BUD FOX & PROF EPPS PRESENT

NUMBERS

THE | ART OF FILM FINANCE PART II

PRIVATE OWNERSHIP | EQUITY MODELS

CONTRARIAN VISION | E BOOK

2007 | 2008

Bud Fox & Prof Epps Presents

WALL STREET│

NUMBE3S│ the

POEMS│ solution to

THE│ ART OF FILM FINANCE PART 11

PRIVATE OWNERSHIP EQUITY MODELS

AN ANTEDOTE TO RISK

CONTRARIAN VISION E BOOK 2007/08

POEMS CONTENT

- **SINGLE PICTURE │ FRAME THINKING**
- **PRINCIPAL │PROTECTED**
- **CAPITAL│ GUARANTEED**
- **CAPTIAL RETURN││ GUARANTEED**
- **OPEN WINDOWS │OPEN POCKETS**
- **ZERO RISK│ INVESTMENT MANTRA**
- **FAIL SAFE│ MARGINS**
- **PERCEPTIONS │ ARE NOT PREDICTIONS**
- **SINS│ RPAS**
- **EQUITY│ FAN ANALYSIS**
- **COLLATERAL│ SUBSITUTION**
- **DEAL MATRIX RISK │PERCEPTION TOOLS**

- **POEM APPROACHES**

- **POEM │ ASSET BACK SECURITIZATIONS │WORKED EXAMPLES**
- **SLATE │ MODEL**
- **SINGLE│ PICTURE ABS MODEL**
- **POEM │LAKE V WATERFALL**
- **POEM │INNOVATION 2008**
- **POEMS │THE FUTURE IS NOWS**
- **ROMEO│MUST NOT DIE**

POEMS

PRIVATE OWNERSHIP EQUITY MODELS

POEMS are the answer to many of life's problems and also potentially the movie business' film finance constant tale of woe. **Private Ownership Equity Models** are designed to create intellectual property ownership of copyrights and to package related revenue streams. The private equity deals of the Tax Shelter Investment Equity boom and from the Wall Street Private Equity boom, all attempted to create finance from ownership of equity interests.

Problematically both the tax shelter models and the Hedge Fund models did not in substance create real ownership. The deal forms used in both scenarios delivered only the illusion of ownership. Ownership to be real must at its core create certain critical minimum economic outcomes.

All the tax shelter/private equity plays we have described saw investors with bottom equity that would most likely never be recovered and would rarely if ever create profit potentials.

POEMS conceptually point to a new mentality behind doing business in this industry. The principal idea is that each film deal should not be financed and produced unless it delivers to all stake holders in the economic pie, a fair piece. We recognize that debt interests need to be secured and the price for that is collateral while the plus is lower interest costs and potentially greater profit for all.

In our 2006 article we introduced some cutting edge concepts that could be used to shape the film business financial landscape. POEMS are our extension of real world best practice and of these cutting edge ideas.

The **LAKE** approach to revenue as a replacement to the Waterfall mentality that exists in the industry is a vital part of our concept. This referenced another idea we introduced called **FEOM** standing for **Fractionalize Equity Ownership Model**. Under the **LAKE** approach film revenue streams are not distributed downward to the first, then second then third layer of secured economic interest. Rather each lending interest or equity investment owns a Fractionalize Part of the total deal.

Under this approach the soft money lender has the tax credit collateral; the pre-sale lender has distribution agreements of determined value while other participants such as talent and equity investors have direct ownership of some asset based right with economic value. It may be a territory or even outside collateral. Under a **LAKE** driven distribution of deal revenue using a **FEOM** thinking method, every debt and equity player could create their own risk profile. Each has distinct interests in various revenue streams to the point of being made whole and then collective interests in relation to profitability on an agreed basis. Bankers twitch when ever their pole position is tweaked. Our point is that this happens anyway on co-finance deals now. If you sell off the rest of world for production cash the US rights funded by your lender enjoy only that collateral.

Over the last year we have evolved the **LAKE** approach and **FEOM** thinking to create **POEM** solutions to Private Equity finance. The Wall Street mess would not happen if our rationale were followed. Here in essence are the ideas behind our structural approach to the industry.

