsgate, Martin Scorsese, to name a few. The collection account manager computes revenue streams, provides the relevant stakeholders with regular reports, and splits revenues between each party in accordance with the party's contractually agreed entitlement. Knowing the producer is using a collection account manager mitigates risk and provides confidence and security to potential investors, talent, and other profit participants.

Completion Bond Commitment

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In the initial loan memorandum, this may be in the form of a conditional commitment letter that will be replaced with the bond commitment in the final loan documentation.

Production Financing Worksheet

To simplify your understanding of this worksheet, Figure 6.1 is below and a formula-charged excel worksheet is included on this book's eResources page, www.routledge.com/9781138050938. As you see, the upper right is a financing sources planning section to be filled initially with placeholders of intended participants while determining each project's financing architecture and eventually changed to the actual sources and amounts. The upper left is an assumption section for interest, fees, and collateral discounts. Once these are completed, the main body automatically calculates and completes the worksheet, revealing the individual collateral net amounts of each category's subtotal, the net loan value applied to production cost, and the total gross loan and license proceeds. These are compared with the project's total production budget (including the completion bond, 10 percent contingency, and reserve for residuals if required by applicable guilds or unions), and a "Yes" is revealed when the plan yields sufficient to produce the project.

The Project's Creative Information

This section should include the project's title, a brief story synopsis, a list of the project's primary talent and their referenced credits, the project's production dates and locations, and the projected core-market theatrical release date.

Business History

The production company may be new, a resurrection of a prior company, a merger of companies, or something else. Regardless how short or long, the bank needs to know about the company's genesis and progress.

Organization Chart

This is a simple chart that reveals the members of the production com-pany team by their responsibilities and relationships to one another. There is a production company chart in Chapter 11 and a worksheet on the book's eResources page, www.routledge.com/9781138050938,.

Principals' Biographies and Balance Sheets

The operators of the business are a key factor in a bank's loan review. The bank

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looks at the experience of those who manage the business and the experience and balance sheets of those who substantially own the business. The bank may not ask for owners to guarantee the loan, but the owners' financial profiles demonstrate their combined experience and success in asset management. This information typically is presented to the bank through brief, but specific, biographical summaries and in some instances a recent balance sheet of each individual.

Company Financials

These are the production company's current balance sheet and, if applicable, a recent profit-and-loss statement. These should be signed by either an in-house accountant or, preferably, reviewed and signed by the company's certified public accountant.

References

This is a list of references that importantly points to the way in which the producer does business and with whom. This list typically includes the completion guarantor (the firm and the producer's contact); the producer's law firm and primary attorney; the producer's current bank and officer; the producer's accounting firm and primary accountant; substantial trade references and contacts; and clients, studios, distributors, and licensees with whom the producer has dealt, along with each of their contacts.

THE LOAN APPROVAL PROCESS

Producers usually work with a bank loan officer. This officer helps the producer to do the following:

1. Identify the strongest international sales agent and international distribution companies.

2. Complete the loan package. The package must be complete before it can be reviewed.

3. Perform a preliminary review. If the loan package underperforms in the loan officer's evaluation, it is rejected. Common reasons for underperformance include insufficient or unstable collateral, an unstable management team, or an unpredictable repayment plan.

4. Present the package to the bank's loan committee. The bank loan committee

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then reviews the package and approves or declines the loan.

5. Deliver the decision to the producer.

6. Prepare and process the loan documentation.

7. Open the funding facility to the producer.

FINANCE PLAN: PRODUCTION FINANCING WORKSHEET

Starting at the development phase of every project, the producer should prepare a production financing worksheet that is the basis for the presale plan and the bank financing package. At the development phase, most if not all of it will be estimated and projected. As the producer continues through the financing process, the estimated numbers will be replaced with actuals and the financing plan adjusted accordingly.

Throughout the project's development process, global distributor relationships should begin early and intensify as development proceeds. These relationships should include the core-territory distributor(s), typically providing at least theatrical, all-screen streaming and home entertainment (DVD or home VOD) distribution; distributors in the leading international markets; as well as prospective premium cable, network television, and other key ancillary licensees. As these relationships advance, it becomes increasingly apparent which of these licensees will enter presale contracts. Before the producer ever approaches the major international territories for their initial presentation and consideration, the producer will have prepared the project's first cash flow projections (a global gross and net earnings forecast for all major windows and ancillary earnings), compared the project to at least ten others with similar target audiences and campaign elements, and identified the international distributors with the greatest propensity to garner the highest gross for this project in their particular territories.

If fewer than four distributors in the major international territories respond positively and agree to correlate with the producer as the project continues its development, then producers should either replace their commitments with alternative distributors or not commence development at that time. Though there is no license agreement during this time, all the participating distributors will be involved in the project's development and preproduction, and will eventually place the project on their release schedule. The producer will exclusively correspond

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with and give press, promotion, and advertising materials to these distributors. However, the project will likely not be licensed to these distributors until development is close to completion.

At the very first distributor contact, these distributors have little motivation to tie up the project's rights. But as the project becomes more substantive—with a shooting script, director, lead cast, locations, production design, video and print promotion materials, representation at the major markets, firm release dates, and as novelization and other rights mature—each of these distributors becomes increasingly motivated to secure the project's presale license for its territory.

The production financing worksheet becomes an extension of the cash flow analysis and places on paper the various financing scenarios, allowing the producer to select the most advantageous course. This financing strategy becomes the basis for the finance plan.

Using the production financing worksheet should be exceptionally empowering, allowing you to apportion each project's budget among several participants, consider the relationships, synergies, earnings, probabilities of engaging each, cost of money, and timing.

At the bottom of the worksheet is the question-and-answer section, as final proof that the financing architecture configuration provides sufficient collateral and capital to fully fund the production. The 'Yes or No' cell shifts from "No" to "Yes" when there is sufficient collateral to yield the full production capital.

Approaching each project's financing by this method spreads the responsibilities and risk in a manner that makes the investment much more accessible to each participant and often retains major creative and business decisions for the producer. Private investors are especially motivated to participate when producers can represent that over half the funding is raised, is provided by multiple participants and most of them from the entertainment industry.

Using the worksheet enables producers to analyze and configure each project's production funding plan early in development, and to adjust the worksheet as the project matures to the point of production, based on the final commitment of each participant. The final worksheet will reflect the actual elements provided and will be part of the bank loan memorandum submitted for approval. This sample worksheet is configured to deliver the project's production budget of $12 million, from the proceeds of the collateralized loan, cash advances, equity, and production

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cost offsets.

Figure 6.1: Production Financing Worksheet

[Picture Title]
[Core-Territory Distributor's Name]

Instructions:
Fill in the shaded areas. Cells will auto-fill.

Picture Budget: $12,000,000

Assumptions		Financing Participants	Percentage	Amount
Borrowing Period in Months	18	Government Production Funding Program Net Receipts	1.0%	$ 120,000
Presale, Brand Tie-In & LC Lending Interest Rate	6.00%	Crowdfunding Net Receipts	0.4%	$ 50,000
Presale, Brand Tie-In & LC Bank Fee	2.00%	Production Incentive Programs	19.0%	$ 2,280,000
Presale Discount, International Territory Presale	30.00%	International Territory Presales	25.0%	$ 3,000,000
Presale Discount, Ancillary Presale	0.00%	Ancillary Presale(s)	10.0%	$ 1,200,000
Production Incentive Discount	20.00%	Talent Profit/Equity	10.0%	$ 1,200,000
Production Incentive Lending Interest Rate	6.00%	Vendor Profit/Equity	12.5%	$ 1,500,000
Pre-Sale Payment Advance	20.00%	Brand Tie-In	9.0%	$ 1,080,000
Brand Tie-in Advance	10.00%	Bank Gap Unsold Territories	25.0%	$ 3,000,000
Gap Lending Interest Rate	6.00%	Private Equity Participant(s)	20.0%	$ 2,400,000
Gap Discount	50.00%	Other Net Receipts	0.3%	$30,000
Gap Bank Fee	5.00%	**Total Participants**	132%	$15,860,000

Description	Amount	Reference
Production Incentive Program(s)		
Production Incentives Total	$ 2,280,000	New York 19% Tax Credit
Production Incentive Discount	$ 456,000	Bank Collateral Value Reduction of Production Incentives
Net Bank Collateral Amount	$ 1,824,000	Net Loan Collateral Amount Before Interest Reserve
Production Incentive Lending Interest Rate	$ 164,160	Interest Reserved For Bank Loan
Net Loan Value Applied To Production Cost	$ 1,659,840	*Net Amount applicable to production budget*
International Territory Presales(s)		
Gross Presale Amount	$ 3,000,000	All International Territory Presales
Presale Payment Advance	$ 600,000	Amount Distributor Pays Producer At Signing
Gross Bank Collateral Amount	$ 2,400,000	Gross Collateral Value To Bank
Presale Discount	$ 720,000	Non-Prime Pre-Sale Distributors Bank Discount
Net Bank Collateral Amount	$ 1,680,000	Net Collateral Value To Bank
Presale Lending Interest Rate	$ 151,200	Interest Reserved For Bank Loan
Presale Bank Fee	$ 33,600	2% Fee to Bank
Net Loan Value Applied To Production Cost	$ 1,495,200	*Net Amount applicable to production budget*
Ancillary Presales(s)		
Gross Presale Amount	$ 1,200,000	All Ancillary Presales
Presale Payment Advance	$ 240,000	Amount Distributor Pays Producer At Signing
Gross License Bank Collateral Amount	$ 960,000	Gross Collateral Value To Bank
Presale Discount	$ -	Non-Prime Pre-Sale Vendors Bank Discount
Net Bank Collateral Amount	$ 960,000	Net Collateral Value To Bank
Presale Lending Interest Rate	$ 86,400	Interest Reserved For Bank Loan
Presale Bank Fee	$ 19,200	2% Fee to Bank
Net Loan Value Applied To Production Cost	$ 892,800	*Net Amount applicable to production budget*
Talent Profit/Equity		
Total Talent Offset Amount	$ 1,200,000	Total Talent Profit/Equity Amount
Net Value Applied To Production Cost	$ 1,200,000	*Net Amount applicable to production budget*
VendorProfit/Equity		
Total Vendor Offset Amount	$ 1,500,000	Total Vendor Profit/Equity Amount
Net Value Applied To Production Cost	$ 1,500,000	*Net Amount applicable to production budget*
Brand Tie-In		
Gross Brand Tie-In Amount	$ 1,080,000	Total Brank Tie-In Amount
Brand Payment Advance	$ 108,000	Amount Distributor Pays Producer At Signing
Net Brand Tie-In Bank Collateral Amount	$ 972,000	Collateral Amount To Bank
Brand Tie-In Lending Interest Rate	$ 87,480	Interest Reserved For Bank Loan
Brand Tie-In Bank Fee	$ 19,440	2% Fee to Bank
Net Loan Value Applied To Production Cost	$ 865,080	*Net Amount applicable to production budget*
Gap Financing		
Sales Agent Unsold Territory Estimates	$ 3,000,000	Sales Agent Unsold Territory Estimates
Gap Discount	$ 1,500,000	Lending Value Bank Gives to Collateral
Net Gap Bank Collateral	$ 1,500,000	Bank Valuation/Risk Analysis Fee
Bank Gap Fee	$ 75,000	Bank Loan Secured by Unsold Territories
Gap Lending Interest Rate	$ 135,000	Gap Interest
Net Loan Value Applied To Production Cost	$ 1,290,000	*Net Amount applicable to production budget*
Private Equity		
Private Equity LC	$ 2,400,000	Letter of Credit (LC) Provided by Equity Financier's Bank
LC Lending Interest Rate	$ 216,000	Interest Reserve
Net Loan Value Applied To Production Cost	$ 2,184,000	Net Amount applicable to production budget
Production Resources		
Total Net Loan Value for Production	$ 8,386,920	Total Collateral, Less Discounts and Reserves
Total Loan Interest Expenses Reserved	$ 840,240	Total Amount of Bank Loan Interest Reserved
Cash Collected from License Advances	$ 948,000	License Advances Collected For Production Budget Use
Talent and Vendor Profit/Equity Budget Offsets	$ 2,700,000	Fully Applied To Their Respective Budget Allocations
Total Gross Production Loan and License Proceeds	$ 12,234,920	Applicable to Budget From Bank Loan, Advances and Budget Offsets
Actual Production Budget (including contingency & interest)	$ 12,000,000	Physical Production Budget of Picture
Collateral Sufficiency?	**Yes**	Is There Sufficient Loan Proceeds and License Advances?

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Excerpted from *The Producer's Business Handbook*

Let's now walk through each section of the production financing worksheet. All areas highlighted in green need to be filled in, which will then automatically calculate and fill in all other amounts and percentages.

ASSUMPTIONS

The producer fills in this section as accurately as possible. Initially these will be estimates, but as financing coalesces, this section will be completed with actuals:

• The borrowing period of the loan should be listed in months. This will typically be 12 to 24 months.

• Presale, brand tie-in, and letter of credit (LC) interest rate is estimated at 6 percent (4 percent over LIBOR [London Interbank Offered Rate], here assuming LIBOR is 2 percent). This is a reasonable percentage spread with which to begin for fully secured collateral.

• Presale, brand tie-in, and letter of credit (LC) bank fees are estimated at 2 percent.

• Presale discount, international territory presale. If the distributor issuing the contract is not financially strong, the bank will discount the value of the contract anywhere from 10 percent to 50 percent. Our sample is a 30 percent discount. If the distributor is financially strong, no discount will be necessary, and then this line item would be at 0 percent.

• Presale discount, ancillary presale. If the distributor issuing the contract is not financially strong, the bank will discount the value of the contract anywhere from 10 percent to 50 percent. Our sample shows a 0 percent discount.

• The bank typically discounts production incentives 20 percent for U.S. programs, 10 percent for Canadian programs, and

10 percent to 25 percent for most international programs. In our example, because we are assuming a shoot in New York, we are discounting by 20 percent. Also, please note under Description: Production Incentive Programs–Amount, we are only taking a total of 19 percent of the full 30 percent below the line, because not every line item in the budget will be considered a New York spend.

• The incentive programs lending rate is calculated at 6 percent (4 percent over LIBOR, here assuming LIBOR is 2 percent).

• The presale payment advance is usually required by the bank to be a minimum of

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20 percent of the total amount for licensing of all rights in a specific territory.

• The brand tie-in advance is usually required by the bank to be a minimum of 10 percent of the total amount for licensing of those rights.

• The gap lending interest rate is calculated at 6 percent (4 percent over LIBOR, here assuming LIBOR is 2 percent).

• The gap discount is typically 50 percent and terms currently with some banks are a maximum $2.5 million or 20 percent of the budget, whichever is less.

• The gap bank fee is calculated at 5 percent, as this is much higher risk collateral.

FINANCING PARTICIPANTS

This section sets forth the ten-primary production budget financing categories, including an "Other" line for anything not covered in the listed categories.

First the producer enters the project's name, then the lead distributor. Next is the production budget at the top. Then, in the financing participant section, each of the ten funding categories is engaged by entering an amount in each that are expected to participate. This will automatically formulate a percentage of the budget, that is shown in the column to the left of each amount.

1. Government Production Funding Net Received

As discussed more thoroughly earlier in the chapter's section "Entertainment Industry Related Funding," this amount includes all net amounts received from that category of funding, typically at the national level, usually reserved for citizens, to both foster that nation's entertainment industry, as well as possible cultural objectives. As these funds typically operate as a grant, there are rarely any discounts and often no repayment obligation. Consequently, these funds are shown as Net proceeds and automatically added into this worksheet's Total Production Proceeds.

2. Crowdfunding Net Receipts

As also reviewed in this chapter's section "Entertainment Industry Related Funding and Financing Sources," this amount includes all net amounts received from crowdfunding sources.

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3. Production Incentive Programs

There are numerous program variations worldwide, most covering 10 percent to 30 percent of the budget. Regardless the plan, their rebate or tax credits comes after the project is produced, allowing the final accounting to be done according to how much money verifiably was spent in the city, state, province, or country, this spending being the incentive source's motivation to offer it. Banks and private funds such as 120dB in the U.S. and Hindsight Media in the UK are typically engaged to advance these incentives for the production budget.

4. International Territory Presales

Especially with the entity consolidations of the late 1990s, most participants financially strong enough to advance a presale are major distributors whose contract will be bank acceptable as collateral. If they are not rated high enough for your bank, the bank will either discount the value of the contract from 100 percent to as low as 50 percent or it may require a letter of credit from the distributor. In our sample, we are securing only presale contracts from "A" list distributors and no letter of credit is required.

5. Ancillary Presales

These are presold rights, like international territory presales.

6. Talent and Vendor Profit and Equity Offsets

Negotiating with one or more of each project's key talent to be chiefly paid alternatively with an increased amount based on the project's projected profits can potentially increase a talent's earnings and potentially give them enhanced tax advantages while providing the project with a significant amount of its budget. This allows talent to earn appreciably more income if the project meets or exceeds its global projections.

