Behind the Scenes

As the entertainment industry adopts new delivery methods, develops innovative technologies, and seeks alternative means of achieving growth and value, it remains focused on the fundamentals and anticipates that securing financing and talent will become even more vital to success – and even more challenging.

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The global market meltdown of late 2008 brought with it dire predictions for the near-term prospects of most industry segments. Amid uncertainty regarding the enterprise valuations and the availability of credit, many businesses sought to cut expenses and streamline operations in order to survive. Revered financial services institutions teetered on the brink of insolvency, as asset managers faced a growing list of concerns from liquidity demands to regulatory pressures. Even some of the most respected firms in the alternative investment community struggled to deliver superior returns and raise capital.

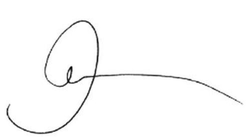
With capital scarce, the entertainment industry was expected to suffer as well. Some analysts forecasted that productions would grind to a halt and that the highly anticipated advent of 3-D technology would be delayed. Instead, the motion picture industry has set box offices records with demand for 3-D content outpacing supply. Meanwhile, digital production has enabled “on-demand” content, supporting thriving, but disaggregated television and internet production. The entertainment industry avoided a harsher fate by providing Americans with a brief respite from the world. Movies, in particular, offered an affordable escape from global economic turmoil and deflated retirement accounts.

The entertainment industry was not entirely exempt from an uncertain economic outlook. As investment managers and traditional lenders reevaluated conceptions of risk and reward, demand for greater transparency extended to production companies as well. Hedge funds, high-net-worth investors and other important sources of capital insisted on reducing risk by investing in content with more projectable returns. As a result, studios have churned out a stream of sequels, prequels and adaptations. Other production companies have focused efforts on amassing libraries of income producing content to help finance future projects. As a result, some critics have argued that predictability has come at the cost of creativity.

In fact, greater investor risk aversion limited production supply even as demand for content has improved with the broader economy. Ironically, the dearth of new content could usher in a new golden age for the industry, as production companies green-light a wider array of projects to overcome this shortage. Securing top-flight talent, incentives and access to proven distribution channels will be important factors in attracting new investment capital, particularly among high-net-worth investors, hedge funds and private equity funds that have been identified as increasingly critical sources of funding. Though investment in entertainment production remains inherently risky, investors recognize that focusing on these elements allows for more effective revenue forecasting and helps them to balance these allocations as a component of a diversified portfolio.

“Behind the Scenes” examines important sources of production finance and other critical factors in determining the profitability and success of entertainment projects. The report draws on the experience and knowledge of the Principals of the Rothstein Kass Family Office Group. We are pleased to share their insights with you and encourage you to contact us to discuss findings.

Thank you for your continued support.



Steven A. Kass
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Key Themes

- The entertainment industry, like most other industries, is concerned about financing pressures and the cost of doing business. Most production company executives anticipate funding to be more difficult in the near- to intermediate-term.

- The alternative investment community – including hedge funds, private equity funds and wealthy families—is expected to be an important source of funding for many productions.

- Tax incentives and rebates are central considerations and essential tools in managing costs when budgeting projects and determining locations. Securing name talent for each project increases the likelihood of success with both funding sources and audiences, and remains a critical component of success.

- Internet-only productions are an expanding part of the entertainment industry and will likely comprise a more significant part of production time and expenditures.

- While return on investment is a priority for most investors, many production company executives have not sufficiently explored beneficial tax strategies to maximize the value of their personal investments in and ownership of the production company entity.

Because of its ability to delight, educate and inspire, the entertainment industry has long captivated the general public. Its allure is perpetuated as each generation of talent rises to prominence and producers continue to deliver a stream of blockbuster hits, featuring jaw-dropping effects and an astounding array of compelling stories. As the recent record box office receipts suggest, even during periods of economic hardship, our fascination with the entertainment industry is an unwavering component of our cultural identity. As a result, “Hollywood” is a term we typically associate with the more glamorous aspects of the business.