SINGLE PICTURE│ FRAME THINKING

"You are on your own… the trail stops with you…. Understand"

Saul │ WALL STREET

Each **POEM** proceeds on the basis that each film stands alone. If it cannot be 100% financed with each **FEOM** element being adequately risk mitigated it should not be made. The finance puzzle then is to create deal chip configurations that balance the risk profile of every piece. No slate driven loss being made up by winners or related slate film collateral, should ever form part of this process.

A significant value of the single picture investment approach is that deal revenue in a single picture after debt recovery goes to equity. Under a slate approach the revenue goes to pay down total slate debt before equity. A collective slate created by grouping **POEM** approach single picture non-cross collateralized interests would see a greater return than equity invested in a slate approach. This systemic flaw is why Hedge Fund Equity in the Wall Street deal model will lose their shirts to the Asset Backed Banker in the deal. Inside a single picture deal frame debt interests can be further portioned out so that revenue of some kind gets to all and is not taken out by lenders originating the deal.

PRINCIPAL │ PROTECTED

"Never knew how poor I was until I started to make money"

Bud Fox │ WALL STREET

The very least that an equity ownership participant in a film deal should expect is a completely securitized credit worthy take out of their equity risk by years 5-7. The value of such a concept is that if an equity investor provided the hit money in a deal they can be assured that at worst their investment is underwritten then he can view his risk *Monte Carlo* simulation differently. The real deal loss in economic terms is the net present value after tax loss of the risk free rate of return after tax income the investor would use in his CAPM. In CAPM analysis, investors adjust each asset class for risk relative to the risk free rate of return and proportion of risk attributable to the investment risk band they are investing in.

Principal protection on an equity investment that is at worse case re-paid in year 5, represents at LIBOR a loss of about 25% net present value (after tax assuming a rate of 30%) of capital. However the *Monte Carlo* simulation now looks somewhat different. With no losers to pick up and a few small wins the return can be attractive. Hedge Funds if they had been principal protected on single picture basis would have in most cases made a good return on a slate.

On a slate debt paid out first basis they would still only get the initial investment back. However money back at least is something better than zero which is what they have now. We see in the post Hedge FUND market a great need to create instruments that principal protect both the debt and equity interests in a POEM.

CAPITAL│ GUARANTEED

"MONEY is one giant pain in the butt if you ask me."

Marvin │ WALL STREET

The extension of the principal protected construct is the Capital Guaranteed concept. Under this form of underwriting not only is the principal protected but the risk free rate of return on that capital. In essence the investor at the end of the investment cycle worse case would get back principal and interest at LIBOR. In effect the value of their capital after tax would be given back. The concept envisages yearly LIBOR reinvested at the after tax rate to earn compounded returns at LIBOR. The two salient issues about such payments is how are they securitized and by whom. In the sub prime mortgage demise many asset backed deals credit enhanced by way of guarantee were found wanting due to denial of liability or lack of credit worthy payers behind the guarantee. The concept envisaged here relates to unconditional payout supported by a letter of credit or pledge of treasury stock from AAA rated sources.

CAPITAL RETURN│ GUARANTEES

"You are going to make a lot of money PAL the stakes are going up and make no mistake you're in for a piece of the cake…"

Gordon Gekko │ WALL STREET

Further extension of this thinking comes in the form of capital return guarantees that return principal plus the projected rate of return. The price for underwritten high rate of return is capped upside involvement if there are super returns. This idea contemplates fat tail revenue from real hits being capped and returned to the party creating the guarantee. Again a slate concept would see the model not operate as well as in a collective single picture frame model.

OPEN WINDOWS│ OPEN POCKETS

"Its perfect, too perfect let's just watch it and think about it."

Gordon Gekko │ WALL STREET

POEM deals contemplate that all deal revenue windows are not manipulated. In the tax shelter equity investment deals the nature of the arrangements effectively took commercial reality away. The deal revenue windows were structured to ensure even in case of a win not all revenue would flow as one would expect. POEM uses the idea of open windows that are not used to manipulate, defer or artificially transfer values under the split right strategy that is used. The ability to enhance window value by creating with distributors and sales agents better fee deals that apply only after certain levels of recoupment is another example. DVD revenue sharing past the 80/20 rule is another indicator.

ZERO RISK │ INVESTMENT MANTRA

"Sure it's about the money. Is a bad bargain if nobody gains but here everybody gains."

Gordon Gekko │ WALL STREET

A POEM investment in intellectual property must past the Zero Risk Test if it is to be viable. The equity interests must whether by way of deal collateral and/or supportive credit enhancement be at zero risk.