Production participants who are a significant part of the project's total cost should be considered as possible funding participants through having part or all their costs paid from the project's profits. These participants are most often lead cast, director, VFX, and post production facilities.

The motivation for these profit participants is that the producer agrees to pay them an amount more than what they would have otherwise been paid, typically 10 percent to 20 percent more, pay it to them from a prioritized portion of producer's gross profits, plus pay them an ongoing percentage of all the project's

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producer's net before EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) that could represent income several times their fee.

The greater each funding participant's portion of the total production budget, the more alluring is the producer's offer to them. **The big items to negotiate are:**

1. How much more will they be paid?

2. As their primary concern is being paid at least what they would have received if they chose not to participate, what priority producer's gross profits participation position (exceeding the participant's percentage of the overall investment) will they be paid until they have at least been paid what would have earned?

3. If their participation is significant enough to pay them an ongoing percentage of producer's net profits before EBITDA, what percentage will this be?

4. If the producer respects the participant's production experience and opinion, and their participation warrants it, they may be provided a creative voice in the project and a producing title.

For instance, if the project's budget is $20 million and the director's fee is $2 million, their fee investment is 10 percent of the budget. The producer's offer could agree to pay the director from 40 percent of the producer's gross (that's four times their investment amount) until they have been paid $2.5 million (125% of their direction fee) and then a continuing 3 percent of the producer's net profits for the duration of the project's long earnings life.

Especially with director and key acting talent, if they are given the opportunity to earn significantly more than they would have, the positive impact on their performance and the resulting production could be major and well worth the extra incentives.

It is crucially important to create the deal architecture for each of these relationships before any of them are negotiated. When producers are negotiating, they need to know the earnings and cash flow impact each deal has upon them and all other participants. They are benefited by having a deal points sheet with everyone's target deals, so when in negotiations, all deals can be weighed, numbers adjusted, and even explanations given as to the producer's terms ceilings.

7. Brand Integration

Branded entertainment or integration is a fairly new term for the sophisticated use of product placement and the integration of advertising into the entertainment

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content whereby the brands are embedded into storylines of a project. Branded integration is an entertainment-based vehicle that is funded by and complementary to a brand's marketing strategy. Ultimately, the motion picture gives the brand an opportunity to connect with its audience in a unique and engaging way. An extreme example is The Lego Movie—in essence the audience is just watching a 2-hour advertisement. The James Bond movies have always been strong in brand integration. Heineken tops the list paying a reported $45 million for a product integration in the 2012 film Skyfall.

For many brands, entertainment projects represent their highest impact and most reasonably priced marketing expenditures and strategies, especially global brands. As projects proceed through each successive release window to increasingly larger audiences, motion pictures become the ever more effective and price-efficient marketing tool. For producers, these brands can also increase a project's creative integrity and cross-promote/market the project. These negotiations typically need to conclude a year before a project's premier release and early enough in the development phase of the screenplay to have the brand creatively integrated into the project. They have and continue to provide a project's significant production and/or distribution funding. The key to securing branded financing is guaranteed distribution. The brand needs to know upfront that their audience eyes will be on the project before they will commit.

8. Gap/Estimate Financing

Gap financing is calculated based on the estimates received from a qualified/bankable ISA on the value of each international territory that was not presold. A sample ISA Estimates list is below (Figure 6.2). It is calculated at Ask price (or highest price for MG) and Take (lowest acceptable MG). The bank will discount up to

50 percent of the territories' aggregate value based on the Take (low) price only. This discounted amount is then lent to the producer as part of the production financing (typically capped at $2.5 million or 20 percent of the budget, whichever is less). Gap financing is a risky model, and banks that do lend on these international sales estimates are constantly assessing the credit worthiness of ISAs and distributors worldwide. Typically, a bank will only accept a handful of ISAs' estimates. Producers must approach the bank early to be sure they are working with an ISA acceptable to the bank.

Though the bank loan fee is high, the producer's advantages to gap financing are

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primarily that fewer presales are made, allowing these licensees to earn higher after-film-completion licenses, and the producer does not have to do the pre-sale work for these territories. The bank will require two and many times three presales from the top 12 territories before doing gap financing. These sales enable the bank to more closely evaluate the estimates supplied by the ISA.

9. Private Equity

The private equity sources in this example use collateral (CDs, treasury bills, securities, and so on) rather than cash. This example uses $2.4 million in private equity secured by a letter of credit, which therefore requires the bank to charge both an interest rate and a fee. If, however, the equity is in the form of cash, neither of these charges will be required.

10. Other

This may include donations from a non-profit anxious to see the picture produced to benefit their cause and mission, or a loan from the production company or other sources. If this is used, include the net proceeds. This amount will automatically add in the total production proceeds.

Figure 6.2: International Sales Estimates

FILM TITLE International Sales Agent Name	ESTIMATES $4.5 M Budget		
TERRITORY	**ASK**	**TAKE**	**PRESALES**
Europe:			
Benelux	$ 150,000	$ 70,000	
France	$ 300,000	$ 150,000	$ 300,000
Germany/Austria/ Switzerland	$ 400,000	$ 175,000	$ 400,000
Greece	$ 40,000	$ 20,000	
Iceland	$ 20,000	$ 10,000	
Israel	$ 40,000	$ 20,000	
Italy	$ 175,000	$ 90,000	
Portugal	$ 50,000	$ 25,000	
Scandinavia	$ 150,000	$ 70,000	
Spain	$ 150,000	$ 65,000	
Switzerland	$ 35,000	$ 20,000	
Turkey	$ 80,000	$ 30,000	
United Kingdom	$ 400,000	$ 175,000	$ 400,000
Total Europe	$ 1,990,000	$ 920,000	**$ 1,100,000**

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Eastern Europe:					
Baltic States	$	40,000	$	20,000	
Bulgaria	$	45,000	$	25,000	
Czech Republic	$	50,000	$	30,000	
Hungary	$	60,000	$	35,000	
Poland	$	70,000	$	35,000	
Romania	$	30,000	$	15,000	
Russia	$	125,000	$	75,000	
Yugoslavia	$	40,000	$	15,000	
Total East Europe	$	460,000	$	250,000	
Asia:					
Pan-Asia PTV	$	150,000	$	75,000	
China	$	120,000	$	40,000	
Hong Kong	$	40,000	$	15,000	
India	$	60,000	$	25,000	
Indonesia	$	50,000	$	20,000	
Japan	$	200,000	$	90,000	
Malaysia	$	40,000	$	20,000	
Middle East	$	50,000	$	25,000	
Pakistan	$	10,000	$	5,000	
Philippines	$	30,000	$	10,000	
Singapore	$	40,000	$	15,000	
South Korea	$	150,000	$	70,000	
Taiwan	$	30,000	$	10,000	
Thailand	$	40,000	$	15,000	
Vietnam	$	30,000	$	10,000	
Total Asia	$	890,000	$	370,000	
Latin America:					
Pan-L. America PTV	$	250,000	$	100,000	
Argentina/Para/ Uruguay	$	60,000	$	35,000	
Brazil	$	200,000	$	100,000	
Central America	$	60,000	$	30,000	
Chile	$	40,000	$	25,000	
Colombia	$	40,000	$	25,000	
Dominican Republic	$	30,000	$	20,000	
Mexico	$	80,000	$	60,000	
Peru/Bolivia/Ecuador	$	60,000	$	30,000	
Venezuela	$	60,000	$	25,000	
West Indies	$	25,000	$	15,000	
Total Latin America	$	655,000	$	365,000	

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Africa:		
South Africa	$ 150,000	$ 75,000
Oceania:		
Australia/New Zealand	$ 225,000	$ 100,000
North America:	$ -	$ -
Total	$ 4,770,000	$ 2,255,000
Less Presales		$ 1,100,000
TOTAL REMAINING ESTIMATES		**$ 1,155,000**
Bank Collateral Finance (50%)		**$ 577,500**

TYPES OF LOANS

If the production loan is in the form of a line of credit, the producer has access to the entire loan amount but is charged interest only on the loan amount actually drawn. With more than $500,000 in potential interest, even a 20 percent interest savings (which is very possible with prudent cash management) will save more than $100,000.

WHEN TO APPROACH THE BANK

Using bank production funding strengthens many aspects of producer operations. The bank relationship and its other related benefits should become integrated into and affect many aspects of the producer's business.

New producers should meet with their bank of choice before completing their project's development. Well before their need for production borrowing, producers should have initial meetings with their bank loan officer, introducing the production company's business plan, the company's development and production schedule, and clearly show the bank's essential participation in the company's overall success.

Producers should ask the loan officer for permission to use the bank and the officer

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as references to others relative to the producer's intention to use the bank as the production funding source for projects. Most bank entertainment divisions are willing to allow producers to do this, if their representations are in keeping with the relationship. Using the bank as a reference to potential licensees and other sources in connection with the producer's finance plan lends substantial positioning strength, especially for producers introducing new production entities.

In addition to production financing and later operating capital funding, bank officers can be well used as business consultants and mentors, contributing excellent business expertise to the production company and opening the way for expanded business relationships.

PRIVATE EQUITY: THE BENEFITS OF A SOLID BUSINESS PLAN

Securing private equity partners as part of each project's financing has become more essential than ever. The financing sources of recent years (Abu Dhabi, India, and Russia) have been replaced by new sources including China, Singapore, and South Korea.

Equity partners expect a priority return-of-investment position, until they have been returned their total investment, and sometimes more (between 5% to 20%) than this amount. Their priority position typically provides them a percentage of profits that is greater than their investment's percentage of the total capital raised. Once the investor has received the agreed amount, then their profit-sharing account indicates they have an "overage" until future profits distributions balances their account. Thereafter, with all other investor participants, they are paid their investment's proportional share of the producer's net profits before EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization).

To secure private equity partners, producers need to have a sophisticated and well-thought-out business plan with financial projections (sometimes referred to as a waterfall) that is tightly structured within an offering that is compliant with the securities laws of the areas in which it is offered. The business plan should include the following elements:

Executive Summary

One or two paragraphs that gives a concise overview of each of the following: the project, the company, the management and advisor team, the goals of the company,

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the finance plan, the marketing plan, the distribution plan, the investment opportunity, risk and its mitigation.

The Project

Give more detail about the genre; include a synopsis; explain the stages of development, production, and distribution; identify your target audience; and delineate your budget and how you intend to control costs. Explain the Finance Plan (how all the financing collateral will come together).

The Company

Explain the legal entity that has been or will be formed to produce the project. Include narrative bios on the managers/producers.

Marketing

Explain who your target and secondary audiences are; describe how you intend to engage them, even during development, preproduction, and production of the film (prerelease marketing), and explain any other methods you intend to use to develop and grow awareness of the film.

Securing Distribution

Without distribution, your investors have no opportunity to receive a return on their investment. Describe your clear and concise model and explain how you intend to implement it to offset the financial risks involved. An overview explaining the different media and ancillary markets, as well as a breakdown of fees and costs, is also recommended to be included in this section.

Investment Opportunity

Include detail about the financing sources that you will utilize and what you are offering the equity investors (i.e., rate of return and profit participation).

Risk Mitigation

Explain that as with all investment, the incentive for extraordinary earnings is tempered by the possibility of complete loss. To mitigate risk, explain all the balanced-producer models this book advocates: some form of distribution in place before beginning production, bank loan for collateral agreements, bond company, production incentives, and collection account.

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Excerpted from *The Producer's Business Handbook*

The Production Team

Attach résumés for all production talent on the film.

Advisory Team

Attach résumés for all advisory team members on the film, and explain how they will assist management.

Appendices

These should include, but are not limited to, a budget top sheet, project comparables or greenlight analyses, a finance plan, financial projections, a production incentives program outline, talent attachment verification(s), letters of intent for distribution or agreements, and any other research information pertinent to the film.

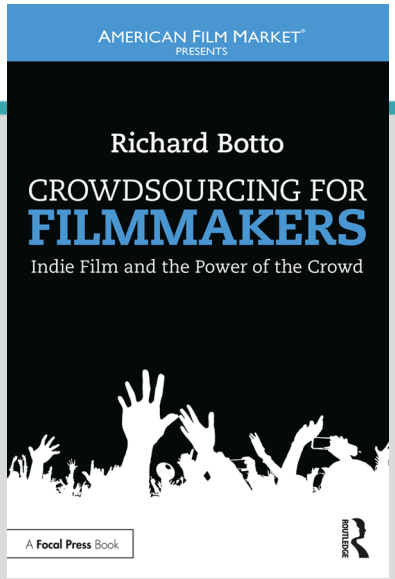
To write a solid business plan, the producer must first develop a financial plan showing how the investors will receive a return on their investment based on buyers' estimates, presales, and a smart distribution and marketing plan.

CHAPTER

3

THE CROWDFUNDING CAMPAIGN

GET YOUR MONEY FOR NOTHIN' AND YOUR CHICKS FOR FREE



This chapter is excerpted from
Crowdsourcing for Filmmakers
by Richard Botto

Learn more

THE CROWDFUNDING CAMPAIGN

Excerpted from *Crowdsourcing for Filmmakers*

No book about crowdsourcing for film would be complete without information on the subject of crowdfunding. The advent and acceptance of crowdfunding as a viable way to raise capital for a project has proven to be a Holy Grail for both novice and established filmmakers. Crowdfunding has launched or changed the career path of many a film creative while allowing for some remarkable, innovative and immensely successful projects to be realized. Whether it's shorts, features or documentaries, projects that would otherwise face an uphill rise in securing funds through traditional methods now have an alternative way to raise capital. Many . filmmakers have turned to crowdfunding not only as an alternative way to fulfill their budgetary needs, but have also recognized that crowdfunding allows them more autonomy as well as full control on how they cultivate a support base and audience. They run their campaigns with an eye not only on various aspects of the project, but on creating and forming their brand as well. They are savvy to what each platform provides, who is likely to frequent them, what the competition is doing, and how they can best separate themselves from the pack.

But for many, the basic tenets of crowdfunding, or simply how to run a competent and engaging crowdfunding campaign, remains a confounding mystery. Some, blinded by ego and hubris (that theme again), believe that by simply posting reels showing off what they believe to be a considerable skill set, people will be so dazzled by their talent, they will have no choice but to donate to their project. I call this the "If you build it, they will come" approach. Others simply do not take the time to review and utilize the legion of information regarding how best to plan and run a successful campaign and choose to ignore the tools most crowdfunding platforms provide. Many more launch a campaign blindly, with no blueprint for how to attract and keep an audience or fanbase engaged, neglecting to realize that any crowd-funding campaign requires constant attention, nourishment and caressing. For all these reasons, and many more we'll outline in the next chapter, failed campaigns greatly outnumber successful ones.

To understand how best to run a successful film crowdfunding campaign, we must first understand the history of crowdfunding, the different types of crowdfunding, how various crowdfunding platforms operate (which will inform which platform is best for you), discuss the vast competition within the crowdfunding arena and investigate and dissect a few successful campaigns.

In this chapter, we'll explore everything mentioned in the previous paragraph, and, in the next, we'll identify the aforementioned problems and cover strategies to help you run a successful film crowdfunding campaign by rising above the din,

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standing out from the pack, identifying and moving the crowd and creating engagement that guarantees the best possible odds for success.

A BRIEF HISTORY OF CROWDFUNDING

Crowdfunding, particularly online crowdfunding, has become something of a phenomenon across the world over the last half decade, with legions of people donating money to projects, causes, services and a variety of other initiatives. As documented by Reuters, journalist Kylie MacLellan, crowdfunding websites helped companies and individuals worldwide raise $89 million from members of the public in 2010, $1.47 billion in 2011 and $2.66 billion in 2012. Of this, $1.6 billion of the 2012 amount was raised in North America. According to The Crowdfunding Industry Report compiled by Massolution (an advisory and implementation firm that specializes in crowdsourcing solutions for private, public and social enterprises), the nearly $2.7 billion raised in 2012 was generated from over one million individual campaigns. Mere weeks before writing this chapter, Forbes reported that global revenues from crowdfunding spiked to $5.1 billion and projected that in the year 2025 revenues generated from crowdfunding would reach $25 billion . . . wait for it . . . *in China alone!*

Did I mention crowdfunding is hot?

But, and this is a big but, that doesn't mean that every project is right or, more importantly, ready for a crowdfunding campaign. This is especially true in the increasingly competitive world of film crowdfunding. We've already spoken about the fact that the barrier of entry for making a film has never been lower and, thus, the number of people entering the space has never been higher. And as the hardware market becomes more competitive and costs continue to decrease, software becomes more sophisticated and intuitive, and as the proliferation of media outlets willing to host and distribute content continues to rise, it only stands to reason the barrier will drop even further. Countless more people will not only be seeking to make a film, but be looking to finance their projects through crowdfunding. So, is that good news or bad news? Well, it depends on your viewpoint. Let's come back to that thought in a moment.