What happens behind the scenes is often as compelling as, but harder to watch than, the finished product. The effort it takes to complete a single production, let alone coordinating multiple projects, requires specialized skills, experience, equipment and planning that only few possess. The demand for production talent is so great that producers and production companies are often tasked with everything from reviewing treatments to organizing and hosting wrap parties. Given the scope of responsibilities and high expectations, production companies are increasingly looking for ways to maximize their profit for the value they provide.

As they continue to explore ways to enhance profit while expanding into new areas, production companies must strike a better balance between expense management and revenue generation. Exploring the viability of sophisticated legal and tax strategies, as well as alternative funding sources, is an effective method to heighten efficiency and better position the company for future opportunities.

Demographics

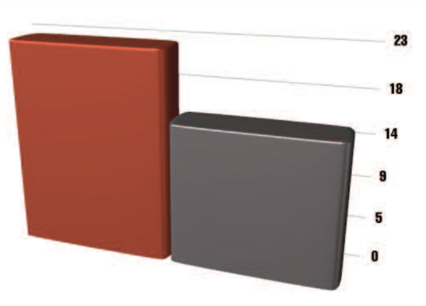
To better understand the unique challenges facing this industry we conducted a survey of 141 production company executives during the first quarter of 2010. The majority, or 60% of respondents, were producers, and another 30% held financial positions within their respective firms (Figure 1). The remaining survey participants were fairly evenly split between creative roles and C-level executives, and held positions such as president, CEO and chairman.

Figure 1: Position at the production company

Creative	5.0%
Financial	29.1%
Producer	59.5%
Other	6.4%

The executives in our survey were seasoned professionals with an average of more than 20 years of experience in the business, and median experience of 15 years. (Figure 2)

Figure 2: Length of time in the business

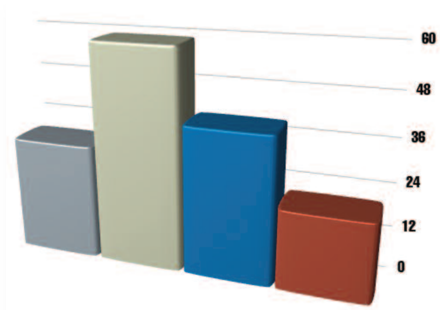


Mean 22.4 years **Median** 15.1 years

Projects

The companies in our survey produced a wide variety of projects. Almost 60% worked on feature films, while nearly 40% cited Internet productions, such as Web-only movies, Web-only serialized programs and promotional initiatives (Figure 3). About 30% of productions were for television, and the remaining 20% of projects included commercials, industrial videos and music videos. Because many respondents were involved in projects in more than one category, the figures below total more than 100%.

Figure 3: Types of productions

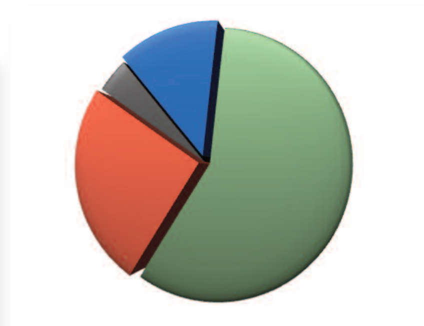


Television	31.2%
Film	58.9%
Internet	39.7%
Other	21.3%

More than 57% of production companies in our survey focused predominantly on mid-size projects, with estimated budgets between US$3 million, and US$10 million (Figure 4). Another one-quarter of projects had budgets between US$10 million and US$20 million, and slightly more than 10% had budgets less than US$3 million.