The split of fractionalized debt and equity interests in a film must each look at their own risk curve. If all of a film's deal pieces can stand alone with their own risk mitigations then the whole film is a zero risk. The ownership equity interests that are under traditional waterfall revenue models the burn money, are those most in need of the rule. If the deal revenues and deal collateral cannot risk mitigate then some other form of collateral is needed to securitize and credit enhance any gaps.

FAIL SAFE | MARGINS

"I am not a destroyer of companies I am a liberator of them."

Gordon Gekko | WALL STREET

Many deal film finance elements are certain. Presales, tax credits and core talent participations. The real art is in assessing the value of unsold territories that will be sold off rather than exploited and the value of rights to be held. Fail Safe Margins are the only way pre-production that one can operate a sound risk aversion program on. Under such thinking we start with a zero value approach to unsold rights values and/or contingent revenue streams. In this thinking we have absolute certainty the worse that can happen is accounted for and risk mitigated. Next we add on the FAIL MARGIN analysis. Under this thinking we project with high confidence levels minimum revenue if the film is a total stinker. This level is below worst sale estimates and adjusted to show a fraction of what is thought possible. Adopting and assigning a confidence level to that margin, we can then do a regression analysis to see our risk curve in relation to certain things happening. The difference between our approach and the slate number cruncher approach is we are not relying on the numbers. The numbers are not pointers of the probability of the outcome but merely set piece analysis of the consequence should such outcomes happen. The deal principal protection and/or capital guarantees effectively remove the need to rely on the numbers.

PERCEPTIONS IS | NOT PREDICTION

"Card counting is not cheating… it is the application of probability theory to games of chance."

Larry Fine Heart | WALL STREET

Sales estimates for sold and to be sold territories can, dependent on the sales agent be quite accurate. But reality is a cruel master as in the face of a dog even the worse projection may not be low enough. The later projections are from production start through to release and post the release, the higher degree of confidence one can assign. Revenue predictions as we have pointed out also vary in accuracy dependent on the windows involved.

Once theatrical and DVD are known the balance of performance is relatively stable. Conversely due to the non linear nature of some windows such Pay TV, Network TV and even some VOD models, a worse case can be projected. Equally the value of unsold territories to be sold can be predicted as nothing much prior to release can really impact the values other than gossip.

Revenue projections for unsold territories should never be above their sale value. This is because there is only a lotto chance of them being true. No sequel can ever for sure at pre-production stage guarantee it will perform anything like the original. In the finance plan such projections are always from a risk management point of view, zero risk numbers. Projected profits can be modeled from such numbers but only on the basis that this is the financial outcome should they occur. No investor should ever think that art has a certain preset value it never has and it never will.

Revenue projection as the Hedge Funds found out is a two edged sword. Selling off up front pre-sales or over time before release, various deal parts is a good risk mitigation strategy. The unspoken price of it that the slate model does not recognize is the cost of the loss of the fat tail if a film is a winner and you have already sold off the best bits. Enter SINS/ RPAS!

SINS/RPAS

"It's all about bucks, kid the rest is all…invention"

Lou │WALL STREET

Synthetic Investment in Notional Securities (SINS) and Revenue Participation Agreements (RPA) were ideas we introduced in our last article. SINS refer to the idea that the underlying assets and securities that flow from the creation of Intellectual Property, can be used to form notional investment structures. The idea for example of creating an investment bond that as to return and principal is secured over the performance of various revenue streams in a film deal. Complex use of SIN thinking would see one trading principal protections or capital guarantees for an earnings cap on the bond income. The idea would be to create low risk non recourse loans - non recourse as to return but not as to principal loan. The ideal film finance tool that creates low risk, low face cost interest finance that would see also film revenues made deductible as interest while still preserving fat tail potential, is a useful deal tool.