A crowdfunding campaign with a compelling bent, coupled with a sound marketing and crowdsourcing strategy, is a revolutionary, game changing way for a filmmaker, producer or any other DIY creative to raise funds for a project. Beyond the obvious,

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as a means of potentially raising money from people you don't know, it also serves as a way to build an audience and fan-base for your project, and the talent connected to the project, before you even consider entering pre-production.

With a traditional raise for a film (and I've been involved in more than a few), you operate within a bubble. You go hat in hand to various individual investors or investor groups, usually with a business plan (many of which look alike, say almost exactly the same things and reference the same batch of previously successful independent films) and a well-oiled sales pitch on why your project is different from every other in the stratosphere. Or, perhaps, if you have any, you dog and pony the name attachments on your movie in front of your potential investor(s) in the hope that your target will become star-struck and, as a result, anxiously loosen their purse strings. Whatever the method, these meetings are usually done in a hush-hush fashion. Besides a unique opportunity, you're pushing exclusivity—the fact that, true or not, the person you're pitching is getting a first look at the plan. No one wants to be presented a pitch for a project they view as either stale or saturated.

With crowdfunding, the particulars of your raise are completely out in the open—absolute transparency is the name of the game. You will not only be targeting individuals, but groups and organizations in an effort to get them to support your project financially and get behind it by promoting the merits of your mission to others. This is why, as we stated very early in this book, every single crowdfunding campaign has an element or elements of crowd-sourcing. However, accomplishing the mission of support from the crowd will require months of planning and a commitment that goes far beyond making a couple of creative/interesting posts or uploading a piece of media when the mood strikes.

This will be a full time job. It will require research. It will require business and entrepreneurial sense and style. It will require a temperament that is patient, receptive and adaptable. It will require you to find people who love you and your project and have the qualities that lend themselves to helping you run the campaign. Even if you feel you have what it takes to get the job done alone (and, again, it's a much more formidable undertaking than you think), forming a team to manage various aspects of the campaign is highly recommended.

But this is all macro strategy talk, which we'll distill in the next chapter. For now, let's get a little more micro as it relates to our crowdfunding overview.

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Excerpted from *Crowdsourcing for Filmmakers*

TYPES OF CROWDFUNDING

There are five types of crowdfunding: Rewards, equity, charity, litigation and debt. For the purposes of our subject, film crowdfunding, we only need concentrate on two—rewards and equity.

Rewards Crowdfunding

According to business crowdfunding website Fundable, the history of crowdfunding began in 1997 when UK rock band, Marilion, financed their reunion tour via ArtShare. At the time, ArtShare was a fan funding website (where they ran a substantial crowdsourcing campaign long before the word crowdsourcing was coined). Mainstream websites such as Indiegogo came into focus in 2009, establishing a new form of crowdsourcing financing, or *crowdfunding*.

In rewards-based crowdfunding, funds raised for projects are provided by individual supporters who make up the crowd (sometimes referred to as the community). The person or group running the crowdfunding campaign sets rewards levels (sometimes called perk levels) spelling out what reward is to be received for donating a certain amount of money to the cause. For example, a film rewards-based campaign might set a level one reward at $5 and give anyone donating that amount a thank you on their social media pages. The next level may be $25, for which the donor receives a poster of the movie. The next could be $50, which guarantees the donor a DVD of the film and so on. The more attractive and innovative the rewards, the better.

Since rewards-based crowdfunding allows the individual or group running a film campaign the advantage of raising capital without offering a return on their investment, it effectively eliminates dealing with the contracts, attorneys, securities issues, profit and loss statements and accounting nightmares that are part and parcel of a traditional film equity raise.

Equity Crowdfunding

Equity crowdfunding involves monetary investment into a commercial enterprise—for example, a film. However, instead of receiving a chotski or some other perk for their money as in rewards-based crowdfunding, the investor is hoping for a monetary return based on the proceeds of the film. Due to the fact that equity crowdfunding involves investment into a commercial enterprise, it is almost always subjected to rigid and, for investors, restrictive securities and

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financial regulations.

Hoping to exempt relatively small investment offerings (defined as $1 million or less), sold to the public in small blocks, from the registration and compliance requirements demanded of large public companies, a group of advocates band together, eventually forming a lobbying group called Startup Exemption. In 2011 Startup Exemption presented a crowdfunding exemption plan to members of Congress and other influential political leaders. Soon after, the Entrepreneur Access to Capital Act was introduced, and in March of 2012 it became part of the JOBS Act, which was signed into law by President Barack Obama on April 5th, 2012.

The crowdfunding provision of the JOBS Act tasked the Securities and Exchange Commission (SEC) with composing detailed rules for crowdfunding, specifically crowd investing. They were given a Congressional mandated deadline of 270 days to write the rules. As of the writing of this chapter they are over two years past due. Further, SEC Chairwoman, Mary Jo White, has given no indication that we should expect a response or resolution to this matter any time soon.

So in spite of the JOBS Act passing way back in 2012, it remains primariily useless due to unworkable rules proposed by the US Securities and Exchange Commission.

Now the good news . . .

Impatient and certainly more progressive of mind and matter, many states have decided not to wait on the government and handle things on their own. At the moment, 13 states have intrastate crowdfunding exemptions in place and 14 more are in the process of enacting/considering sponsored legislation regarding intrastate crowdfunding. A couple of these states, Texas to name one, have some extremely liberal guidelines.

Equity crowdfunding for filmmakers is an exciting and potentially game changing proposition, but it's still in its infancy and will be evolving for years to come. However, that doesn't mean you can't start planning or participating now. Just be sure before doing so, you review the rules (they vary greatly) of each state and cover your bases by consulting an attorney.

THE PLATFORMS

As more states pass legislation to allow equity-based crowdfunding online, you can expect many new crowdfunding platforms to pop up. But, for the purposes of this

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section, let's concentrate on what's mainstream: Rewards-based crowdfunding platforms. Here's how most work:

You, the project manager, upload a project and set a monetary goal. In this example, let's say that's $10,000. Again, we'll touch on the planning and strategy on how all of this goes down in the next chapter, but assuming you have all your ducks in a row, you'll start your campaign on a certain day and begin taking monetary pledges for the project in exchange for rewards based on the tiers you've decided on.

I, the person donating, make a pledge to your project. Let's say $500. This payment can be made through a credit card or through an online payment entity such as PayPal, Amazon Payments or Stripe. Assuming the monetary goal of your project has not been met yet, my card will only be checked to see if I have the funds available for what I pledged. If so, that amount will be held and you will be notified of the pledge. Additionally, the amount will be reflected in the total on your campaign page. My card will be charged the $500 donation on the final (deadline) date of the campaign only if the project goal has been met or surpassed. (Some platforms allow the campaigner to keep any and all pledges made to the campaign. In this instance, I would be charged immediately upon making my pledge. More on this below.)

On a majority of rewards-based crowdfunding platforms, there is a 3–5% processing fee which will be deducted from each donation to the project. Additionally, the company running the platform will take a cut as well, typically 4–9%, but sometimes as high as 15%, depending on the rules set forth by the platform.

On a sidenote, there are some crowdfunding platforms that allow you to keep any monies raised even if you do not reach your set goal. Sounds great, right? But there are a couple of drawbacks. One, you will pay a much higher percentage to the platform on the top of your raise, typically 5% or higher than if you had hit or surpassed your goal. Two, some potential supporters look down at this practice, feeling that if you did not do your job marketing and attracting other donors to the project, you probably don't have your act together or, perhaps, aren't serious about the project and therefore shouldn't be trusted with their donations. For many other potential supporters, this isn't an issue. They feel if they're behind a project, that's all that matters. Ultimately, no matter which platform you choose or whether you decide on an "all in" or "any money raised" strategy, you should set reasonable

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goals and properly promote your campaigns so that the end game is collecting all the money while paying the lowest fees possible.

There are numerous platforms to choose from, and new and intriguing sites enter the mix regularly. Each comes with its own personality, following and rules. I'll outline some of the more popular ones below, but it's up to you to do your research and due diligence to decide which platform is right not only for your project, but would be best suited for the crowd you're hoping to engage and move.

Indiegogo

One of the originators of the crowdfunding space remains one of the brightest innovators within the space. Indiegogo does a phenomenal job keeping their audience informed, engaged and educated. The site is easy to navigate, has a wide, global audience and provides stellar customer service and support. With sections such as their Campaign Playbook, they are consistently progressive in developing offerings for project managers in an effort to provide the tools and information required to give each campaigner the highest probability of success.

Whether you're an independent filmmaker of shorts or features, a documentarian or webseries creator, Indiegogo will allow you to post your campaign while giving you the course knowledge (and personal hand holding, if so desired) necessary to get it in front of the most eyeballs.

Indiegogo also allows you to choose a fixed or flexible funding campaign. With a fixed campaign, you will only receive your funds upon reaching or surpassing your goal. With a flexible campaign, you'll receive any funds raised on the closing day of your campaign.

FEES (Fixed or Flexible Campaign)

- 5% platform fee (upon reaching your goal)
- 3% + $.30 processing fee for credit cards
- 3–5% processing fee for PayPal
- $25 wire fee: Charged once when non-US campaigns have raised funds in US dollars via credit card. The funds are wired in one lump sum to a non-US account after the campaign has ended.
- Additional currency fees may also apply.

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Kickstarter

The other behemoth in the space along with Indiegogo. Film represents Kickstarter's second most popular category after tech, but with a somewhat tougher review and project acceptance process than most platforms. Th at doesn't necessarily mean it's the best platform for all filmmakers. Some projects are taboo altogether. For example, if you are looking to crowdfund an industrial film on Kickstarter, you'll have to look elsewhere.

Some view Kickstarter's stricter parameters and selectivity to be a huge plus, allowing for less quantity and more quality. Fewer posted projects provide a higher concentration of eyeballs and greater opportunity for support. A higher quality of projects brings legitimacy to the campaign, the thought being that if the project is worthy of Kickstarter, it's worthy of attention and, in turn, a donation.

The Kickstarter Basic section offers a robust FAQ, user tools and other information designed to help you get the most out of your campaign.

Fees

- 5% platform fee (upon reaching your goal)
- 3% + $.20 processing payment
- Pledges under $10 have a discounted micro-pledge fee of 5% + $.05 per pledge

GoFundMe

According to GoFundMe's getting started section, most people use the platform to raise money for themselves, a friend or loved one during life's important moments. This includes things like medical expenses, education costs, volunteer programs, youth sports, funerals and memorials—even animals and pets. However, GoFundMe users also list products and services as well. Because of the lack of heavy competition, many filmmakers choose GoFundMe as their crowdfunding platform of choice. Films that carry a social message work well on GoFundMe due to the socially conscious and charitable donors who frequent the site. A recent perusal of the various fillm offerings listed on GoFundMe found campaigns for a narrative on bullying, a documentary on marijuana legalization, and a short on the subject of child trafficking all performing exceptionally well.

GoFundMe allows users to create their own website to fully explain why they are

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looking to raise money. They also allow campaigners to share their site via integrated links through social media.

Unlike many other platforms, you need not reach your goal with GoFundMe to receive the monies donated. You can withdraw any or all of the funds in your account whenever you please. Also, there are no required time limits or deadlines associated with a campaign. However you can choose an "All or Nothing" option which requires you to set a time limit to hit a certain goal. Failure to do so results in a forfeiture of all monies raised.

Fees

- GoFundMe deducts 5% from every donation received
- Approximately 3% processing

Seed&Spark

Unlike the platforms mentioned above, Seed&Spark is devoted strictly to filmmakers and film lovers. It's a truly independent community where film-makers and audiences can join forces to fund, promote and watch the best new independent films.

Seed&Spark takes a different approach to crowdfunding. There is still an overall monetary goal to be obtained, but Seed&Spark's crowdfunding tool is designed to work like a wedding registry. Filmmakers make a "wish list" of the individual items they need to make their film. Supporters can contribute money towards a specific line item—say, costumes or camera— or, if they have that item themselves, they can loan it to the filmmaker directly and the loan counts toward the overall goal of the campaign. This wedding registry approach allows for a more personal interaction between the supporter and those running the campaign and effectively gives the supporter a feeling of more ownership in the project than merely being a financial supporter.

As an added perk for filmmakers, Seed&Spark offers distribution on their platform so that the fans the platform services have the opportunity to view films funded through the site. They have also announced that they will soon be extending offerings out to other distribution platforms as well.

Like other rewards-based platforms, filmmakers offer incentives to their supporters, but unlike other platforms, Seed&Spark o.ers incentives to backers as well. For

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funding, following or sharing a project, users earn "Sparks"—rewards points that can be redeemed to watch movies on their streaming platform.

Seed&Spark does not require you to hit your goal in full. If you make it to 80%, they will release your funds. Additionally, although they take a mostly standard 5% for their fee, they also offer funders the opportunity to add 5% to their contribution to cover the site's fee on the filmmakers' behalf. According to Seed&Spark's FAQ, over 70% of backers choose to add the extra 5%. In 2014, filmmakers paid on average 1.95% in site fees and no third party payment fees (such as to Amazon or PayPal on other platforms).

Seed&Spark claims a current campaign success rate of 80%, which they claim to be "the best in the business."(1)

Fees

- 5% upon reaching 80% of your goal
- 3% . at processing

Remember, carefully reviewing which platform you will use to house your film project's crowdfunding campaign should be a very big part of your pre-campaign strategy and should not be minimized. Take your time and do your homework thoroughly. Do projects similar to yours have a high success rate on a particular platform? How does the platform list or rank all of their projects? Is it a random process or will you be able to control your own destiny based on certain criteria (example: money raised in a 24-hour period), or is it possible to purchase a premium placement? Does the platform offer personalized service, guidance and hand holding when needed?

These are just some of the questions that need to be asked. I would also highly recommend seeking out people who have successfully crowdfunded a film campaign and ask them (kindly, complimentary and with genuine interest) if they wouldn't mind sharing their experiences. You not only want to learn what pertinent strategies they believe were paramount to their success, but missteps made along the way, what they did to adjust/pivot, and what strategies they would implement to prevent similar pitfalls the next time around. Not only might you gain some insight that will help you decide whether the platform in question is right for you, but you may also gain some critical course knowledge along the way.

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Excerpted from *Crowdsourcing for Filmmakers*

THE COMPETITION (OR *!#$@! ZACH BRAFF)

So now you're ready to dig in and begin looking over the various crowdfunding platforms. You sit at your computer, your creative synapses sizzling and snapping, your fingers tingling with excitement. You're about to take the first step in your project's journey. How cool. You pause for a second, re.flect on the road that brought you to this moment—the hard work, the late nights outlining and planning, the insecurities you had to overcome as a creative to feel compelled to believe that your project is a worthy crowdfunding candidate. You channel your inner Stuart Smalley and think to yourself: I am going to post the coolest campaign ever and be so engaging and informative that people are going to beg me to take their money. And you know why? Because I'm good enough, smart enough, talented enough and, goshdarnit, people like me. You punch the keys of your keyboard with confidence and authority, typing in the URL of the first crowdfunding platform for review. An impenetrable wall of film crowdfunding campaigns loads before you like an endless skyscraper reaching above and beyond the clouds. You load the next page . . . another wall. The next page . . . yet another.

You feel a light gurgle push up from your stomach, rising higher until it escapes from your lips in the form of a nervous laugh. Your eyes dart back and forth across the screen. Campaign after campaign. Hundreds, no, seemingly thousands of them. Webseries, music videos, promotional videos, documentary shorts, full-length documentaries, shorts, features! And wait, isn't that the guy I went to film school with?! The guy that didn't know which end of the camera to look through?! He's raised 75% of his goal in seven days?! And isn't that the guy who won that huge film festival last year?! He's looking for money too?! And that writer, the one who won that screenwriting contest . . . I know him . . . He's a filmmaker now?! He's looking for money?! And, wait a second . . . I think I recognize tha . . . isn't . . . it can't be . . . Is that *!#$@! Zach Bra.?!?!?! What the hell does he need money for?!?! How many millions?!?!? But he's famous!!!! He has more money than God!!!! Or at least the guy who played God in that movie I saw!!!! Holy shit, I'll never watch Scrubs again!!!!!!!

Your synapses go from sizzling to singed. Your hands from tingling to numb. If Stuart Smalley was in front of you, you'd punch him in the teeth.

Relax. It's OK.

Let's start with Zach Braff and celebrity crowdfunding in general. The first high

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profile celebrity crowdfunding campaign—or at least the one that caused everyone to jump out of their seats and cry foul—was The Veronica Mars Movie Project. Veronica Mars was a fairly popular television show created by Rob Thomas that aired on UPN/CW from 2004 to 2007 and starred actress Kristin Bell. When Mars was ultimately canceled, the show's fer-vent fanbase took to the internet to express their disappointment. Th e large swelling of support inspired Thomas to write a full-length script which he hoped would convince the powers that be at Warner Brothers to put up the funding in support of a feature film. They declined.