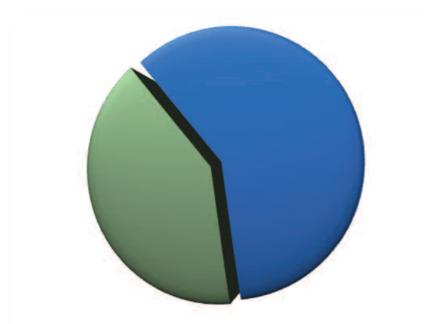
Nearly 60% of the 2010 projects being managed by survey participants are slated to be produced in the United States. (Figure 5).

Figure 4: Average budget of individual projects



$0-$3 million	12.8%
$3-$10 million	57.4%
$10-$20 million	25.5%
$20+ million	4.3%

Figure 5: Percentage of 2010 productions that are US-based



Non-US based 41.1% **US based** 58.9%

Financing

Most entertainment executives agree that securing financing remains central to the success of their organizations. Almost 80% said it is currently a priority, and almost 95% expect it will be even more relevant in the near future (Figure 6).

Obtaining financing for entertainment projects has always been challenging, but difficulties were mitigated by the industry's appeal. Historically, high-net-worth investors would provide equity financing, often realizing that the investment would yield an inferior return. For these individuals, the thrill of being a part of the production was worth the price. Over the years, as the industry has benefited from the emergence of more diverse sources of capital, fewer projects are relying as heavily on primary equity financing. Individual projects often have several investment tranches, each with risk profiles suited to different classes of investors. Coordinating equity, debt and mezzanine financing represents a substantial commitment for production company resources.

"For the most part, the 'Hollywood vanity project' is a relic of the past. Already in decline, high-net-worth investment in the one-off project to gain access to the entertainment industry all but vanished amid a liquidity crunch caused by global economic volatility. High-net-worth investors were forced to reassess investment objectives, shifting toward asset preservation from pursuit of investment returns," said Mark Hutchison, a principal in the Rothstein Kass Family Office Group. "While we are starting to see some renewed interest, the profile of the individual has changed. More frequently, high-net-worth individuals are backing projects not because they believe they will see investment returns, but because they believe in its artistic vision or political agenda. Production companies may find these projects more difficult to finance. If they lack mainstream appeal these projects must be viewed as an inherently risky investment."

Figure 6: The ability to obtain financing is "very" or "extremely" critical to success

Today 78.7% In 3 years 93.6%

Sourcing Capital

In today's environment, production companies rely on a number of sources for financing their projects. According to survey respondents, the benefit from international-, federal- and state-level rebates and tax incentives is considered more important than any other single source of financing. Among capital providers, banks are rated as important sources of financing, with hedge funds and private equity funds also frequently identified as reliable sources of funding (Figure 7). Looking forward, production companies expect funding from these four areas to increase, along with capital from high-net-worth individuals. Pre-sale rights to foreign countries are also seen as an area for exploration. Conversely, financing from studios and other countries is expected to decline during the same timeframe.

"While jurisdictional incentives strongly influence where production occurs, securing foreign investment is still a difficult proposition in many cases. Most investment capital provided by international sources is from corporations. Sovereign wealth funds and high-net-worth sources have been less reliable, partially due to cultural issues. In addition, government restrictions limit capital flows from Chinese investors, while the capital market crisis in Europe and the Middle East have siphoned capital from other emerging sources," said Mr. Hutchison.

In the past, well-managed hedge funds and other alternative investment vehicles often viewed film and television finance as a high-risk component of a diversified portfolio. As its relationship with the entertainment industry evolved, these investors have become more sophisticated in their approach. At the same time, the market demand for enhanced transparency and due diligence could compel funds managing institutional assets to reduce allocations to entertainment industry projects in pursuit of more predictable returns. However, for hedge funds with the appropriate risk profile and investment philosophy, direct investment in entertainment finance remains an appealing option. For these funds, transparency can be elusive. Industry relationships – and working with the right production company – will help to reduce, but can never eliminate, risk.