RPA deals may not in and of themselves constitute security interests as they relate to any set of legal rights that entitle the RPA holder to deal revenue. Some RPA arrangements if paid for by equity or if coming as part of a capital transaction may be security interests. Equally others given to talent or entities assisting in the production process may be simply a deferred compensation model. In POEM thinking saving expenses in terms of upfront cash to make something a go picture is as good as earning revenue. Better yet it is mathematically certain now. The use of RPA deals to secure talent, services or better cost profiles from any deal participant a critical risk mitigation tool. The timing of payment, what and how they are secured are critical. Under a lake approach rather than a Tom Cruise first dollar waterfall hit that kills every lower level debt/ equity interest, a lead actor for a low price may take France or some other territory as payment. Half or all of the revenue from that sale or exploitation may flow directly outside the waterfall to that party. RPA use was first seen in the shortfall insurance deals and got a bad wrap. If created for real cash then the rights values in terms of tenure may also be deductible. Conceptually under Section 181 they may qualify if they meet the wholly and substantially test. SINS/RPA models cut the cake in new ways and in doing so release value solutions that can be then shared across all deal participants.

EQUITY FAN│ ANALYSIS

“Life comes down to a few moments and this is one of them.”

Bud Fox │ WALL STREET

Each Private Ownership Equity Model generated deal interest under a LAKE approach enjoys credit enhancement by way of at least principal protection. In this respect the equity invested is not a face value risk but a time value risk. The equity fan relates to the unique deal interests that insure that some revenue falls into the equity owner’s hands. The ability to have a minimum revenue interest from say US domestic returns on say the first $2m, is a huge deal carrot. The money is likely to come in and to the extent it does it does not have to go elsewhere in the waterfall. In a traditional approach this money would go to support a lender. Worse in a slate approach it would go to support money lost on another film.

COLLATERAL │ SUBSTITUTION

"Wake up Pal if you are not inside, you are outside."

Gordon Gekko │ WALL STREET

The LAKE approach divides the revenue potential of a film both certain and prospective in new ways. The impact is often that in order to support a risk free equity ownership interest collateral must be obtained. Substitution of collateral by way of providing principal and capital guarantees to the lenders by third parties is one solution to this issue. On the plus side the interest rate cost of debt sinks to near LIBOR and the extent of the underwrite frees up deal collateral for other participants. The use of such wrap around products to create secure low cost lending is now viable. The quid quo pro being a trade off and creation of another deal interest relating to the assumption of the risk.

DEAL MATRIX│RISK PERCEPTION

"Isolate their gambling history… isolate the money flow and maybe we will find a pattern… use a multi-variet time series analysis to break down where the money goes by month, week, day and maybe even hours."

Larry Fine Heart │ NUMBE3S

In a Beautiful MIND the brilliant math genius but socially inept John Nash stood at a campus bar with his friends. All wanted the smoking hot blonde in the midst of the group of her reasonably attractive girl entourage. It was at that moment that Nash rationalized that in Adam Smith's selfish driven model of society all the men were in competition for the same girl. Only one man could win but competition for her as the only one would put off all the girls surrounding her. Hence too many suitors would kill off the chance of any man winning at all. The brilliant insight he had was that if every man approached one girl in the group then all the men could win a girl and one man would win the hot girl. One man winning the hot girl was preferable to no man. This is how cooperative game theory math was born. Out of the idea that not all games are zero sum and the sometimes the optimal solution lies in compromise that unlock unseen values making all sides winners.

In the misuse of math applied by Wall Street much has been missed. The value savings for example of outsourcing production to real production houses to lower production costs.

Producers who manufacture at a price designed to keep them in business not too burn their life savings. The ability to put downward pressure talent costs not insure by unwarranted demand they rise. The ability to cut studio overhead and finance costs of the system all can create new wealth to underwrite a better capital market model.

In our writings in 2001-2004 we were the first to flag the use of math as a risk perception tool. Sadly our work was to some degree misunderstood. The use of tools is only a perception tool indicative of the risk profile of a private ownership equity interest. WALL ST used it as a predictive tool and it was never ever mean to be that.

We have developed however out of the real operative math that applies to pre-production revenue risk assessment models some useful approach techniques.

The 2004 AFM article we wrote on Linear and Non Linear revenue models and the role of soft money tax shelter was predicatively correct. Risk assessment under a POEM approach would see us combine a FAIL SAFE REVENUE MARGIN with known sales values from pre-sales and soft money incentives to create analysis of each debt and equity ownership interest in a deal. The LAKE method makes such analysis easier than under a waterfall approach as the random variable of interest costs and up front participations does not have the same deal impact.