The project sat in limbo until March of 2013 when Thomas and Bell decided to take the project to Kickstarter, believing fully that the passion to see the Mars characters on screen still ran deep with the fans. They set up some creative donation incentives (for $8K you got to name a character in the movie. For $10K you got to be in the movie). They enlisted fellow Mars actors Enrico Colantoni, Ryan Hansen and Jason Dohring to appear in a video promoting the campaign. Then they launched. Their goal? Everyone put their pinkie finger to their lips like Dr. Evil . . .

$2 millllllionnnnn dollars.

They reached it in ten hours.

In the end, they had set a record for the most backers on a single Kickstarter project with 91,585 donors who pledged $5,702,153.

There were some who were outraged by the fact that those working within the system would use a medium that was clearly invented and designed for the cash poor, struggling independent film artist (although that was certainly never stated by anyone running a platform). The flip side to that argument, voiced by the stars themselves and others coming to their defense, was that there was no other option. They reminded anyone who would listen that the studio that owned the property wasn't interested in funding the film. Further, Thomas and Bell couldn't finance the movie on their own, but believed enough in the project and in the support from the fans of the series to commit their time to launching, supporting and nurturing the campaign. Eventually the news cycle surrounding this story died down and peace was somewhat restored.

Sensing safer tides, more and more celebrities jumped into the crowdfunding ocean. Spike Lee (Kickstarter: $1.2M goal, $1.4M raised for his feature film *Da*

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Sweet Love of Jesus), Shaquille O'Neal (Indiegogo: $450K goal, $459K raise for his video game *Shaq-Fu: A Legend Reborn*), Don Cheadle (Indiegogo: $325K goal, $345K raised for his feature film *Miles Ahead*), Whoopi Goldberg (Kickstarter: $65K goal, $74K raised for her documentary, *I Got Something to Tell You*), Ed Begley, Jr. (Kickstarter: $25K goal, $29K raised for his webseries, *On Begley Street*), and even legendary Ren and Stimpy animator, John Kricfalusi (Kickstarter: $110K goal, $137K raised for his cartoon series *Cans Without Labels*) got in on the act and ran hugely successful campaigns. Other high profile stars such as James Franco (Indiegogo: $500K goal, $326K raised for his feature *Palo Alto Stories*) also tried their hand at crowdfunding their projects, but came up short.(2)

But it was Braff who, despite not being first or even the highest profile celebrity raising funds through rewards-based crowdfunding, would become the poster child and whipping boy of the "Celebrities Abusing the System" mob. Braff kicked offhis campaign for *Wish I Was Here* on April 24th, 2013 with a target goal of $2M. From the get go, Braff made a few things well known: One, outside of the potential crowdfunding raise, he was investing his own funds into the movie. Two, he was counting on foreign pre-sales (selling the right to distribute the film in different territories before the film is completed) to round out the budget (estimated at the time to be about $5–$6M). Three, one of the benefits of choosing the crowdfunding route to supplement the budget was to retain complete creative control.

The outrage was quick, vocal and vast. Here was a rich, privileged celebrity taking real estate and supporter dollars away from the starving film artist who truly needed the assistance. Here was someone who could (some thought) easily (it's never easy) find traditional financing and support. The torches were lit and the villagers were at the gate. But in a vote of confidence for the wise Irish dramatist Brendan Behan, who said, "There's no such thing as bad publicity except for your own funeral," the supporters—46,520 of them—fought back by opening up their wallets. In the end, *Wish I Was Here* raised $3.1 million, a little more than 150% of the set original goal.

But that didn't quell the debate.

Neither did the fact that the film was selected for the 2014 Sundance Film Festival, adding more fuel to the "privileged" fire. Now, not only was Braff stealing supporter dollars from the starving film artist, he was stealing prime festival space as well.

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"I was completely taken aback by the criticism," Braff said at the Zurich Film Festival.

I was expecting a conversation because it's a fascinating and new model. But I felt the criticism was unfair and uninformed. It was frustrating having the debate with people who didn't have all the analytics and facts. I knew we were driving new people to Kickstarter who then invested in other projects, for example.

The onus was on me to explain why someone like me couldn't get a film made in the traditional way [Bra. continued].

This was not an attempt to make a lot of money. I was a little shocked my quest got lost in the Kickstarter conversation.

If you gave ten dollars to our film, it didn't mean another film wouldn't get funded. By contributing a certain amount, people felt part of the film. Crowdfunding can be a very emotional medium. (3)

By raising the idea that the high profile nature of his campaign actually informed and educated people who previously had no knowledge of the presence or mechanics of crowdfunding platforms, Braff was able to silence some of his harshest critics. But not all. Even today, the argument rages on, with some celebrities admittedly terrified of risking their brand and/or their good will with the general public by launching a campaign.

So who's right and who's wrong in this argument? Before I answer that question, let me highlight a few, lower profile film crowdfunding success stories involving non-celebrities to add some color to the conversation.

Worst Enemy

Lake Bell was a little known actress back in 2010 when she decided to follow her dreams of becoming a writer/director. Reluctant to lean on her contacts in the industry and hoping to gain support from the general public for her short film, she launched the Kickstarter campaign for *Worst Enemy* with a modest goal of $8,000. She worked her campaign tirelessly and without cashing in on whatever celebrity she had at the time. She surpassed her goal by $625 and went about making her film. Later that year, she entered the short at Sundance and was accepted. The film was extremely well received and reviewed. Three years later, she was back at Sundance with her feature film, *In a World*, which not only went on to become a

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critical success and an indie darling, but also won Bell the Waldo Salt Screenwriting Award. (4)

Dear White People

Writer/Director/Producer Justin Simien had nothing but short films on his resume, and none in five years, before hooking up with producers Lena Waithe, Ann Le and Angel Lopez to launch the $25,000 Indiegogo campaign for Dear White People. Campaign tagline: A satire about being a black face in a very white place. With active, engaging and motivating updates and con-tent, the campaign surpassed its goal by over $16,000. In 2014, the film played at the Sundance Film Festival, winning Simien the US Dramatic Special Jury Award for Breakthrough Talent. On January 29th, 2015, Indiegogo sent out a press release stating that Dear White People had broken the box office record for a crowdfunded film with a take of $4.4M to date, not so ironically besting the previous record holder, Zach *!#$@! Braff's, *Wish I Was Here*. (5)

A Girl Walks Home Alone at Night

Described by Writer/Director/Producer Ana Lily Amirpour as the "First Iranian vampire western," *A Girl Walks Home Alone at Night* originally began as a short, winning Best Short Film at the Noor Iranian Film Festival. Amirpour, along with producers Sina Sayyah and Justin Begnaud, launched an Indiegogo campaign seeking $55,000 with the intent of extending the material into a feature.(6) I mean, come on, who wouldn't want to see a black and white vampire movie in Farsi with English subtitles and with Southern California doubling for an Iranian ghost-town called Bad City? I mean, who wouldn't be on board with that? (For the record, I was, and in a big way.)

Clearing their set goal by just a couple of thousand dollars, the film was completed in February of 2013 and premiered at the 2014 Sundance Film Festival, where it had tremendous buzz. It was also the opening night selection at the MoMA for the New Directors/New Films Festival Presented by the Lincoln Center in New York. All of this led to Kino Lorber and Vice Media getting involved in the distribution and promotion of the film with Vice Creative Director Eddy Moretti calling Amirpour "the next Tarantino."(7) As a result, Amirpour almost immediately landed financing for her sophomore film, *The Bad Batch*. The film premiered at the 2016 Toronto

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Film Festival.

These are three films that made it into Sundance on their own volition, helmed by relative unknowns—Bell, a first time director, and first time feature directors Simien and Amirpour. None of these films had major star attachments or power player producers, nor was a traditional funding avenue an option. Yet, due to meticulously run campaigns, they all made their crowdfunding goals and went on to realize successes which launched each of their careers.

WHERE DOES THAT LEAVE US?

So let's go back to those questions I posed earlier. Have celebrity crowdfunding campaigns helped the starving artist filmmaker by raising recognition of rewards-based crowdfunding, thereby effectively increasing the pool of available funds? Or have celebrity crowdfunding campaigns taken money, significant money, away from the pool and devalued the already jammed real estate of crowdfunding platforms accepting film campaigns?

As my terrific publisher, editors and I were performing the focus studies referenced throughout this book, the issue of celebrity crowdfunding was raised often as a subset within the subject of crowdfunding as a whole. This was on your minds. You had passionate opinions about it. Some of you brushed it off saying, in the spirit of our friend Brendan Behan, no publicity is bad publicity—the more eyes the better. But many more of you weren't buying that notion. A couple even mentioned that until celebrities were banned from the major crowdfunding platforms, it was worthless to even think about launching a campaign on any of them—too competitive, the playing field uneven. One of you even went so far as to include an extremely colorful, beautifully textured takedown of Zach Braff which inspired the title of this section—you're a hell of a writer, by the way.

So needless to say, because it matters so much to you, it matters much to me. And because of that fact, I've given this a ton of thought. Certainly, I can appreciate both sides of the argument. So much so, I found myself having Sybil-like discussions in my head, occasionally muttering to myself, much to the concern of friends and co-workers.

But then an interesting thing happened. As part of my research for this book, I began watching crowdfunded and crowdsourced films. A ton of them. I watched

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some from unknown, on the rise and celebrity filmmakers alike. I watched the three films I mentioned above. I went back and looked at the nuances of their campaigns, all of which are archived online in case you'd ever like to do some reconnaissance yourself. Suddenly, it all came clear. I had my answer.

It doesn't matter.

It's just another excuse.

It certainly didn't matter for the three filmmakers highlighted above. Watch their films. See the confidence. Look back at the campaigns. See the plan.

In the "A Brief History of Crowdsourcing" section above, I posed the question of whether a lower barrier of entry to making a film and, therefore, more people flocking to film crowdsourcing platforms to fund their projects is a good thing or bad. Well, pragmatically, any new money channel for financing films is surely going to bring in the haves and the have-nots, but guess what? Your job remains the same.

Be original. Put your unique voice and vision on display.

Identify the crowd. Engage the crowd. Move the crowd.

Control what you can control.

Let go of what you can't.

That's how you rise above.

NOTES

1 www.seedandspark.com

2 https://www.kickstarter.com/projects/1869987317/wish-i-was-here-1

3 http://www.fashionnstyle.com/articles/26529/20140929/zach-braff-shocked-by-controversial-kickstarter-campaign-backlash-wish-i-was-here-actor-refuses-to crowdfund-future-movies.htm

4 https://www.kickstarter.com/projects/teamg/worst-enemy-short-. lm-dir-lake-bell

5 https://www.indiegogo.com/projects/dear-white-people#/

6 https://www.indiegogo.com/projects/a-girl-walks-home-alone-at-night-feature-. lm

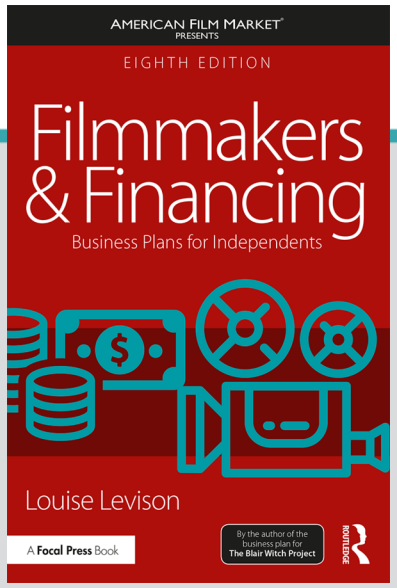
7 http://www.nw. est.com/festival-2017/featured-guest-ana-lily-amirpour

CHAPTER

4

THE FINANCIALS

FORECASTING WITHOUT FEAR



This chapter is excerpted from

Filmmakers & Financing

by Louise Levison.

Learn more

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FORECASTING WITHOUT FEAR

Excerpted from *Fimmakers & Financing*

It is a capital mistake to theorize before one has data.

—SHERLOCK HOLMES TO DR. WATSON

BEING IN THE PREDICTION BUSINESS

When I first started in the film business, several accountants insisted that I couldn't predict the future. I said, "Yes, but it is a lot of fun trying."

The truth is that we don't know the future. Then why do we attempt to forecast? No one can afford to run a country, school, or film business without having an educated guess about what will happen based on current and past results. Math is just a device to organize this data into a rational picture. Whether you are planning one film or a slate, only when you have a clear picture of future results can you proceed with a feeling of confidence. In the past 183 years since moving images were shown on a zoetrope (moving drum for animation created by a British mathematician), little has changed except the technology and net profits. In the beginning, there was no sound. Now actors talk, and we have 3D.

For filmmakers, predicting the revenue and costs associated with films to be made is a necessity. As long as you have a good rationale, you can't let fear stand in the way. Will you be right? Chances are that audiences, critics, and other forces out of your control will interfere. Yet you need to have a logical basis for going ahead with the project and asking other people for money. This chapter reviews how to find data, what to do with it after you find it, and how to create your own financial forecasts.

"I can't do math" is a statement I have heard for years from students. In reality, they can but just don't want to. Their idea of a business plan is a synopsis of their film and, possibly, an idea of who wants to see it. Although important, these items are the given quantities on one side of the equation for estimating revenues and costs. Remember the investors? They are going to read the Executive Summary first and then go quickly to the financials. Money is the glue that holds these building blocks together. As I indicated on page 1, the math is simple. What you will learn is how to analyze the answers.

A filmmaker recently asked me whether my business plans only showed films making a profit, no matter how low. The short answer is "Yes." Before investors hand over hard cash, they want to believe that your project will be profitable. A

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Excerpted from *Fimmakers & Financing*

Mark Twain quote that I used to use at the beginning of this chapter is, "Get your facts: then distort them as you please." In rethinking the quote, I became concerned about the phrase "as you please." Partially, this is true. However, keep in mind that whatever the forecast, it has to look reasonable to "the person who has the gold."

Forecasting is an art, albeit not a precise one. Sophisticated business writers like to say that the one sure thing about a prediction is that it will be wrong; they are probably right. The value of a forecast is as a guide for making decisions; the better informed the forecaster, the closer to actual events the forecast will be. By researching history, obtaining the best data possible, looking for relationships among the data you find, and making assumptions about the future based on those relationships, you hopefully have a rational basis for your forecasts.

When writing your business plan, you have to decide which group of numbers tells your story best. The most recent data may be a year or two behind because of the flow of revenues. Rather than putting whatever spin on these statistics appeals to you, a few more years of historical information is needed. Remember our discussions about investors in the previous chapter? They value two things most of all: facts and common sense. Your goal is to show that the independent film market is robust and that profits can be made.

Anyone Can Do It

Sometimes the questions are complicated, and the answers are simple.
- Dr. Seuss

There is no mystery to forecasting revenues and expenses. You do not have to be an accountant or hold an MBA. You do not need previous knowledge of regression analysis or internal rate of return. This jargon is used by financial whiz kids to speak to one another; life can go on without it. You can take numbers from the most credible sources and create projections that look feasible. You will take the elements that seem to influence the outcome of a film—genre, stars, director, distribution, revenues, and costs—and analyze how much you think each will influence the resulting revenue. The only math skills you will need are adding, subtracting, multiplying, and dividing, as well as an elementary understanding of ratios. For example, how much times the budget is the box office? Mix these skills with some good judgment and you have a forecast. If you can balance your

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checkbook, you can create a forecast. If you actually can't balance your checkbook (which is different than just not bothering to do it), hire someone else to do the analysis.

The word trend is another word that seems to bother filmmakers. You will see it a lot in the online instructions on forecasting. If I asked you what genres are currently popular with audiences, you would have an answer. If I asked what genres are trending, you might or might not recognize it as the same question. It is simply showing a tendency in what the audience may like. In forecasting, we use the ratios to show the tendency of revenues and costs to go up, down, and remain the same over a few recent years. The book's companion website takes you through easy steps to calculate the trends.

FINDING THE DATA

What Are Comparative Films?

Forecasting requires that you use films that reasonably can be com-pared by theme, budget, and release date. Due to inflation, audience tastes, numbers of screens, and other film business trends, the industry standard has been five to seven years including the cur-rent one. I have always used the five most previous years plus the current year.

What makes a comparative (comp) film is a combination of factors. First of all, making an independently financed film does not mean that you can only use independent films. For low budgets, most of the films within a reasonable budget range are likely to be the only ones available; however, that has changed over the last four years. If you recall, we mentioned that the studios have been moving back into the low-budget arena by making deals with successful filmmakers. Nevertheless, if you were forecasting a film with a budget of $1 million, few if any comparatives would be studio films. On the other hand, a film with a budget of $40 million is going to have more of a mix. The more independent films you can use, the better. What you are trying to show, however, is what films with a mix of certain genres and themes have done whether or not they were made independently.

