# BANKROLLING A BLOCKBUSTER

INDEPENDENT FILMS HAVE A REPUTATION AS A HIGH-RISK YET GLAMOUROUS INVESTMENT, BUT THERE ARE OPPORTUNITIES FOR INVESTORS ACROSS THE RISK APPETITE SPECTRUM. *JESSICA TASMAN-JONES* TAKES A LOOK AT HOW FAMILY OFFICES ARE INVESTING

Make fewer bets, but make 'em big. It's the sort of advice that flies in the face of conventional investment theory, but that's what's happening in Hollywood where studios are investing more and more exclusively in "tentpoles" – action-packed blockbusters often with nine-figure budgets. It might seem like high-risk stuff to those accustomed to spreading risk, especially when a film could easily flop, but big bets regularly pay off. Marvel Studios' *The Avengers*, 2012's top grossing film, for example, cost $220 million (€161 million), but returned $1.5 billion at the box office.

"All six of the main US studios have reduced the number of products they're putting on to the market, they've decreased their slate sizes [film speak for a collection of films]," says Matthew Lieberman, director in PwC's entertainment, media and communications practice based in Los Angeles. "But the composition of the slate is focused heavily on tentpole films because of the returns they can generate, and because of the revenues from more consumer products – so being able to sell all the action figures, and the clothing and the bedding."

Disproportionately big investments in a few mega franchises is a business tactic that makes sense in Hollywood, argues Anita Elberse, a professor of business administration at Harvard University. In her new book *Blockbusters: Hit-making, risk-taking, and the big business of entertainment*, Elberse says because production costs are very high, but reproduction costs – getting copies of the film into cinemas around the world – are very low, Hollywood responds by making big bets on a couple of sure things: sequels, bankable actors, special effects, and stories that have established their value elsewhere (think the *Harry Potter* franchise based on the successful books).

Lieberman says this has left a lack of finance for independent filmmakers thereby expanding the niche for ultra-high net worth investors – who have a long history of being lured by Hollywood's glamour. While studios are increasingly entering co-financing deals, these usually carry price tags in the hundreds of millions, meaning opportunities for family offices often lie in the independent space.

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Photography: c.W.Disney/Everett/REX, c.Weinstein/Everett/REX

**Left:** *The King's Speech*, about a stammering monarch's journey to find his voice, certainly didn't stutter at the box office. Starring Colin Firth, the independent film cost $15 million to produce and reaped $414 million worldwide

**Opposite:** Robert Downey Jr stars as Iron Man, a character who has appeared in a number of films produced by Marvel Studios, including the *Iron Man* trilogy and *The Avengers*

These independent films can still have budgets upwards of $50 million, and attract A-list stars, but they rely more heavily on storytelling rather than dramatic special effects. Tax partner at Rothstein Kass's Beverly Hills office, Mark Hutchison explains: "The independent filmmaker is like a wildcat drilling for oil, hoping he drills down, makes a huge hit and makes a ton of money." Unlike a consumer product, you can't test a film with punters before you've made a huge upfront investment in the production – it's only when the critical opening weekend takes place that you can accurately gauge how well a film is going to do.

But independent films can make huge strikes. The 2010 biopic of King George VI's speech impediment, *The King's Speech*, was produced in the UK on a $15 million budget, and reaped $414 million at the box office worldwide. Romantic comedy *My Big Fat Greek Wedding*, filmed for $5 million in 2002, returned a phenomenal $369 million.

The box office, however, is not where investors typically see their return on investment, explains Nik Bower, managing director of the media division at UK-based Ingenious Investments, which offers a number of film funds and helped finance *Avatar*, the highest grossing film of all time. "There are some that are successful from box office alone, because the theatrical performance to budget is so strong, but theatres typically keep about half of the box office gross and the distributor takes their distribution fee off the balance, and then prints and advertising can be very substantial. More often it is the revenues from television and home video that tip a film into profit."

Hutchison says many investors arrive in Hollywood after a huge liquidity event, and dump tens of millions of dollars in a single project only to lose everything. While studios are relying increasingly on a few big bets, advice to private investors not familiar with the industry is to spread risk across a slate.