The Risk Matrix in conceptual terms looks like:

$$\frac{\textbf{Known Revenue + Fail SAFE Margins}}{\textbf{DEBT OR EQUITY Interest}}$$

KNOWN REVENUE = PRE SALES+
SOFT MONEY

FAIL SAFE Margin = NON LINEAR +
LINEAR adjusted

+ or - Principal Protections and other Collateral

What the formula says is that each debt or equity interest under a LAKE approach has to be looked at in relation to the KNOWN revenues from PRE SALES + SOFT MONEY + the FAIL SAFE MARGIN REVENUE sales estimates for NON LINEAR revenues such as CABLE and NETWORK TV and discounted worst sales estimates of the still to be sold territories under the LAKE that apply to the interests stake in the deal. The analysis takes account of any outside principal protection or capital guarantees. The use of substituted collateral is also a deal factor.

The value of territorial rights is initially shown as a zero value then scaled up using regression analysis to show the impact of that interest of that revenue. The risk matrix is a

tool for showing what each deal piece risk curve is like, not for predicting what it will be. Under this analysis each deal participant can assess their risk reward ratio.

POEM | APPROACHES

"There is nothing like the smell of overly oxygenated air and the prospect of pecuniary promise."

Larry Fine Heart | NUMBE3RS

All the foregoing conceptual ideas feed into the **POEM** approach. The ability to finance each film as a stand alone deal means wins do not get swallowed by other losses. Zero risk assessment using the Risk Matrix approach to determine risk and then see what needs to be done to mitigate it, is a critical key to perception tool thinking.

The use of the **LAKE** approach to create the basis for an optimal cooperative game theory approach to film finance over the current zero sum game is more optimal and makes everyone a winner. New wealth and new cost savings can emerge by use of SINS and RPA tools.

The zero risk profile supported by the concepts of principal protected, capital guaranteed and capital return guarantees with substituted collateral unlocks new ways of dividing deal revenue and of reducing finance cost charged to the deal. The new ways mentioned of underwriting risk have been used in other industries to mitigate downside risk. To date as far as we are aware they not been applied to the film business.

The use of open revenue windows designed to share all the revenue rather than to skew it in favor of certain interests adds more core value to a film's investment equation.

Abandonment of the winners versus losers approach in favor of a total risk mitigated one, is capable of a better math driven analysis. The use of revenue projections as illustrative nor predictive by inclusion of only certain deal values known during the production cycle create accurate risk assessment tools.

The idea of **POEM** is that in a sophisticated global market there are many different ways to structure equity and debt interests that can independently stand alone as to valuation. The oppressive non-thinking waterfall model is a powerful deal killer that ensures a slate approach favors only bankers and the studio. The **LAKE** approach using **POEM** execution unlocks the magic of film finance. The ability to create investment grade debt and security interests in film via credit enhancement is using these tools is now a viable choice.

POEM | ASSET BACKED SECURITIZATION

"The public is out throwing darts at a board sport. I do not throw darts at a board. I bet on sure things… read Sun Tzu The Art of War every battle is won before it ever fought"

Gordon Gekko | WALL STREET

The sub prime mortgage crisis and the Film Industry Hedge Fund madness share one key common denominator - the moral hazard of self assessed income potential combined with the reality of loan originators ability to down sell risk and responsibility through the magic of ABS.

Asset Back Securitization (ABS) refers to the transfer of assets to a bankruptcy remote body set up by an originator as a special purpose entity (SPE). The SPE then creates or loans bonds secured over the interests in the SPE securitized by the assets transferred to the entity. The originating bank who owns the loan or bond portfolio then down sell parts of the loans or bonds to others.

The originating bank then has made substantial fees and profits bearing no risk exposure on its books to the loans. The buyers of those securities then wishing to on sell risk themselves raised further funds by putting the bonds into other SPE's using the same process. The high art saw in the sub prime market creation of products on products creating different bands of risk and return in relation to the same loan.

In the film industry the ability to create an SPE that was loaded with 25% equity and 75% debt secured over either the intellectual property copyrights or rights revenue flowing from them was a new spin on an old play. The Deals loaded with layers of debt within the total created different risk profiles - Senior debt over pre-sale, soft money incentives, Mezzanine debt secured over unsold territories and held rights. The bottom of the cake was the equity which was the only real burn money on the table. This was down sold to a number of hedge funds to then parcel out risk. Those funds were themselves levered so the real equity in the whole deal was minimal. The whole pyramid of illusion relied on the principal of all deal elements with the returns promised to come back.