Secondly, what is a reasonable budget range? With a $2-million budget, I would like all comp films to be at $8 million or below on the high side. To find enough films, however, you may have to move the upper limit of budgets that you are

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using. In recent years, I have had to go to $10 million depending on the genre of the film. Nevertheless, as talented as you may be, don't use a $15 million film in this comparison. Production quality and cast become more important the higher you go. With the advent of digital film, the concept of having a budget that includes a trans-fer to 35mm is important. I have found it is often difficult for filmmakers to comprehend. At this point, of course, there aren't enough films to compare. As discussed earlier in the book, despite the number of digital screens, all the profitable low-budget films that I have found were released theatrically in both digital and 35mm. What if you are shooting on 16mm film? What will your film look like when it is transferred to other formats and shown on the big screen? When comparing your film to other movies, remember that the audience doesn't care what technical format you used to make the film, they care about what the film looks like and who is in it.

On a statistical basis, I feel that at least four to five films per year are required over the three years for which worldwide data are available. Since it takes up to two years for all the worldwide data to be in a credible database, in 2016 I am using films released in 2012 to 2014 for the worldwide data. For the two current years of 2015–2016, I am using the domestic box office and budget only. (Different timeline assumptions that apply to documentaries, animated films, and large format are discussed in Chapter 12, "Breaking the Rules.") Now that you have decided your time span and budgets, you can then start looking for films that fit.

Matching Your Film

Do they all have to be just like your film? Films can be similar in genre and subthemes; however, it is unlikely that at any budget you will find 15 films "just like yours." After all, your film is going to be unique. Therefore, start with your overall genre. You may have a crime drama. The film also could have action, romance, gay themes, coming-of-age, or a host of other themes.

The goal is to use films that relate to at least one of these. To fill out your list, budget is also a consideration. Since you are likely to be asked by an investor why you used certain films, have a reason for each film that you use. All you can do is your best to have a rationale for each film. There isn't a rule as to what will seem reasonable to a given investor.

The data that you gather about previously released films will serve two purposes: (1) show the profits of films recently released and (2) supply a basis for estimating

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the revenues and total costs for your films. The first part of your numerical story consists of showing what has happened with films that have already been produced and released. You use these examples to build a case for the ultimate success of your film. Select recent films that have a relation to your planned production in terms of genre, budget, or other common factors.

Genre is a common way to group films; however, use what-ever characteristic you feel links these films together. But whatever your rationale for grouping films, use budget clusters that make sense. The films you include in your business plan depend on what is available. It is your choice whether to include films that have lost money. There is no database that includes all the films ever made, so you can't have a "fair" sampling no matter what you do. How-ever, if you use only three films with extraordinary results for your projection—for example, Paranormal Activity: The Marked Ones, The Purge: Anarchy, and The Gift—you are being unrealistic; and you will be recognized as such by most investors. Of course, with those films, you can't use Mad Max: Fury Road, either. What is that? You think I am being facetious, because it doesn't relate in budget or genre. You would be surprised at the comparatives I see in the business plans that filmmakers ask me to critique.

Recently, I did a business plan for a $3 million-thriller film that was not horror. I went to IMDB and used the "Titles" feature to look for thriller films released between January 2012 and December 2014. A list of 3,843 films came up. Of the films that were less than $10 million in budget, many had either no U.S. box office or one that was too minimal to use. There were four films that I felt I could use for forecasting in this particular business plan. I could use the higher budgeted films in the Markets section, where you can use a film of the same genre regardless of budget. For the comps, though, there still were crime and romantic drama films that were reasonable (notice how often that word pops up) to use, as the story lines and budget ranges fit this particular movie.

Where Do You Find Information?

The first step is to see what films you will want to use. I always use IMDb Pro. The site is the best way to search for likely films by genre and keywords. For example, Crime is a genre and murder and bank heist are keywords, as are many others not included in the "main" genres that you can click when using the "Titles" category on the home page. It is the best way to know what films might be available.

Once you have picked the films you want, including budgets can be another question. Hopefully, most of the films you use will have budgets from the same

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source. Often you have to go to other sites. Since I recommend checking the total box office grosses at boxofficemojo.com, I would look there first. Otherwise, check for interviews with filmmakers and reviews in the public press. For current films, check television and radio shows for the appearance of a filmmaker. They often appear on the daytime and evening news and talk shows to promote their films. The film festivals are another place where you can gather extensive financial information. Many producers and directors of independent films attend, and they will usually answer questions about not only the cost of their films but also the source of their financing. People often feel more comfort-able about revealing proprietary data when face-to-face.

For the total domestic box office data, I double-check boxofficemojo.com. Since the box office dollars include Canada and Puerto Rico, I refer to the grosses as domestic or North American rather than United States.

Revenues for ancillary dollars, both domestic and foreign and foreign box office, as well as the amount of the prints and ads (P&A) costs are harder to find. If you see this information on the Internet for free, the chances are that it is wrong. You need to have credible source for the data to withstand any challenge from an investor. To find all the data you will need for your three years of world-wide numbers, you will need to buy the information. The source I currently recommend is Gracenote: http://www.gracenote.com/ video/studio-and-celebrity/. Scroll down to "Studio Intelligence" and then fill out the form and mention FRCEs. Someone from Sales will contact you. As Gracenote recently bought the Baseline data-base, this contact and the prices may change. At the moment they appear to be $100 to $200 per film. I will keep track on my website.

In previous editions, I had a separate section for average foreign revenues. The section included a table of typical revenues from individual foreign territories for a $1.5-million film. With presales in flux and foreign territories giving more and more screens over to their locally made films, I don't feel it is appropriate to put together such a table at this time. Distributors either are giving very low numbers or saying that there aren't any foreign sales at all for low-budget independent films. As always, the foreign value of any film depends on the story, cash, etc. In addition, the trade papers have been reluctant to estimate such sales since. The trade papers used to have charts of foreign revenue with titles like "The Going Rate" and "Global Revenues." The last of those charts appeared in 2007. Note their names in case they reappear when the world economy gets on a better footing.

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Excerpted from *Fimmakers & Financing*

When I feel there are real numbers, I will include the information on the book's companion website.

When forecasting, you always want to be conservative, so you would use the average return of dollars. For example, in Japan, you see that the high is $70,000 and the low is $20,000. This does not mean that all distributors will pay you $70,000; generally, the most they will pay is ten percent of the budget. Use the average figure, which is $45,000. You have to go with the best information you can get. Whatever tact you take, heed this warning: DO NOT INVENT NUMBERS. If lying does not bother you, getting caught in a lie will. Then the game will be over. If telling the truth isn't reason enough, you may have investors check some of your sources, which will be listed at the bottoms of your tables. Or, as I have seen many times, some friend of theirs will claim he saw "something somewhere that was another number." Worse yet, your potential investor may have a relative or friend in the film business who can check the data. All sources will not necessarily have the same information; however, you want to be able to point to your sources as the most credible you could find.

ANALYZING THOSE PESKY NUMBERS

Did I say "without fear" in the chapter title? You must analyze the data before putting them into your proposal. Be strong. You can do it. When collecting and analyzing, keep in mind another favorite quote from Mark Twain: "There are three kinds of lies: lies, damned lies, and statistics." The discussion of financing and your presentation of comparative films, projections, and cash flows is the single most important section of your business plan. The filmmaker's job is to be honest and use common sense.

I have said it before, but filmmakers have convinced me that I cannot say it too often. This analysis is your job, not the investor's. Do not expect the investor to accidentally happen upon useful information while browsing through the 15 or 20 pages that you have photocopied or downloaded from a website. It is your duty to find useful information and present it in an easily understandable way.

Tables 11.3 through 11.6 included with the sample business plan (see Chapter 11, "Sample Business Plan for a Fictional Company") are examples of methods for presenting comparative films. The films listed in these tables are fictional but are based on the results of real films. These sample tables include the following items:

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Excerpted from *Fimmakers & Financing*

1. Domestic theatrical rentals: Domestic rentals are the portion of the North American theatrical box office that reverts back to the distributor (or producer). (The tables in the trades include Canadian box office figures in this total.) There has been confusion in recent years, as we also refer to DVD rentals. The term domestic theatrical rentals is the industry standard and should be used. As mentioned earlier, when working with numbers, you should avoid factoring in exceptional movies that would make all your averages too high. If you want to include Fireproof, list it and indicate in a footnote that it is in your chart for reference only. Just as on any given day any team can win, it is theoretically possible for any film to be a breakout hit.

2. Domestic ancillary revenue: The ancillary revenue includes all nontheatrical sources, such as DVD/Blu-ray, streaming, cable, free television, syndicated television, pay-per-view, and digital. Distributors have been trying various

formulations of revenue sharing as opposed to paying per unit. In addition, there are ongoing changes in the newer ancillary forms. However, new standards have not been set, and it is too early to know their effect on independent film. Pay-per-view is growing, although not as quickly as analysts have expected.

When specific numbers do not exist for individual films, some analysts use a general estimate. Those estimates are derived mostly from studio films, so they are more appropriate for budgets over $15 million than for other films. Although release times (windows) into home video have become shorter for studio films, the windows for indies have remained the same on average. Cable and the premium channels are getting movies sooner than they used to, also. Be aware that although a few of the indie films financed by cable networks have had a U.S. theatrical release, most do not. In the past, PBS has also financed documentaries that have had a theatrical release prior to being shown on television.

3. Foreign theatrical revenue: The distributor is responsible for collecting money from other countries. In the United States, the industry assumes that the North American box office drives all the other windows. If a picture does not perform well in U.S. theaters, therefore, all other theatrical and ancillary venues may be worth less money. On the other hand, some films that have only moderate results in the United States do much better overseas. In addition, it is more frequent than earlier for an independent film to be released in either multiple countries at the same time or overseas before the United States.

To make the picture even murkier, there are films that do very well at the domestic

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box office and in domestic ancillary revenues but have virtually no foreign revenues that are recorded. Depending on the gross profit of those films, they can still be used. The type of film and the stars often have a lot to do with these results. For example, Tyler Perry's Madea films have historically made big profits; however, the databases show little foreign revenue for them. On the other hand, certain U.S. television stars whose shows are marketed worldwide are important to filmmakers for the foreign markets. Before making any assumptions about the value of actors, however, it always is good to check with distributors.

4. Foreign ancillary revenue: Foreign ancillary presents a great opportunity. Television companies often buy exclusive product. The potential revenues for English-language films, even small ones, in other countries remain much stronger than for foreign-language films in the United States. Markets have opened up in Eastern Europe and Asia. China began to expand the number and types of U.S. films they would accept in 2011. Independent film companies established alliances with Chinese companies. For example, Chinese private-equity firm Hony Capital and Huayi Bros. Media Corp invested in STX Entertainment; China's Fosun Group in Jeff Robinov's Studio 8; Chinese conglomerate Citic Guoan Group Co. Ltd in Dick Cook Studios; and China's Meridian Entertainment in James Schamus's Symbolic Action. In addition, China's Dalian Wanda Group bought Legendary Entertainment and AMC Theaters, North America's second largest theater chain.

5. Total revenue: This is rentals plus domestic ancillary plus foreign equal total revenue. The foreign dollars are assumed to have the exhibitor portion removed and, therefore, can be added to the domestic dollars to find total revenue. Always be sure that you are comparing apples to apples.

6. Negative cost, P&A, and total costs: We have already discussed finding the production, or negative costs, of the film. These are not the total costs, however. P&A are an important expense. It is necessary to include these costs to get a total profit picture. As films stay in distribution, the P&A costs grow. Therefore, if you are forecasting the initial release cost, indicate it. The most credible source for this type of information is still Baseline.

7. Gross profit (loss): Gross profit (loss) equals the revenue minus the direct expenses before the company's operating expenses. In this case, direct expenses are the negative and P&A costs. They relate directly to your film, as compared to the company overhead costs, which exist whether a film is in production or not. Notice the parentheses around the word loss. When preparing financial statements,

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use

parentheses rather than minus signs to indicate negative numbers. Both words can be written on the profit line. However, if there isn't a projected profit, you may want to rethink the whole idea.

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Now we come to your film. Here are two guidelines for projecting your revenues. First, be conservative. A generally accepted business principle is to forecast your income on the low end and your expenses on the high end. Probably, all filmmakers who have ever done a budget have padded it to be sure that they did not run out of money. You want to take the opposite path for revenues. If you are making a $1-million Indian-themed film, you would be fooling yourself to assume that the film will gross $141 million, as Oscar-winner *Slumdog Millionaire* did. It is nice to aspire to be an Oscar winner, but you can't plan on it.

Second, be honest. As long as the data of your historical films are as accurate as possible and the films you choose are comparable to those you plan to make, you should be all right. The type of comment I've heard most often from filmmakers with an inspirational film is, "Include *The Passion of the Christ* as an average film." Yes, here we are in 2016, and filmmakers with inspirational dramas want to include an extraordinarily successful movie from 2004 in the comparatives. Feel free to discuss it in your analysis as an example of an iconic film with an exceptional result to hold out the brass ring as a hook for the investor.

Assumptions

Before opening a new Excel table, you should write down your assumptions. Unless you have concrete reasons for the forecasted revenues in your tables, people may assume that you invented them. There has to be a thought process leading to these numbers. Since you have just written 15 or 20 pages for the preceding sections, you have already gone through the thought process. In most cases, the crucial elements have already been mentioned, and the list is a recap for your benefit and for the investor's. Do not expect readers to remember the specifics from the body of the business plan; you are not playing a game of hide and seek with the investor.

Explain your assumptions at the end of your Financing section, directly before the

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tables, to be sure that the reader knows how you came to your conclusions. If you do not do this, it may look like you have no rationale. Review the assumptions in the sample business plan both in the book and the files you have downloaded from the companion website before continuing.

Revenue and Expenses (Income Statement)

The Projected Income Statements (Tables 11.7 through 11.9), also known as the Statement of Revenues and Expenses, show the profit for each film. Likewise, the Summary Projected Income Statement (Table 11.1) indicates the bottom line for the company. In a one-film plan, you will have two tables of comparative films and Table 11.3 will show your net profit.

As I say in a preamble to the sample business plan, whether you are doing a business plan for one film or a company, the methodology is the same. In a one-film plan, you won't have summary tables. On the book's companion website, you will find a complete Financing section for one film using Len's Big Thrill from Chapter 11, as well as a sample business plan for one film.

The sample shows a straightforward production company in which all the income is from films. If you are planning to produce other products or have additional divisions, such as direct-to-DVD or distribution, you will need other methodologies and types of tables for those items. You will have to provide separate assumptions and cash flows for those products because they function differently from film. Then make a combined statement that includes all the products. Unless you are a very experienced filmmaker who already has owned a film company, however, I suggest that you don't diversify yet. Add other divisions after the initial film company is profitable.

Looking at our numbers, you can take the average or the median (the point above and below which half the films fall) of all the films, or you can give more weight to the more recent films. (Do not panic. The "how-to" is contained in the downloaded files.) It depends on whether you feel that the genre is gaining more audience approval or has been drawing the same amount of box office dollars for the past few years. You have to look at the available data and use good judgment.

Note that these tables show worldwide results. As you will not have these for the two most recent years, you want to include a table for each film (Tables 11.4 and 11.6) that shows the box office and budgets only for those years.

The net profit (loss) line is the sum of the company's revenues and expenses.

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Commonly, the phrase "before taxes" is added to indicate that this is a preliminary income forecast. Do not let these phrases throw you. An accountant can easily prepare these statements for you.

Cash Flow Statement

A cash flow statement shows the timing of incoming revenue and outgoing cash. The dollars will not come in all in one week or one month. Table 11.10 shows the cash flows for the individual films, and the summary is given in Table 11.2. Notice that in the columns for the tables, I have used generic terms—Year 1, Year 2, Year 3, and so on. If you are looking for the production money, your year starts when that money is in the bank. To specify the first year—for example, 2017—could create a problem. What if you are still wandering around two years later looking for money? Finding money and get-ting the cash in your bank account is hard; no need to announce it to your current prospect.

In addition, each year is further divided into quarters. This seems to make the most sense for showing cash flow. I would shy away from individual months. There is no way to actually track each month. Unless you have the distributor's monthly accounts for various films in front of you, there is no way to track such data accurately. You have to give your investor a readable document, even if you aren't crazy about the idea. Use my formula. I retest it with each new edition.

In the sample cash flow statements, all of the production money is outgoing in Year 1. I have assumed one year from the beginning of production to the end of post-production. (The exceptions in this cash flow scenario are animated and large format films, which are discussed in Chapter 12.) I use six months (two quarters) before I indicate the release of the film.