## REAPING GOLD FROM THE SILVER SCREEN

So how can investors take advantage of an industry set to be worth $106 billion by 2017, according to PwC? As Bower explains, there are opportunities for investors with all levels of risk appetite. "Every film has a capital structure and as an investor in film you can choose to invest anywhere in the capital structure," Bower says. "There are a lot of films you wouldn't want to go anywhere near, but so long as you know the business and you know what type of film makes a sensible investment you can choose to expose yourself to the level of risk and return that you're comfortable with."

Nicole Kidman stars in *Grace of Monaco*, which will open the Cannes Film Festival this year

**Left:** Having seen the success of the *Harry Potter* books, Warner Bros was willing to make a big bet on the movie franchise, which went on to make $7.7 billion in worldwide receipts

**Below:** Hollywood loves films that can extract further profits through consumer products, such as these soft toys based on characters from Marvel Studios' superhero franchises


Source: *The Hollywood Reporter*

he decided senior debt financing was a channel where he felt risk could be mitigated. "It was a completely different approach, which convinced me that this might actually be the key to investing in that space."

Largely raising money from European-based family offices and wealthy individuals, the fund has since financed around 20 films, including last year's Second World War drama *The Railway Man*, starring Colin Firth and Nicole Kidman, and Grace Kelly biopic *Grace of Monaco*, due to open the Cannes Film Festival in May, and again featuring Kidman in the lead role.

"Every single one of our investments was successful and profitable and we had not one where we lost money," Bauknecht says of the fund. Silver Reel provides cash-flow for government tax monies and pre-sales (which are secured before production and give a distributor the right to release an independent film in a particular country once it is complete) as well as "gap" financing – mezzanine debt, which covers the shortfall between equity and senior debt. Bauknecht says Silver Reel's investors see returns in the region of 10% per year and with time horizons usually between six to 24 months for each deal. "Typically we are divested once the film is starting in the cinemas and this makes us completely independent of the box office success." But he explains the fund has equity kickers in place should a film be a huge hit.

Approaching the other end of the risk appetite spectrum, London-based film finance partnership Xantara Film Capital has been connecting equity investors (in the industry "equity" is actually subordinated debt) with feature film projects, across genres and budget levels. Xantara partner

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Single family office investor Gero Bauknecht initially considered film investment to be a risky asset class best avoided. "Although there are exceptions to the rule, many equity investors in film do not recoup their full capital, nor make great returns," he says. But when Claudia Blümhuber, a former business partner, approached him in 2008 to establish the Silver Reel Entertainment Debt Fund,


Photography: Press Association, Associated Press, Snap Stills/REX, Everett Collection/REX

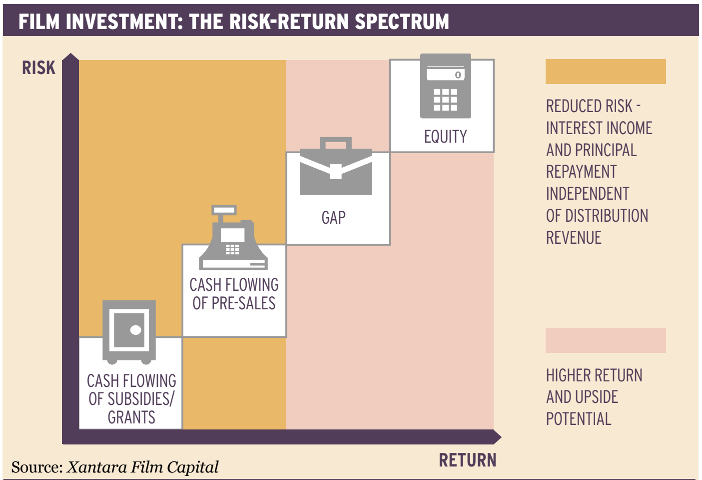
Gabriela Christian-Hare, one of the fund's legal and finance experts, explains the firm examines films just before production, when a director and key cast are attached and the script is finalised. "That's a far less risky stage to get involved because the key ingredients that make for a very good, successful, commercial film will already be in place."