The risk tree under these deals had been magically reshaped by the process of securitization. The lenders were very happy as the slate lurk significantly improved their risk position over a single finance model. All debt in a slate over winners and losers must be paid out before equity. In a collective of stand alone single pictures the winners do not have to pick the losers.

The ability to create ABS was further enhanced in the sub prime market by credit enhancement. This is where a credit worthy third party guarantees the loans of the SPE to create a credit rating and lower interest cost to the SPE than the underlying asset values on their own would ever justify. The appeal to purchasers of these loans is that they did not need to look too close at the assets in the SPE. As the market moved at a pace, no one noticed whether the credit enhancement terms or provider were in fact credit worthy. In the melt down many were proven to be far from it. The only values left in the SPE then were found wanting.

In the film business there is little evidence of credit enhancement but to the extent a Studio provides it and therefore improving the break even point under the deal. Hedge Funds were attracted to these deals because the rate of return to generate a 15% + yield was not needed over the whole fund. The lower blended rates on the debt portion meant the hurdle rate to attain this goal was not as high one would think.

The bankers lending under a slate model to an SPE faced little risk as the cross collateral value of known deal revenues and fail safe numbers across a slate covered their risk. In fact the slate model in a failure insured the interest portion in the budgets would blow out.
Perversely due to the deal model this blow out risk was covered and earned the banks more money as films failed. The impact however was that the real equity at the bottom got eaten up by these costs. The real break even point over a failing slate was in some cases to recover equity plus 100% of initial strike price.

The equity at the bottom was to all accounts not principal protected or capital guaranteed. The internal levering of investors meant that their own debt pyramids relied on the equity being safe. The reality of even getting money back would still create losses. Like sub prime where borrowers did not have to prove income the revenue projections of films were simply air. The math to support them was flawed and found wanting over identical slates in Germany over the preceding five years.

Intellectual property ABS transactions can if correctly used facilitate investment in either intellectual property copyright ownership or revenue rights flowing from such ownership. The ability to create principal protected and capital guaranteed interests that are credit enhanced allows the creation of investment grade interests in film industry assets.

Such ABS type funds are technically possible now. The use of a non slate approach to improve the lot of equity investors substantially changes the risk curve in their favor. The only issue in doubt is given the market concerns over the film business and ABS transactions generally, whether there will be a receptive market for down sale. The products now capable of creation may not need down sale as they are attractive in any portfolio.

POEM thinking and **LAKE** driven division of revenues can use ABS thinking to create investment grade securities. The film business needs a stable capital market to survive one where risk cannot be removed from return.

POEMS│WORKED EXAMPLES

SLATE│MODEL

"Not bad for a QUANT… but is it a dog with different fleas…. come on Pal tell me something I did not know, it is my birthday."

Gordon Gekko│ WALL STREET

Assume an SPE invests in a slate of 10 films costing $10m each where 8 films earn $40m and 2 earn $20m and $40m respectively. The SPE borrowed $75m and $25m was put in by Hedge Funds. The cash came in over two years and the interest on debt was $10m

Under a slate model the $100m in revenue would go to replay the $75m in debt principal and $10m in interest. The balance of $15m would leave $10m in the equity uncovered. A loss of 40% of the equity base.

SINGLE PICTURE│ APPROACH

"You ever wonder why fund managers cannot beat the SP 500? It is because they are all sheep and sheep get slaughtered!"

Gordon Gekko │WALL STREET

Same facts but assume none of the 8 films recouped any equity only debt. The $100m in revenue would see $40m (8) + $15m (2) =$55m go to recover $75m of debt interests. Lenders holding essentially the gap and super gap risk layer would lose $20m. Sounds a familiar tale in the business does it not?

The equity player would lose $20m on the bad films. But make $60m from the winners and use $15m to pay off the debt leaving $45m to recover the equity portion of $25m and a profit of $20m.

It is easy to see why debt lenders love a slate approach. The law of large number becomes more applicable the more certain base revenue in a slate is. The fate of gap and super gap lenders on a single picture basis is easy to see. The slate removes that risk at the expense of equity. The bloated costs of Gap and Super gap eat up equity on a failing slate.

POEM│ TRANSACTIONAL MODELS

SOFT MONEY│ ABS MODEL

"Hello I have some very important news that happens to concern your financial future… Hello….. Hello are you still there…. Hello?"