An independent filmmaker won't know the actual timing in advance unless she is doing her own distribution. There is no aver-age length of time between end of post-production and the release date for an independent film. Even if you already have a distribution agreement in place, you won't know. (I am making an assumption that vertically integrated companies like Lionsgate and The Weinstein Company aren't buying this book to find out how to calculate cash flows.) In order to make the table readable, I skip the two quarters before distribution starts and make it clear that the plan is not promising a specific interval. Note there is the following comment at the bottom of the table: "For reference only. How and when monies are actually distributed depends on the contract with the distributor."

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The first rentals are shown during the quarter in which distri-bution begins. Throughout the year, we track domestic grosses week to week to find trends in the number of theaters and the amount of grosses. Going through that exercise will reveal a pattern that you can use. Average release "windows" give you an idea of the money flow from other sources. Most films don't stay in the theaters longer than six months; however, due to some long stays in the theater, I have a small amount of revenue still coming in a third quarter. The median stay for independent films is about four and a half weeks.

We can track when films go into home video but not necessarily how long they are there. In addition, there may be a different method on how the dollars flow back to your distributor, the head of your revenue food chain. Therefore, I have chosen to include them, as the distributor normally does the accounting for money that is owed to the filmmakers and their investors—once a year.

For foreign revenues, all sources are grouped into one number. Not all films are released the same way. Some countries actually legislate the time period; in other cases, the distributor negotiates it. Some films go directly to home video, which is a more popular distribution method in Europe and Asia. Trying to figure this out country by country would be excessive. The timing has been very fluid lately, so it is a good idea to research the topic to keep cur-rent. The films go into foreign release in the third quarter of Year 2, approximately seven months after the domestic release date.

The total line is the sum of the incoming cash minus the outgoing cash. Do not panic over minus totals. While your film is being made, there is no revenue. The amount of eventual profit is the deciding factor. In companies, the minus total may last longer than in a one-film plan. As in Table 11.2, depending on how often you plan to start pre-production on the next film, the costs for the next film coming in, as well as the P&A money spent by the distributor, may keep a negative number in the cumulative total for several years. In a multipicture company, the cash flow statement allows you to see whether you will have enough money coming in to keep production going.

Overhead (Administrative) Expenses

This table is used only for a business plan with multiple films. In the overhead table (Table 11.11), I have not included specific numbers. It is meant to show you what line items you may have to use. These differ from film to film, city to city, and country to country. While the films are clearly fake, I don't want to take the chance

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that the reader someone will copy the dollars in my overhead sample. You must research what those costs are in your community. In addition, add anything that is specific for you and leave out line items that don't relate to your film. The total for your overhead expenses is then adjusted by the net profits for each of your films.

An ongoing company has its past history to report, along with a statement of its present position. Your accountant will do the serious reports for you, such as Sources and Uses of Funds, Balance Sheet, and so on. These go into your Financing section along with the other tables. As new companies have less to report, don't worry. Just report what there is. There may or may not be a bank account worth mentioning. Present information that must be included in the business plan, even for a very small company.

If you are setting up a company, you will have ongoing expenses, far less than those of the studios, of course. These general administrative costs include salaries that are not attributable to a specific film budget as well as all of the company's tools of the trade—office equipment, telephone charges, entertainment costs, and so on. Your company may have fewer people or no salaried employees at all. Before Year 1, there are generally start-up expenses. You may rent an office, option a script, buy a computer, or scout locations in the Dardanelles. Any expenses that are necessary to get your company going are shown in this table. Even if you wait for investment funds before doing any start-up, list these costs separately. Some of them—like the computer—are one-time costs.

Like everything else, administrative costs are projected over the time period of the business plan. Look ahead to the number of films that you plan to make three or four years down the road. You may need additional office staff, more office space, or increased development money. Everyone knows that these numbers are guesstimates; how-ever, as a general rule, you should include all the expenses you can think of. On the other hand, do not give yourself a salary of $1 million. I see this item in a lot of companies that never get funded. Because you are partners with the investor, your salary should be moderate.

What If I Only Have One Film?

No matter how often I mention it in the book, filmmakers often don't understand that the biggest difference between doing a one-film plan and a slate of films is more films and tables. A one-film plan has the same text sections with perhaps less text in each one. As a filmmaker (producer, director), you are the manager of a small company. The other big difference is that any expenses need to be in the

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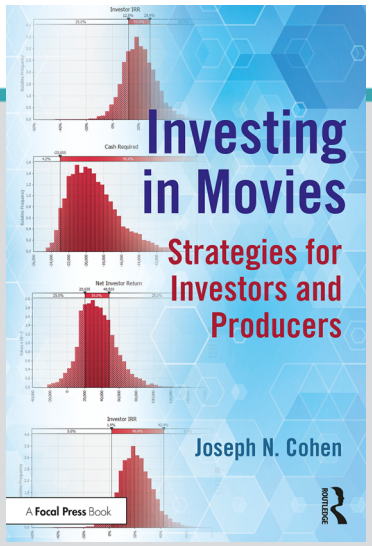
budget of the film rather than a separate overhead. Don't over-burden this poor film with your car and house payments. Include only those things that belong in a film budget. You will be splitting those massive (let's be positive) profits with your investors.

The layout is the same for one film as for multiple films, but fortunately you have less number crunching. Your first table will be comparative films for the past three years (or four if you need them) for which you have worldwide numbers. Your second table will be the two years for which you only have U.S. box office and budgets. Then you have an income statement (without the over-head) and a cash flow statement, which will be similar to any of the individual films in the sample business plan.

CHAPTER

5

PROS AND CONS OF MOTION PICTURE INVESTMENT



This chapter is excerpted from *Investing in Movies* by Joseph N. Cohen.

Learn more

THE PROS AND CONS OF MOTION PICTURE INVESTMENT

Excerpted from *Investing in Movies*

Summary - *Investors in any business need accurate information in order to assess risk and project rewards. The movie business, however, does not provide the full panoply of publicly available information to make such judgments, so prospective investors have to seek other sources of information to augment their analysis. In particular, this chapter distinguishes between "budget" and "actual film cost" and points out the lack of transparency with regard to domestic and international distribution and marketing costs and the difficulty of determining accurate correlations between domestic box office and ancillary revenue streams, such as home video and free and pay television. The first challenge that prospective investors face, assuming they are looking at financing a single picture or a slate of studio films, is how budgetary discipline will be exercised. The chapter addresses a number of considerations that impact budgetary discipline. Finally, the chapter reviews historical expectations with regard to investing in a portfolio of studio films and why expectations and actual results did not always match.*

Invariably, whenever I tell someone that I advise very rich individuals with respect to their film and television investments, that person is skeptical about my clients' intentions: "They really don't expect to make money, do they?" For some reason, it's really about hobnobbing with the stars, or getting their girlfriends (or boyfriends) in the movies, or impressing their cronies. I won't deny that I have come across investors who have acted out of one or more of these questionable motives. But most of these "fringe" investors typically never show the color of their money. They make lots of promises, but rarely close.

My clients are self-made multimillionaires or billionaires, for the most part. Some are scions of inherited wealth, but the scions of inherited wealth are usually surrounded by legions of legal and investment advisers who do their darnedest to keep their legatees out of the clutches of fast-talking producers. These fiduciaries are basically risk adverse. They aren't knighted for generating above-average investment returns, but they face the danger of being axed if they invest in areas that are perceived to be exceptionally high risk—and the movie business certainly has the reputation of being not much better than the slot machines in Vegas.

The self-made rich, however, are used to taking risks. That is why they have as much money as they do. But they tend to be extremely analytical in their approach to risk management. It's all a matter of probabilities, and the fact that they have opted to play in this space is indicative of their belief that rational investment strategies are possible in the movie business. The bets are too large to simply act

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out of whimsy.

That is not to say that their initial incursions into the motion picture industry were not somewhat capricious. Several major players I am aware of, including several of my clients, were in fact the "victims" of fast-talking producers. You have to realize that producers are some of the most persuasive salesmen around. They have to be, because they are dependent on their gift of gab for hooking studios or wealthy individuals to pony up significant sums of money on the basis of a "pitch," a script or a package (director and stars). In the case of wealthy individuals, most instances of being taken to the cleaners did not involve major losses, because their basic reticence about the bona fides of film investment served as a natural drag to the contagious enthusiasm exhibited by the producers. In general, smart investors can be fleeced only once, maybe twice, and then they either leave the field or decide that they want to learn the rules of the game and apply the same set of rigorous investment strategies that they have employed in their primary businesses. The self-made rich do not like to be made fools of. Hence, their stubborn insistence on mastering the macro- and microeconomic facts that underlie the motion picture business. Once this intellectual mastery has occurred, they can proceed to explore rigorous business strategies, culled from the experiences of the major studios and successful independent producers. Now they are in the world that business consultants are familiar with, throwing around concepts like market share, leverage, risk transfer, niche strategies, co-financings, return on investment (ROI), tax shelter, etc. They have gone beyond the perception of the business as a veritable crap shoot.

Hollywood soaks up information, just like Wall Street, and while the quantum of information transmitted in Hollywood contains a far higher percentage of industry gossip than Wall Street, the information flow is also characterized by virtually instantaneous transmission. What books are available to be optioned, what films have fallen apart (so the director and actors are now available), what executives are about to be sacked (so do not waste your time pitching new projects to them)—all of that represents insider knowledge that is not generally available to the public at large. What is readily available to the general public is the latest box office data—at least the top 10 grossing films for the weekend. Those box office numbers by themselves are not sufficient to determine the profitability of a film, or even whether the film is profitable at all. Arguably, it is a fact that most of the key parameters that determine a film's success are hidden below the water line, much like an iceberg, which discourages serious investors from dabbling in the movie

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business.

The first impediment to investing in the movie business, therefore, is lack of concrete public information. This is particularly frustrating for Wall Street types who, in the Internet Age, are used to being able to extract any item of quantitative data they desire at the push of a button. If anything, stock and bond market analysis may be oversaturated with data, and one of the first tasks of analysts these days is to sift through the data to learn what they should take seriously and what they should ignore. The film industry is nowhere near as transparent.

Let me try to be more precise. No totally reliable data is published regarding film budgets. Occasionally, you will see estimates in the press, but these are only estimates. No sources for these estimates are given, and I have seen vast discrepancies among estimates on the same film. There are many reasons for the lack of published data. Most important, there is no incentive for the producers or studios to reveal their hand. By doing so, they give away valuable information to competitors as well as to the creative participants (actors, directors and writers) who are profit participants in the film. Like sports franchise owners, it is in the studios' interest to plead poverty. Since all the major studios are subsidiaries of large public conglomerates, whose annual 10K's are about as long as Ph.D. theses, there is no way you can glean the profitability of individual films from SEC filings. The film operations are buried within larger divisions, which frequently include television programming, broadcasting, theme parks, video distribution, etc. Studio bragging rights are determined primarily by box office share, and generally only domestic box office share ("domestic" in the quaint parlance of the industry means both the United States and Canada). There is no definitive way to measure individual studios' profit margins. Even box office share is not weighted for the number of releases in the studio's release calendar for that year.

In general, studios tend to understate budgets rather than hype them. There is an embarrassment factor at work here. Let's face it—in an era of excess, where the mega-rich are buying $100 million homes and $10,000 pocketbooks (conspicuous consumption has returned after the economy has recovered from the recent economic debacle)—it is a little obscene to make a movie that is more expensive than the GNP of half the countries in the world. In addition, the industry has a predilection for *Schadenfreude*, which is a German expression for taking pleasure in other people's misfortune. Hollywood practically oozes *Schadenfreude*—not because its participants are more misanthropic than most, but because there is an

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abiding superstition that Hollywood is a zero-sum game. If you succeed, it means that there is less available success out there for me. Perhaps that principle makes sense when applied to competing films on the same weekend, but it clearly is wrongheaded when applied on a macro-basis. If you make a baseball movie that works, contrary to established opinion, that will increase the odds that my baseball movie may also get made (as long as mine isn't the fifth film in the cycle, and the three previously produced baseball films didn't tank). But, as we shall see later, given that there are few variables (I will suggest two, somewhat tongue in cheek) that show consistent positive correlations with box office success, repeating successful genres or themes is no guaranty of future success. Sequels to highly successful films, so-called franchises, are a different matter, and there is definitely a reasonable positive correlation there. In fact, there used to be a rule of thumb (another one of those rules of thumb that are more industry wives' tales than empirically grounded truths) that a sequel should do roughly 75% of the domestic box office achieved by its predecessor. Many sequels over the past 5 years have outperformed their predecessors, but studio executives are concerned that more recent experience has been much less positive.

The very notion of "budget" is a shifty concept. Sometimes it refers to the projected cost of the film going in, and sometimes it refers to the actual cost of production, as determined when the film is delivered ("delivery" is a technical term that refers to the fact that all the elements needed to exploit the film have been completed and made available to the relevant distributors). As initially prepared, budgets represent best guesses regarding the ultimate cost of the film, prepared on a line-item basis and then tallied up. The responsibility for preparing such budgets falls to the so-called line producer and his staff. The line producer is the person who is the chief operating officer of the film. He or she is generally not the senior producer on the project. The senior producer is the person who typically acquired the rights to the project, developed the screenplay, hired the director and the key cast, brought in the studio to distribute the film and secured the necessary financing. In the old days, the senior producer function rested with one individual. Now that role has often been fragmented particularly with respect to putting together the financing and arranging distribution. Those tasks fall to individuals who frequently take "executive producer" rather than "producer" credit. The line producer answers to the producer, who, depending on the power and oversight of the financiers and distributors (who are often one and the same), may be the autocrat of the project or the factotum of the money guys, who are

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unaffectionately known as "suits." Nevertheless, only the credited producers on a film get to ascend the podium to receive the Oscar for Best Picture.

In Figure 1.1 you will find a sample "top sheet" for a film shot in New York that my company was an advisor on. The top sheet represents the first two pages of a standard film budget and includes an overview of all the major costs associated with the film.

If you examine a complete budget, you will be reviewing 50–80 pages of numbers broken down into categories, like Art Department and Visual Effects, with a summary statement, the top sheet. The top sheet is broken down into two sections: above-the-line and below-the-line. Above-the-line represents the cost of the rights (including development expenditure related to the screenplay), actors, director and producing group, while below-the-line represents the actual production costs, including crew, construction, locations, transportation, visual effects and film stock, as well as post-production expenditure, including editing, music, etc.

Before these numbers can be calculated, the line producer has to "break down" the screenplay and figure out how many days it will realistically take to capture on film all of the action and dialogue contained in the screenplay. Typically, the line producer is given fairly free rein in coming up with this breakdown. Of course, this is done in the context of what kind of production the given project is likely to represent. If it is a big studio production with major stars and a prominent director, the line producer will approach the budgeting process with a certain bias, while if it is an independent film that clearly has limited capital available, he or she will approach the job with a radically different frame of mind.

Enter the director. Frequently, the line producer has been selected by the director or is even the director's own man (or woman). That is, many directors typically work with the same line producer time after time. There are advantages to the production in this cozy relationship. Given that the two are used to working together, there is a greater probability that the shoot will go more smoothly. The line producer knows the strengths and weaknesses of the director and is better able to support him or her. But this symbiosis is also fraught with danger, particularly as far as the "suits" are concerned. When the line producer is effectively an arm of the director, when he or she clearly knows where his bread is buttered in the sense that he or she will continue to work with the director in the future but may never see the financiers on this project again, there is tremendous risk that there will be less than total financial conscientiousness displayed in the

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construction of the budget and less than total financial discipline exercised during the making of the film.