Christian-Hare says their investors are interested in equity for its possible returns. "Certain films have the potential for enormous box office success, but also continuing revenue streams for the investor as well, through home entertainment, or the pick up of a film by free TV or pay TV, as well as ancillary revenues from merchandising and music sales. These combined give film significant high upside potential."

At Ingenious Investments, Bower explains, family offices are showing a lot of interest in their gap fund, which has a targeted rate of return around 25%, but some found the $5 million maximum ticket price was too low. This year it will launch a fund co-financing studio productions, which he predicts will be of a scale better suited to family office needs.

Xantara aims to raise $200 million for a global film and technology fund, with debt and equity allocations, and sees opportunity for growth in its partnerships in China, and "transmedia" – storytelling across multiple platforms, such as film, graphic novels, e-books, comics, video games and social media. *The Avengers* and other movies produced by Marvel Studios, such as the *Thor* and *Iron Man* franchises, serve as prime examples, reaping revenues across films, comics, video games and other platforms.

**FILM INVESTMENT: THE RISK-RETURN SPECTRUM**




Source: *Xantara Film Capital*

**Above:** *The Avengers* was 2012's top grossing film, returning $1.5 billion at the box office - but its success doesn't end there. The film has been a springboard for multiple consumer products and spinoffs

Xantara partner Rae Parsons, who also has a legal and finance background, says: "The fund might take the senior debt position on one film, the mezzanine on another, the gap on another or the equity or a mixture of all four. The aim is to achieve income immediately from the senior and mezzanine positions, and capital growth from the upside potential while managing risk."

Family offices needn't worry about production risk either. Most film investors seek a completion bond, which kicks in when a film goes over time or budget meaning a *Titanic*-type blowout (the 1997 film's budget doubled to $200 million during production) will not hit investors in the pocket. Parsons says: "Guarantors do an awful lot of due diligence on the film, as do we, so it gives you a second level of eyes on this project. Is it going to get produced on time and on budget? For us that's a really nice thing for the investors to have, and if it does fall through, they'll get their money back and a bit of interest on top of it."

## CRACKING CHINA

China, whose government has made film a growth priority in its effort to shift its economy from export driven to consumer led, is due to see its media and entertainment industry grow 17% year-on-year between 2010 and 2015, according to Ernst & Young. Its film industry is forecast to surpass the US's as the world's largest by 2020. The country's box office accounted for almost 10% of revenues for James Cameron's 2009 sci-fi hit *Avatar*, bringing in 1.39 billion yuan ($204 million). According to Lieberman, "Whereas a couple of years ago less than half of revenue for a US film product was generated overseas, now it's at 69%."

Last year Australian media and gaming mogul James Packer told local media he'd like to see his business interests in film spread evenly across China, the US and Australia, off the back of his $450 million co-financing agreement with Warner Brothers. And Canadian mining tycoon Robert Friedland announced in November his company Ivanhoe Pictures would be entering a $130 million co-financing deal with Fox International Productions to produce local language films in China, Taiwan, Japan, Korea and India.


Not every film will make it to screens in China, however, due to the nation's notoriously strict media censorship, particularly shy about sex, violence and criticism of governments or communism. The country also has a quota system, restricting foreign film releases to just 34 a year. But as Anja Gohde, a film expert at Xantara, says: "As soon as a film qualifies as a Chinese film, which you can achieve via an official co-production, you do not fall under this system. So we are looking at eventual co-productions with Chinese production companies, and the co-operation with our Chinese partners gives us the ability to directly access the Chinese market and Chinese products and revenues for the fund."

Photography: c.W.Disney/Everett/REX, Press Association

## BEHIND THE SCENES

So why are family offices investing in film? The industry seems to be recession-resistant, explains Judith Chan, director of media banking at London-based Coutts. "People still want to be entertained. They might not be able to afford to go on holiday, but they might still be able to afford to go to the cinema."

Coutts is one of the few financial institutions that has remained in film finance since the global financial crisis – with some leaving due to capital and liquidity issues. It provides senior debt finance against government tax rebates and distribution pre-sales. The effect of reduced institutional film financiers seems to have attracted more private investment globally into films, Chan says.