Marvin │ WALL STREET

A fund of $100m to fund 30 films with tax credits ranging from $2m to $10m. Same debt and interest cost as above. The failure rate of tax credit transactions on a slate basis is 2%. Interest paid out is at 7% approx $5m is charged to producers at 12%. $12m – interest $5m – losses on failure $2m = $5m profit on $25m= $20%.This is a low risk arbitrage business that for low default risk, creates a 20% yield on equity investment in what are essentially sovereign securities. An equity investor in a **POEM** could invest equity equal to the credit in the film by pledging credit to a tax credit lender. The funds could then be used to finance the equity investment. The credit when received pays off the loan the investor has an equity interest for nothing. The interest cost would be partially financed by the tax component of the interest write off.

POEM │ Lake Approach Vs Waterfall

WATER FALL

Presales	30%
Tax Credits	20%
Gap	15%
Super Gap	10%
Equity	25%
	100%

Under a traditional model approach the bank lender on pre-sales comes out first. The tax credit lender from the Tax Credit, then the GAP and then the Super Gap loan and last the equity. On a revenue curve of 75% it is likely that after an interest blow out a little bit of super gap will be lost and all of the equity. This is the industry typical modality seen endlessly in the UK, GERMANY and America.The same deal under a LAKE APPROACH would have with proper deal structuring a totally different outcome.

LAKE APPROACH

"If you need a friend kid get a dog."

Gordon Gekko │ WALL STREET

Using securitization of all the debt elements 100% would then enable a partial release of deal collateral by the lender. Further lower interest costs would come from the credit enhancement of the loan creating lower deal break even points. Equity interests could then further be expanded to cover the tax credit collateral. The savings in interest would also come back into the deal switching interest into profit related collateral.

Equity is covered by the tax credit, savings in interest, and partial collateral release from the securitization of debt. Plus 20% of the sales value assigned to cover the equity and create a window for the bottom equity recovery exclusively.

So the **LAKE DEAL** would see all interest secured but in a better way for all.

DEBT 55%
EQUITY 45%

100%

The **DEBT** is secured by a credit enhancement that uses the 55% of 75% of deal revenue plus everything above that from those rights plus other territories covering the equity part once equity is made whole via a SINS deal.

The **EQUITY** is secured by a tax credit for the 20% part leaving 25% covered by deal sales value of territories assigned to collateralize the equity exposure exclusively until made whole then to top up debt until paid out. All revenues from the release collateral pool go to equity less a kicker to the securitization SPE.

The created equity interest could be further split into two different **POEM** interests. A private equity interest of 20% covered by Tax Credits and another private ownership equity interest covered by the Sales Values assigned to cover just that equity interests.

The Debt Interests are redeemed by the Sales Values from the reduced Fractionalized Territory Sales Values and topped up by the credit enhancer. The credit enhancer by a SIN in turn retains a share in equity upside but is only exposed to the debt default between actual sales and what is needed to stump up the delta to the debt lender. Presales of 30% cover most of the 55%. The balance of unsold territories covers the exposed 25%. A recapture of only half this leaves the credit enhancer almost whole. A little bit of work

can close this gap also as the interest cost savings applied across the whole deal applied to the credit enhancement fee and release substantially close it.

The **EQUITY POEM** interests are almost certain to recover between 50% and 75% of the exposure. This means that a very small exposure to risk can finance the equity in a film. In a $10m film a $1.2m ($4.5 x 25%) exposure is a small gap. One that with a little more work can also be risk mitigated toward zero risk.

The POEM lake model delivers a much higher level of risk aversion than the waterfall model. The ability to get debt is enhanced as is the ability to get equity. The burn money of old bottom equity now has a chance to be made whole regardless of how poor a film performs. A Matrix Risk analysis across arrange of outcomes will show POEM equity can be risk mitigated toward zero risk.

POEM│ INNOVATIONS 2008

The following innovations should be on the radar of savvy players in 2008.

- TAX CREDITS: The ability to max and layer tax credits and tax shelters on top of each other is a necessary deal resource. The smart will find news ways to ensure soft money potential contributions are taken to their highest level.

- DEBT│ CREDIT ENHANCEMENT: The ability to use ABS credit enhanced type debt thinking can reduce interest cost. Cost savings in interest and the ability to free up deal collateral to attract other equity pieces opens up new solutions to the deal film finance puzzle.