Type: Feature; Format: Digital	Prep Date: 2016 (7 weeks prep)
Producers:	Shoot Date: 2016
Producers:	Wrap Date: 2016
Director:	Schedule: 26 Shoot Days (25 days location + 1 day Stage)
Writer:	Location: New York, NY
Script Pages: 105	Post: 17 Weeks (NYC)
Script Dated:	Unions: WGA, SAG, DGA Level 4C, IA Tier 3, Teamster
Budget Created:	Hours: 13 hour Shoot Days
	Holidays During Shoot: 1 - Memorial Day

Acct#	Category Description	Page	Total
1000	STORY RIGHTS	1	51,792.85
1100	WRITING	1	122,046.59
1200	PRODUCER	2	269,029.94
1300	DIRECTOR	3	145,620.07
1400	TALENT	4	1,745,535.87
1500	BITS & STUNTS	8	150,242.14
1900	ATL TRAVEL & LIVING	11	125,922.12
	TOTAL ABOVE-THE-LINE		2,610,189.60
2000	EXTRAS	13	361,949.90
2100	PRODUCTION STAFF	15	1,004,271.78
2200	ART DEPARTMENT	23	194,516.10
2300	CONSTRUCTION	26	298,168.49
2400	SET DRESSING	28	615,901.57
2500	PROPERTY	32	163,276.08
2600	CAMERA	33	499,639.12
2700	LIGHTING	38	317,700.94
2800	SET OPERATIONS	41	374,999.32
2900	SOUND	46	161,061.49
3000	WARDROBE	48	754,944.55
3100	MAKEUP & HAIR	52	267,895.26
3200	LOCATIONS	55	607,167.04
3300	STAGES/OFFICES/FACILITIES	57	168,237.48
3400	TRANSPORTATION	58	1,164,042.61
3500	ACTION PROPS (PICTURE VEH & ANIMALS)	65	52,150.05
3600	SPECIAL EFFECTS	65	66,168.65
3700	TESTS	66	20,913.60
3800	FILM & LAB	66	47,492.26
3900	BTL TRAVEL	67	6,905.71
	TOTAL BELOW-THE-LINE PRODUCTION		7,147,401.99
5000	EDITORIAL	68	345,692.89
5100	VISUAL EFFECTS	69	29,766.01
5200	SOUND EDITORIAL & RERECORDING	69	181,428.58
5300	MUSIC EDITORIAL & SCORING	70	133,532.69
5500	TITLES	70	11,906.40
5700	POST FILM & LAB	71	82,869.76

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Acct#	Category Description	Page	Total
5800	DELIVERY REQUIREMENTS	71	65,848.36
	TOTAL BELOW-THE-LINE POST PRODUCTION		851,045.89
7000	PUBLICITY	72	12,117.15
7100	INSURANCE	72	142,161.26
7500	GENERAL EXPENSE	73	190,404.82
	TOTAL BELOW-THE-LINE OTHER		344,683.23
7900	FINANCING FEE : 4.0%		438,133.02
8000	CONTINGENCY : 8.0% (303,205 EXCLUDED)		847,384.68
9000	COMPLETION BOND : 1.5% (0 EXCLUDED)		165,121.57
9001	CONSULTANT FEE : 0.5%		54,767.07
	Total Above-The-Line		2,610,189.60
	Total Below-The-Line		8,343,131.11
	Total Above and Below-The-Line		10,953,321.90
	Grand Total		12,458,727.05
9100	NY TAX CREDIT		−2,458,727.05
	Net Total		10,000,000.00

FIGURE 1.1 (Continued)

One must remember that some directors, not all, are first and foremost artists. The French refer to these directors as auteurs. That does not mean that such directors do not exhibit financial discipline, but it does mean that their primary responsibility is to their artistic vision. If that vision requires reshooting scenes or expanding the scope of the production design or low-balling the true budget to entice the financiers to commit to the project, even the most ethical of directors will be sorely tempted—and not every director starts out with the highest ethical standards. There are some directors who are marvelous in terms of being able to create cinematic masterpieces whom I would never bankroll because they cannot be controlled. Some producers may con themselves into believing that they can control any director through sheer force of will, but for the most part, they are kidding themselves. On the set the director is basically king. Yes, you can fire him (subject to what I will discuss later as an "essential elements" clause), but then you really risk the film going totally out of control, both financially and creatively.

Lack of budgetary discipline cannot always be laid at the foot of the director. Studios are often just as much to blame. Many studio executives who have responsibility for overseeing productions do not have a lot of physical production experience. After all, it's not their money, and it's not necessarily in their interest to

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keep the director on too tight a leash. Like the federal government, studios frequently attempt to solve problems by throwing more money at them. This is particularly true on the big action and special effects films, where there is a great deal of pressure to come up with state-of-the-art action and special effects. Granted, if you skimp on these sequences, you jeopardize the commercial pros-pects of the film—but all too often the studios acquiesce to a shooting schedule on a straightforward production that is far too accommodating. Clint Eastwood is not only a great director, but he is also the opposite of prodigal when it comes to the pace of his direction. As an example, Clint took only 36 days to shoot Mil-lion Dollar Baby. This can be compared with the 70-day-plus schedules that are not uncommon today even on studio dramas and comedies.

Let's confess to a not-well-kept secret that is relevant here: More and more, the studios are turning to younger, less-experienced directors who are considered hipper and more attuned to the youth audiences that are the primary demographics for a large percentage of the films the studios are making today. Many of these directors have honed their skills on commercials and music videos that are incredibly good-looking but short on plot and characterization. To a significant extent, these inexperienced feature directors are learning on the job, which often entails longer production schedules.

Independently financed productions, because of tighter capital constraints, tend to be much more disciplined when it comes to budgets. But frequently this translates to a less-polished finished product. Just because an independent producer says that he can shoot a given film in 5 weeks on a budget of X doesn't mean that the film will be roughly comparable to a studio version shot in 10 weeks on a budget of 2X. While capital constraints are incredibly important, they cannot succeed in placing a square peg in a round hole. While I have complained about excesses with respect to the number of days utilized for principal photography, there is the flip side of the coin that places a practical floor on the least number of shooting days that can accommodate a given script. There are only so many set-ups (individual scenes from a script breakdown point of view) that can be accomplished in a given day, irrespective of the number of takes that are required. Independent producers should always keep in mind the mantra of independent filmmaking—good, fast and cheap.

Enter the completion guarantor. The completion guarantor is the entity that covers budgetary overages and guarantees that the film will be delivered by a specified

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date. Virtually all independent films, apart from ones with micro-budgets, as well as a growing number of studio films (although the vast majority still self-bond) utilize completion guarantors. To the extent a bank is involved in providing any portion of the financing, it is necessary that the film be "bonded" by a reputable completion guarantor. Similar requirements are often placed on the film by equity investors.

There is a very good reason that banks do, and equity investors should, require such protection. With respect to project finance lending (that is, stand-alone single-picture financing), the banks are lending primarily against bankable contracts from distributors who commit to paying an advance upon delivery of the film. Entertainment banks may give some credit for the estimated value of unsold rights, so-called gap lending, but in either case if the film is abandoned or if the film goes over budget and there is no source to provide the required additional capital, the value of those distributor advances is nil. In addition, distribution contracts stipulate outside delivery dates, and if for whatever reason the producer fails to make timely delivery, the distributor is no longer obligated to honor the contractual advance. Completion guarantors take on the burden of ensuring that such events do not happen, and, if they occur, the completion guarantors ensure that the named beneficiaries on the bond are made whole. In the case of an abandoned picture, for example, the completion guarantor will reimburse the financiers for any monies expended to date.

There is obviously a cost associated with utilizing a completion bond company. First, the bond company will insist that a contingency be added to the budget. This contingency functions much like the deductible on your homeowner's policy. The contingency is typically 10% of the budget, possibly with certain exclusions, (but may be more in the case of complicated special effects films), and it must be fully expended to cover any budgetary overages before the completion guarantor kicks in. Second, the completion guarantor charges a fee, which is typically around 2–3% of the budget (more precisely, of the defined budget, which for completion bond purposes may exclude certain expenses) but volume users generally get a discount on that price. Studios usually function as their own completion guarantors because they fully expect to have to cough up whatever is required to deliver a film that they believe can be commercially successful. Why pay someone else to fulfill a role that you are prepared to play yourself—unless you are very worried for some reason about your ability to avoid excessive budgetary overages? If you are nervous about the fiscal discipline of your director, you can be sure that the

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completion guarantor is equally nervous. The well-capitalized independents recognize that you never really want to call on the bond. If you do, you may jeopardize your good standing with the bond company, and your future rates—as in automobile insurance—will surely rise. Thus, completion bonds in the eyes of the major players in the industry are a kind of catastrophe insurance. They should be called only if a major financial disaster is the alternative. Accordingly, when most films go over budget, and there is a bond in place, the producer will put up the budgetary overages if he or she has the financial wherewithal. That probably works if it does not happen too often. However, I know of one major indie that had great distribution output deals in place. The deals were so good, it was difficult to see how it could lose much money on any production—except the company went invariably over budget to the tune of 10–15%, which it covered, and this represented the imputed profit margin on its portfolio of films. So after several years of not being able to exercise budgetary discipline, it closed up shop.

There are very few completion bond companies that serve the industry. As of the writing of this book, there are only three major completion guarantors that can handle studio-level features (the largest company in terms of volume gobbled up the second largest a few years ago). Thus, producers can't afford to burn any bridges by getting a reputation of calling on bonds with any regularity.

I was asked recently by a private equity guy who had invested in one film whether completion bonds were a good business. My response was equivocal. The good news is, as I said earlier, producers do not want to call on bonds except in a disaster scenario because it jeopardizes their ability to bond films in the future. The bad news is that the fees a bond company charges (typically 2–3% on one-off films and less if a well-capitalized indie commits to an overall relationship with the bond company) are, in my opinion, somewhat light given the risk bond companies bear. It must be noted that if a bond company takes over a given film, its investment is subordinated to the existing equity investors, plus the bond company does not enjoy any profit participation. The latter fact provides a strong motivation for the bond company to spend the minimum amount of money to deliver the film, irrespective of its impact on the film's commerciality. So, the completion bond business is about accumulating as many 2–3% commissions as possible to offset any underwriting losses. Thus, to succeed, a bond company must bulk up in volume—which led the largest bond company, Film Finances, to acquire the second largest bond company, International Film Guarantors (IFG), a few years ago. IFG was backed by Allianz, the huge insurance company, whose other

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subsidiary (Firemen's Fund) was a leading provider of overall insurance to the film industry—cast and production insurance as well as errors and omissions insurance (a special form of insurance that protects a film's rights holders from the potentially devastating impact of lawsuits for libel, slander, invasion of privacy, infringement of copyright and other specified torts, including improper handling of unsolicited scripts, failure to obtain appropriate rights for music and film clips, failure to obtain appropriate releases from individuals appearing in the production, and improper use of celebrity's name or likeness). IFG/Fireman's Fund benefitted from its ability to provide joint coverage for both general insurance and completion risk, but it came as no surprise to me that Allianz was a willing seller of its completion bond subsidiary. If a completion bond company can manage its risk properly and if it has a sufficient volume of business, I suspect it can achieve an acceptable return on capital particularly given that it can reinsure a large portion of its risk with mainline insurance companies and be left with a limited deductible. So bond companies can play the leverage game as well.

Completion bond companies serve another important purpose on productions. As it is clearly in their interest to do their homework on scripts and budgets presented to them, they employ experienced in-house physical production executives who go over these budgets with a fine-tooth comb. Bond companies are not hesitant about challenging budgets presented to them by producers, and they frequently insist that additional shooting days be added to the schedule or that various departmental sub-budgets be augmented. This, of course, has the consequence of increasing the budget. It should be pointed out that completion bonds are not in force until the producer has demonstrated that he or she can fund the film to the "strike price," which is the fully loaded budget for bond company purposes. Because banks won't lend a dime to the production until the completion bond is in place, producers frequently have to bridge required cash flow themselves, or find outside financiers who specialize in providing such bridge financing, until the bond and bank loan both close. Industry outsiders are flabbergasted when I tell them that it is not uncommon to close on the bank loan on an independently financed film after the start of principal photography. This is generally not a problem for my clients, who all have the financial capability of bridging the funds required for pre-production (and even the first couple of weeks, or more, of principal photography), but it is an enormous burden for production companies that are not well-capitalized. At the very least, it adds significantly to the financing costs, and thus to the overall budget.

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Excerpted from *Investing in Movies*

It is not unusual for films to eat through their entire contingency (because, like Mount Everest, it is there!) as well as incur additional budgetary overages. Thus, there is great variability between the going-in budget of the film and the actual cost of completion. When you see the occasional budgetary numbers thrown around in the press, you can assume they are referring to actual final cost, but there can be no assurance that these numbers are accurate or that they include all the relevant costs. For example, financing costs are often ignored. By financ-ing costs, I mean the fees the bank charges for making the loan as well as inter-est to delivery. Technically, the bank will provide for interest costs 2–4 months beyond delivery to give itself a cushion, but if there is anything left in this interest reserve at delivery (either because the film was delivered promptly or the bank's projected interest rate during the course of production was excessive—the banks like to give themselves a cushion here as well), it reduces the amount that has to be paid back to the bank. The bank's legal fees are also born by the producer, and these fees have tended to escalate as a result of the increasing complexity with respect to how films are financed.

Fifty years ago, most mainstream films were either cash-flowed by the major studios or banks lending against studio contracts for worldwide rights (so-called negative pick-ups). In the 1950s internationally sophisticated producers began to tap into the foreign markets by "preselling" titles to foreign distributors. These producers would then bank these contracts to provide a large chunk of the necessary financing for their films. Thus, the "bifurcated" film model was borne, whereby producers lay off domestic rights to the major studios or so-called mini-majors and license foreign rights (i.e., outside-North America) on a territory-by-territory basis. Given the multiplicity of contracts now relevant to a single picture financing, the legal paperwork also increased exponentially as did the lawyers' fees.

Over the past few years, so-called soft money benefits (governmental rebates and tax credits) and tax-incentivized investment structures have proliferated greatly to the extent that they have frequently become a necessary piece of the puzzle on independently financed and also studio films. On one hand, the tax-incentivized investment structures (the German and UK Equity Funds, the old Canadian tax shelters), in particular, added significant degrees of complexity to the financial package and dramatically increased the legal fees associated with such transactions. These structures also carried with them high levels of fees and commissions for the middlemen who sourced such funding, which either added

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directly to the financing costs that had to be financed as part of the budget or required disproportionate revenue participations for these funds in order to permit them to recoup the costs of their raise.

Governmental subsidies, on the other hand, typically represent "freebies"— that is, they are outright cash rebates or they can be monetized by selling the tax credits to tax-paying entities in the jurisdiction—and don't have to be repaid nor do they participate in the film's profits. Such is the case with the benefits provided by most U.S. states (at time of writing, roughly 75% of the states had film subsidy programs in place) and all of the Canadian provinces.

There is another important variable that affects the true cost of the film, which cannot even be quantified at the time the film is delivered. This variable is a function of the quantum of so-called gross profit participations in the film. Many "A" level actors, directors and producers have negotiated gross profit participations that enable them to receive significant remuneration above and beyond their fees in the budget, irrespective of whether the film has recouped its negative cost for the financiers. These gross profit participations are couched as a percentage of gross receipts, and their fees in the budget are typically applied against their percentage entitlement of gross receipts.

It works like this: Let us assume that a given actor receives a $10 million fee in the budget (so-called fixed compensation) against 10% of the gross. In fact, it's not really 10% of the gross because certain off-the-top deductions—such as taxes, shipping costs, Motion Picture Association of America (MPAA) dues, etc.—apply. Hence, "gross" becomes "adjusted gross." In addition, home video gross receipts that are included in the total revenue base do not represent true gross receipts, but are calculated on an artificial royalty basis, which typically is based on 20% of wholesale revenues (higher in the case of major stars). There are historical reasons for this (it is based on the traditional reporting model for the record industry, to which it bears some resemblance), and the guilds are constantly fighting for a redefinition of video residuals, which are also based on the same royalty definition. The studios have resisted these efforts for a very good reason: The traditional royalty definition represents a fraction of the studios' share of video revenues, even after taking into account manufacturing and marketing costs. Not surprisingly, as digital distribution platforms replace physical video sales and rentals, this issue has become less relevant.

In this case, the actor in question would not receive any additional compensation

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until adjusted gross revenue equaled $100 million (i.e., when he had earned out his $10 million fee based on 10% of the gross). When studios account to profit participants, they include gross participations in their calculation of bud-gets. Arguably, there is good justification for this if gross participations kick in prior to the studio's having recouped, since they serve to push back the studio's breakeven just like any other budgetary item. But if they kick in after recoupment, they simply function like any other profit participation, which simply reduces the profitability of the film for the studio. By including gross participations as a budgetary item, the studios can also charge interest on such sums as well as include them for purposes of calculating the overhead factor that they tack on to the budget of every film they produce. Thus, a budget is a rolling definition that increases over time, even after the film has been released.

I should point out that as overall economics of the business have become more challenging, studios have cut back dramatically on their willingness to pay a share of gross, even to top stars. The mantra is now cash break even, whereby actors do not receive additional compensation above and beyond their fee in the budget until the studio has recouped (typically before taking into account distribution fees).

I think you get the message: "Budget" and "film cost" are not synonymous. Even if you think you have a reasonable handle on the cost of making the film, you still have to address the cost of marketing and distributing it, which can frequently exceed the cost of production. So-called prints and ads (P&A) costs have grown faster than production costs over the past 10 years. In 1998, according to MPAA statistics, average production cost of an MPAA member (primarily studios) film was $52.7 million.1 In 2007, it was $70.8 million—representing a per annum growth rate of 3%.2 In 1998, average marketing expenditure was $25.3 million.3 In 2007, it was $35.9 million—representing a per annum growth rate of 5%.4

These numbers don't look too bad if you believe them; I don't, at least not with respect to recent studio experience. It is interesting that the MPAA has not published average production and marketing expenditure numbers since 2007. A cynic might attribute this to the fact that one or both categories are out of control, and the MPAA does not want to fess up to that fact publicly. I suspect the culprit is more the "A" side of the equation (print costs are actually dramatically in decline as films are now distributed digitally for the most part). Based on the projects that I have knowledge of, I believe the studios now find it difficult to release a

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high-profile film—that is, a film that has one or more "A"-list actors and is released broadly on at least 2,500 screens—without spending north of $30–35 million in domestic marketing and distribution costs. Not only are they throwing more advertising dollars against the wall—for television and radio spots and Internet advertising—but they have also become more spendthrift than ever in crafting their creative campaigns. That is, the studios think nothing of hiring multiple vendors to create a multitude of trailers, finishing often more than 100 television spots, conducting vast research efforts related to testing the film and the marketing campaign. The cost of the creative campaign alone can run on the order of $10 million—and this is before the studio has spent a dime on advertising to create public awareness and want-to-see. Later in this chapter I highlight the disappointing experience that many institutional investors have experienced on the so-called studio slate deals. It is not unreasonable to assume that this may be due in large part to the lack of fiscal discipline the studios have exhibited in marketing their films. Ironically, as I indicated earlier, the studios have been showing greater discipline in controlling burgeoning production costs, particularly with respect to talent remuneration.