Bauknecht says his family office invests in film because it offers "very good returns in a time when you have almost no interest rate left". "Silver Reel is completely uncorrelated from any capital markets, if financial markets are good or bad, it doesn't really matter. It actually helps us even more because the worse the financial markets are the less competition we have in financing movies and we can negotiate on our terms."

**Below left:** A billboard at a cinema in Beijing, China advertises *Avatar* – the country accounted for almost 10% of the film's revenues

**Below:** Judith Chan, director of media banking at Coutts, says private investment in film seems to have increased in recent years

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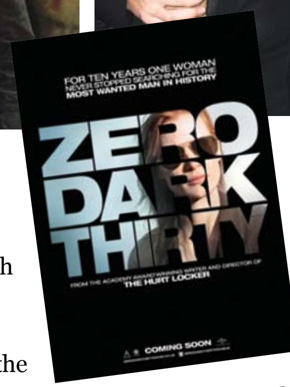
One of the most common ways Chan currently sees wealthy individuals entering film financing in the UK is through government sponsored schemes such as the Enterprise Investment Scheme, which provides tax breaks for investments in high risk industries. Ingenious Investments offers several funds that tap into this scheme, such as its Shelley Media EIS 9 fund, which includes 30% income tax relief on the amount subscribed, and has a targeted rate of return of up to 18%.

Back in the US, Hutchison says equity investors may be able to take a tax deduction of up to $20 million for federal taxes for US productions, as part of the domestic film production incentive programme

**Left:** Megan Ellison joins *Zero Dark Thirty* star Jessica Chastain at the 71st Annual Golden Globes. She provided finance for the independent film, about the manhunt for Osama bin Laden

**Below left:** Single family office investor Gero Bauknecht says film offers good returns in a time when the economic situation means there is almost no interest rate left




started in 2004. This provision allows the tax deduction to be used to offset passive income elsewhere in a family's investment portfolio, such as in real estate. Although it expired at the end of last year, Hutchison explains this provision is expected to soon be renewed and retroactive to the beginning of 2014.

As for multi family offices, London-based Oracle Capital says it's in negotiations with several film funds to include them in its alternative asset allocation, which it recommends is never more than 5% of a portfolio. Head of investment services Kirill Ganin says due to film's potential risk they are extremely vigilant in their due diligence. "The managers of the funds we look at usually have direct experience in the film industry. We look to invest in films with big names and international appeal, and where funds have a successful track record in terms of making good returns."

Glamour, Lieberman says, is surprisingly a consideration many wealthy investors take into account when they buy into film. Premiere passes, dinners with A-list cast, pre-release screenings and marketing opportunities, were some of the perks offered by film funds *CampdenFO* spoke to. "It's fascinating," Lieberman says, "we talk with individuals who we work with across a number of investments across industries, and in another industry glamour is not something we would consider, as far as a risk-return consideration, but for film they will go for it, all in."

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The creative side of film production can be another draw. One family office principal from Asia, who did not want to be named, had experience financing a small independent film for the first time. He says his objectives had been to learn about the film business, more so than making money. Initially providing capital for the final phase of the film and its marketing, he then travelled to New York, Singapore and Hong Kong to promote it. "In its distribution phase and marketing phase there were a lot of events associated with the launch of the film. So overall I had a really great time, through my travels and with the people that I met, and of the things I learnt from this experience." Next time, however, he says he would be interested in providing financing earlier on, to see the full process from genesis to completion.

Larry Ellison's daughter Megan has financed several films that might not have had the chance of being made otherwise, including *Zero Dark Thirty*, which grossed more than $108 million at the box office and was nominated for five Academy Awards, including Best Picture. Directed by Kathryn Bigelow and based on the decade long manhunt for Osama bin Laden, Ellison covered the full $40 million price tag.

The filmmaking process is something Bauknecht says he also enjoys. "For me, it's not about meeting actors; for me it's about the storytelling, the creation, how things come together. It's an incredible effort to bring together a good movie." But he's not about to get too creatively attached: "It has to make sense numbers wise". "In the end you have to find a way to get the money back, and for a certain type of movie, you know there has to be a limit on the budget." It may be a glamourous investment, but even in showbiz it's all about the bottom line. FO

Photography: Snap Still/REX, c.Col Pics/Everett/REX, Press Association