- PRINCIPAL│ PROTECTED: The ability to "principal protect" and or "capital guarantee" equity investments or any POEM interest changes the risk profile of the film finance industry.

- SINS│ RPA: New innovative techniques like these will package deal revenue and create new deal tools to reorder film finance risk.

- LAKES│ The ability to reorder risk beyond the skewed waterfall formula of the past opens new ways to attract funding and lower costs.

- POEMS│ Allow the creation of new interests that stand alone. The ability to divide a cake into discrete non dependent parts is a new wave of innovation. The bottom equity burn money game that sees only banks, distributors and producers get money can be ended by such approaches. The ability to create a sustainable renewable capital base of equity investment in the business can come from such thinking. POEM thinking ends the sucker search.

NEW ABS: The ability to use **POEM** thinking to create new asset back securitization models to collectively lower film finance lending and equity investment risks is here. The ability to package **SINS/ RPA/ TAX CREDITS/ DEBT RISK BANDS** in new enhanced ways is a product of **POEM** approach thinking. The winners pick up losers ABS models that ensure equity in a slate always dies can now be reordered.

POEMS | THE FUTURE IS NOW

"I bought this painting last year for $60k. Now they think it will bring $600k. The illusion has become real and the more real it becomes the more they want it.

Gordon Gekko | WALL STREET

Private Ownership Equity Models are a concept whose time has come. The ability to carve out varying private ownership interests each with uncross collateralized recapture corridors create new levels of risk aversion and mitigation. Lower deal costs, lower risk and the ability of each financial contributor be made whole or near it is a vast improvement.

The high art we are now capable of past these simple examples creates the power to principal protect debt and equity. The best art allows debt and equity to be securitized and also capital guaranteed.

POEM logic is a long needed answer and a way when combined with the magic of **LAKE** thinking and use of **FEOM** deal models to create investment grade securities. The math is not easy, the thought required to create optimal **POEM** interests requires mastery of many different skills.

The challenge can only be met on a deal by deal basis. The slate fixes all mentality cannot solve deal vulnerability on a wholesale basis only single picture by picture solutions can. Slates made out of non cross collateralized **POEM** interests are a winning formula. No losses to pick up means every winner creates income that goes straight to the bottom line. Our use of this acronym was deliberate. We wanted to separate these ideas from the murky road private equity has just been on. Our work so shows that large films can be financed on very little money with very little risk of loss. The reel outcome is totally dependent on the facts and the quality of the film finance plan.

Post Script

“I think I have a friend who would not mind making some easy money.”

Bud Fox │WALL STREET

ROMEO │ MUST NOT DIE

ART must flourish and to do so the creative imperative that drives **ART** must be returned to the solvent and the sane. **WALL STREET** as it is not the movie has become the real life killer of the motion industries core value its creative capital.

The ability of the idiot off spring of law, investment banking and stock broking firms to hold sway and power must end. Bad **ART** can never be saved by Tax Shelters, Hedge Funds, and soon Arab Petrol Dollars it can only be created by it. The emancipation of equity over the last two years has seen a crazy supply of bad **ART** unleashed on the world. Rich players with ambition are always welcome but in show business you have to pay your dues. Fewer films better made that have to fight for oxygen of real money some how end up being better art. Romeo must not die but neither does he need a better condo in a tax haven. All he needs is pen and paper not for *Monte Carlo* simulation but simply to dream. The dream needs money but the money cannot as it has become the dream. Numbers can help **ART** but they cannot become it.

POEM is our contribution to creating financial discipline. A move to a more defined long term capital market is now viable. The ability to create lower costs and to once more create a stable artistic existence is worth the fight. **ART** needs money but it cannot take money by using the illusion of **ART. ART** is what it is and that is where it derives its worth. Romeo must Live to create **ART** not create **ART** to **LIVE** off others.

“Invest the rest in a tax free mutual fund. I want to see how you do before I invest real money. And save the cheap salesman talk it is so obvious…. I don’t like losses, nothing ruins my day more than losses. You do good you get lots of perks, lots of perks.

Have a good lunch buddy.”

Gordon Gekko │WALL STREET

THE END

WALL STREET

NUMBE3S

THE ART OF FILM FINANCE

Money Never Sleeps PAL | Money Is Never Made Or Lost

Money Simply Transfers | One Perception To Another

WALL STREET 1987 | 2007

CONTRARIAN VISION | 2007
EDUCATIONAL | E BOOKS

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