By the way, the P&A numbers compiled by the MPAA refer to North American costs only. There is absolutely no public database that represents a comprehensive compilation of marketing and distribution costs outside of North America. One reason for this is that many films distributed by the studios in North America are handled differently in the foreign marketplace. The good news about foreign, though, is that marketing expenditure has historically trailed domestic spend, mainly because television spots are less expensive; plus, some countries, like France, do not even permit television advertising for films. But, over the last few years, P&A spending internationally has accelerated dramatically.

In my course on film finance in the Peter Stark Producing Program in the USC Graduate Film School, each student was required to construct a financial model analyzing the profitability of individual film projects. The model is based on a set of correlations relating revenues and costs. The key performance variable in these models is domestic box office. Thus, all revenue streams are keyed to domestic box office: home video, free and pay television, pay-per-view, video on demand non-theatrical (airlines, universities, military bases, etc.), merchandising, music publishing and sound track, both domestic and foreign. While the database represents generic correlations, I make it very clear to my students that for the model to be effective it must permit them to override any specific revenue stream

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or expense item, depending upon the characteristics of the film being modeled.

Thus, you cannot come up with a generic multiplier that relates overall film revenues (in particular, key ancillary revenue streams such as home video, which also includes video on demand and free and pay television) to domestic box office—notwithstanding the glib assurances of the hedge fund manager I referred to in the introduction. Profitability data is extremely hard to come by in the film industry, unless you have privileged access to studio data. But why would the studios open their kimonos? Well, they would and have under a rather obvious set of circumstances; to the extent they were trying to attract major institutional investment, they understood that they would have to disclose precise revenue and cost information to prospective investors in order to enable those sophisticated investors to run Monte Carlo simulations to quantify risk and assess projected returns.

Monte Carlo methodology is based on computer-generated random number techniques that are used in business to calculate risk, but also have widespread use in science and engineering to study systems with significant uncertainty in inputs. In fact, the methodology was invented at Los Alamos in the 1940s to predict the likelihood of nuclear fission being accomplished based on various assumptions regarding radioactive processes. In the case of motion picture analy-sis, you generate thousands of likely portfolio results based on historical data to generate a bell curve measuring probability of loss and projected returns.

Institutional investors—primarily hedge funds—were initially attracted to Hollywood because they recognized that movies were a pre-eminent asset class that was totally non-correlated to the stock market. Thus, they were a perfect addition to portfolios that were seeking to diversify beyond stocks and bonds. Portfolio diversification by itself, of course, is not a sufficient determinant of risk mitigation. A portfolio also has to consist of asset classes whose performances are relatively independent of one another. As an example, if we assume that utility stock performance is correlated with the bond market, a portfolio manager would not be accomplishing much in terms of risk management by diversifying his bond portfolio into utility common shares. It did not take much in the way of research to recognize the relative independence of film performance versus the stock market. Everyone can cite the fact that people still went to the movies during the Depression. As I will argue later, profit margin trends in the movie business are more a function of technological innovation within the industry than

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macroeconomic trends.

Now I would like to introduce the term "moral hazard." Moral hazard occurs when one person takes more risk because someone else bears the burden of that risk. While moral hazard is a feature of all insurance policies, the interests of policy holders and insurers are usually somewhat aligned. That was not the case when insurance companies dipped their toe in the water in the mid-1990s by providing shortfall guarantees on several packages of films. It goes without saying that the producer who was in the deal primarily for his fee could care less how the insurance company made out. That is what goes to the root of moral hazard. The first such deal was initiated in 1995 by the well-known producer Mike Medavoy, who was looking for financing for a five-picture package including The People vs. Larry Flynt and The Mirror Has Two Faces. Chase Manhattan agreed to act as lead bank for a loan syndicate and a group of insurers underwrote part of the financing package. The People vs. Larry Flynt bombed at the box office and while The Mirror Has Two Faces did reasonably well theatrically, the picture still showed a loss because the star, Barbara Streisand, pressured the distributor (Sony) to overspend on P&A. The insurance syndicate balked at compensating Medavoy's production company, Phoenix Pictures, for the tens of millions of dollars in losses and sued Chase and Heath Insurance Brokers, the broker that placed the Phoenix policies. In full disclosure, I acted as an advisor to Heath's counsel in the litigation. The plaintiffs claimed that they had relied on the "principle of utmost good faith" (which is a principle in British tort law) but had been misled by misrepresentation and non-disclosure.5 The defendants countered that such a principle did not apply under U.S. law and that the insurers could not unilaterally void their contracts. After prolonged litigation, Chase and Heath prevailed, which caused other insurance companies that were involved in other unsuccessful deals to cut their losses and run.

Today, banks generally run the other way when someone brings up the notion of an insurance-backed guarantee, although savvy insurance underwriters can point to several flaws in the shortfall guarantee structure that were embodied in the Phoenix deal and then replicated in other transactions. First, the insurers did not fully understand the notion of diversification (five or fewer films in a package implies too much volatility). Second, the insurers had too much risk on a per-picture basis. Several analysts suggested that a significantly lower percentage of the budget should have been covered to lower the risk of moral hazard. Finally, the insurers should have written into the contract a more protracted period before

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they paid up (the make-up payments were required in as little as 2 years after the theatrical release of the last film in the package, after which the insurance companies would step into the shoes of the banks and collect future revenues to make themselves whole).

I might mention that an old partner of mine, Harris Maslansky, and I have recently come up with a new insurance structure that is quite dissimilar from the shortfall guarantee structure promulgated in the Phoenix and other deals. I don't want to disclose the structure because we have not yet tested it in the market, but we are confident that at least the lending banks should be satisfied that payments under the policies are reasonably bullet-proof.

Wall Street learned from the bad experience of the insurance structures, and—always on the lookout for new investment products that can be sold to their clients—banks and brokerage firms soon glommed on to the idea of "securitizing" slates of studio films by creating various tiers of risk that could appeal to more than one class of investors. In addition, they trumpeted the importance of achieving a diversified portfolio by investing in a studio's entire output (with some notable exceptions) over an entire year, and sometimes longer.

These studio slate deals were typically comprised of three separate tiers. The senior pieces, which historically represented the first 55% or so of the overall slate, were provided almost entirely by commercial banks. The mezzanine pieces, which historically represented 25% or so of the overall slate, were largely provided by hedge funds, many of whom also participated in the equity slice as well. Wall Street houses and insurance companies have also participated in the mezz loans. The final equity investments, representing 20% or so of the slate, were entirely provided by hedge funds. As more hedge funds caught the fever, some deals were done with equity pieces representing as little as 15% of the overall slate (remember, leverage is a two-way street—in success, it can jack up your ROI, but in failure it magnifies losses). But as senior and mezzanine lenders perceived that there was greater risk in structures than they originally thought, they demanded greater equity cushion beneath them.

Over a period of roughly 5 years up to the financial meltdown of 2008, more than $13 billion of slate financing (including slate financings for independent production companies) was raised.6 The jury is still out as to overall rates of return, but I think it is fair to say that, except for some notable exceptions, investors' experiences have significantly underperformed expectations (which may

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have been too high in the first place). On several deals the entire mezzanine pieces have been wiped out or largely wiped out.

All of the studios climbed on the slate bandwagons as well as many of their specialty film divisions. Interestingly, the most successful specialty film division, Fox Searchlight, which has been responsible for such cross-over successes as Juno, Little Miss Sunshine and Slumdog Millionaire, refused to participate. The reason given to me was quite simple: The division was too profitable, and the cost of capital on these slates was too high.

When the slate financing structure was first introduced, the pricing on the senior and mezzanine pieces was quite attractive from the studios' point of view, with the senior interest rate in the area of LIBOR + 1.75–2.50% and the mezza-nine coupon in the area of 10–12%. As the spreads on less than investment grade securities widened overall, the pricing on the mezzanine pieces also deteriorated with the market quoting 16–18% on the mezz.7 But then everything imploded, and the market for slate financing came to an abrupt standstill in 2008–09.

It should be pointed out that the analysis that senior and mezzanine lenders engage in is fundamentally different from the approach taken by equity investors, although the Monte Carlo simulations they run are based on the same database. As I indicated earlier, Monte Carlo techniques as applied to film investment are designed to compute probability of loss as well as projected returns. Senior and mezzanine lenders are more focused on the probability of loss calculation. In particular, they set acceptable probability of loss parameters, and if the param-eters are exceeded, a prospective investment is automatically rejected. Clearly, mezzanine lenders are prepared to accept higher loss potential than senior lend-ers because they charge a significantly higher cost of capital to justify the higher degree of risk assumed. Once it is determined what the likely probability of loss is, the senior and mezzanine lenders can determine the pricing of their respec-tive tiers, taking into account as well their own internal guidelines as to bench-mark returns. Equity investors, in contrast, tend to be more fixated on probable upside. Not surprisingly, given the projected equity returns they expect in the private equity and LBO markets, hedge funds wanted some degree of comfort that 20% plus internal rates of return (IRRs) were achievable on these slate deals. The studios would not give them such comfort because of the risk of legal liability, although they would provide historical data and let the hedge-fund boffins crunch their own numbers. The promoters who married institutional investors with the

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studios had fewer qualms. Halfway through my course at Peter Stark, I attempted to quantify studio returns while standing on one foot—it was a fairly down-and-dirty analysis since I quickly got tired in that pose. In a very brief analysis, I projected single digit (maybe low double-digit) type returns. Even first-year graduate students can understand that it is tough to transform such base IRRs into 20% plus returns, even through the use of substantial leverage (remember the studios will still charge the slate distribution fees off-the-top, albeit on a reduced basis). I have a slate presentation that just crossed my desk (provided confidentially by presenter) that shows a projected IRR on committed capital of 15% (27% on drawn capital) predicated on a base-case cash on cash return of 1.18x—not bad, but I believe the model embodies an accelerated time-line for receipt of revenues and I do not know if it factors in management carry and administrative costs. I suspect the targeted IRR is inflated and will require much better than median performance to achieve. Please keep in mind that IRR reflects the time value of money (the idea that a dollar today is worth more than a dollar in the future), unlike ROI, which simply represents profit as a percent-age of investment, irrespective of whether it takes 1 year, 5 years or 50 years to achieve that return. IRR is the proper way to assess an investment because it represents the compound interest rate at which an investment has to grow to generate certain proceeds over time.

The question immediately comes to mind as to the cause of the divergence between results and expectations. After all, institutional investors who were given complete performance histories by the studios soliciting their investment were in a much better position to construct financial models than my students at Peter Stark who have to research their correlations. The investors had complete breakdowns of historical costs and revenues. Accordingly, five possible explanations come to mind. The first I dismiss out of hand—namely that the historical data the investors received was inaccurate. The potential legal liability associated with providing false information is enormous, and these studios are all parts of much larger publicly traded conglomerates. No, that is a game we associate with individual shysters. The second explanation is that the data was incomplete or misleading. I have reviewed some of the worksheets provided, and I have not found any sign of incompleteness, but in one sense the data may be misleading if not analyzed properly. Most of those slate deals do not encompass all of the films produced by the studio from a point in time going forward until the funds are fully expended. The studios in general have excluded sequels and animated films from the slates

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funded by outside investors. They have done this for a very good reason: Sequels are invariably sequels to extremely profitable films. You do not make a sequel to a box-office bomb or even a mediocre performer. Thus, it might rightly be concluded that ROI in sequels exceed overall returns on the studio's entire slate of films. It does not take a rocket scientist to make the necessary adjustments to the historical data to exclude sequels or potential sequels, assuming, of course, that the historical data provided actually identify the specific films produced by the studio or the studio itself excludes such films in the overall database. In some cases I have examined, this was done, or could have been done by the investors if the actual films were identified in the worksheets they were provided. I wonder, however, if the necessary adjustments were always made. Similar comments apply to animated films, which also tend to outperform studio averages, not surprisingly since they typically demonstrate four quadrant appeal.

The third possible explanation is that the future did not resemble the past for whatever reason. I stress "for whatever reason" because this discrepancy with regard to future versus past performance may be a result of changing macroeconomic conditions or industry-specific conditions, or it may be a result of changing studio behavior. It is the latter charge that lies at the root of some of the litigation that is currently percolating over disappointing slate results.

The fourth possible explanation is that investors underestimated the under-lying variability of film portfolios—as a result of not having sufficiently many films in the slate. In the beginning, investors insisted on having 25–30 films or more in the slate, but as money piled into the sector, underwriting standards weakened and investors were prepared to accept 20 films and sometimes as low as 15 within the slate.8 Since the movie business is a hit-driven business, the probability of hitting a home run in a diminished slate, I would argue, was dramatically reduced. I haven't compared key probability metrics for slates with different film samples, but I am confident my gut feeling is correct.

The fifth possible explanation, and the most likely in my opinion, is that the deck was stacked against the investors. This explanation can be broken down into a number of possible categories. To begin with, perhaps the studios charged too-high distribution fees—in fact, the studios over time have reduced the level of distribution fees they have charged slate deals considerably below what they charge on single-picture deals. The real problem, as I indicated earlier, was that sequels (and animated films) were typically excluded from the slates. Sequels tend

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to be concentrated in the upper echelon of studio budgets. Several years ago, one investment firm did extensive Monte Carlo analysis of studio results as a function of budgets. Interestingly, the firm found that studio films in the under $25 million budget category generated very positive returns, while above that returns declined dramatically in a straight line to zero until budgets hit $100 million, where the returns spiked and even exceeded the performance of the under $25 million budgets.9 But you shouldn't be surprised—that is why studios today are concentrating on large tentpole films and why they excluded generally bigger budget sequels and animated films from these slates. While I can't prove it, I also suspect that studios took advantage of this huge influx of capital to drive up marketing budgets. Since they recoup P&A off-the-top, such aggressive tactics didn't raise the studios' risk profile that significantly and enabled them to buy "gross." That refers to the fact that studios calculate distribution fees off gross, not net, revenues so it is in their interest to hype gross receipts given that the slates' typically bore 50% of the risk related to the financing of the budget (with the studios bearing the remaining 50%). The MPAA for years published detailed statistics on theatrical costs for its members—studios, mini-majors and large independents—as well as marketing expenditure. But, as I mentioned ear-lier, it stopped doing so in 2008 on the excuse that the increasingly complex nature of film financing and distribution made it difficult to obtain reliable data. Cynics, however, suggested that the reversal came about as a result of studio pressure. The MPAA chairman and CEO, Dan Glickman, a former congressman from Kansas and a former Secretary of Agriculture, was probably not in a mood to push back on his studio bosses, especially in light of his inability to lobby successfully for tax breaks for Hollywood in the federal stimulus package that was passed to preserve U.S. jobs after the economic debacle of 2008–09. The same studio bosses were probably not keen to reveal how much they were spending on making and marketing their films during a time of severe recession and massive layoffs. Needless to say, Glickman's contract was not renewed in 2010.

Notes

1. Robert W. Welkos, "Movie Production Spending Dips, but Marketing Costs Rise, Valenti Says," Los Angeles Times, 10 Mar. 1999, http://articles.latimes.com/1999/mar/ 10/business/fi-15740.

2. Pamela McClintock, "MPAA: Specialty Films See Rising Costs," Variety,

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http://variety.com/2008/film/markets-festival/mpaa-specialty-films-see-rising-costs-1117981882/.

3. Welkos, "Movie Production Spending Dips."

4. McClintock, "MPAA: Specialty Films See Rising Costs."

5. "A Fine Romance," The Economist, 29 Mar. 2001, www.economist.com/node/554490.

6. Kimberly Owczarski, "Becoming Legendary: Slate Financing and Hollywood Studio Partnership in Contemporary Filmmaking," Spectator 32, no. 2 (Fall 2012): 50–59, https://cinema.usc.edu/archivedassets/32_2/6_Owczarski.pdf

7. According to author experience.

8. According to author experience.

9. Confidential internal company analysis (American Entertainment Investors).