"The private equity industry, with reserves of capital available for deployment, is likely to become more active in production company finance. These firms will be less inclined to participate on a project-to-project basis and will instead pursue acquisition of income-producing libraries of entertainment properties. Larger hedge funds are also increasingly holding bank debt of production companies seeking outsized returns for limited capital expenditure. In rare instances, these funds may come into possession of valuable entertainment libraries that can help to fund future investments," said Rick Flynn, a Principal in the Rothstein Kass Family Office Group.

Figure 7: "Very" or "extremely" important sources of financing

	Today	In 3 years
Studios	15.6%	9.9%
Foreign pre-sales	17.0%	25.5%
Hedge funds	29.8%	45.4%
Private equity	36.2%	56.7%
Banks	50.4%	58.2%
Wealthy individuals	19.9%	39.0%
Foreign countries	14.9%	9.2%
Rebates/tax incentives	63.1%	85.8%

Securing Talent

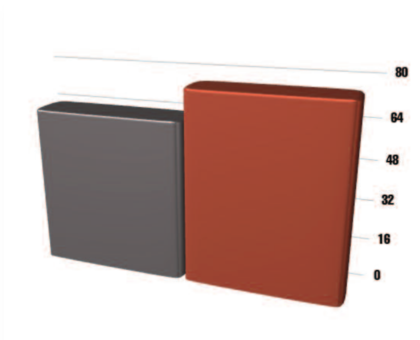
Star power has its benefits, and production companies believe that attaching brand name talent – whether it is an actor, director, producer or writer with a proven track record – to a particular project makes obtaining financing significantly easier, and will make it even more so in the future (Figure 8).

"All sources of capital to the film and television industries – from banks to hedge funds – have been reevaluating their commitment to entertainment finance, and most have reached a common conclusion: they are demanding access to the best projects. No single factor is more important than attaching star power to a venture. Films with uncertain print and advertising prospects are less desirable, and their investors often elect to invest in distribution instead of production," said Mr. Hutchison. "As investors increasingly require access to highly anticipated projects, studios are more frequently looking to syndicate risk by packaging established winners with those with less mainstream appeal."

While it is apparent from survey findings that producers understand the enterprise value that star power adds to a production, past research has clearly indicated that most celebrities are unfocused on the business aspects of their careers. Consequently, many A-list stars fail to recognize and unlock the inherent value of their personal brands.

"Because celebrities typically amass wealth at a younger age, their opportunities for second careers are nearly limitless. However, since their careers often have a limited life span, insufficient attention to advanced planning functions such as estate planning and asset protection can have disastrous results," said Mr. Flynn. "High-profile celebrity implosions offer cautionary tales that have driven the growth of the emerging Celebrity Family Office model that approaches financial, lifestyle and family planning as unified components of an overarching wealth management strategy."

Figure 8:
Name talent is "very" or "extremely" important in getting financing



Today 63.1% **In 3 years** 75.2%

Name talent: i.e., actors, directors, producers, writers.

Business Concerns

Like executives in most industries, those in entertainment must juggle a host of issues that can harm their projects and diminish profits if not handled deftly. Today, the top three concerns are diversifying sources of revenue, owning intellectual property, and managing above-the-line expenses (Figure 9). While most executives still expect to be addressing those concerns in a few years, they also anticipate increased sensitivity to infringements from piracy, ancillary rights from productions, and advancements in certain technologies.

"The digital delivery model commonly employed by film and television production companies has facilitated project management. Unfortunately, it has also supported a new wave of technology-enabled piracy. The film and television industries have developed and introduced a variety of measures to prevent loss resulting from piracy. However, because the profits of these nefarious enterprises are often substantial, the intellectual property thieves continue to operate aggressively and often remain elusive," said Mr. Hutchison. "The entertainment industry is taking a multifaceted approach, combining technological capabilities, a vigorous enforcement agenda and financial deterrents to more effectively combat these criminals."

Ownership of intellectual property rates as one of the most significant factors impacting the business today and is expected to increase in importance over the next three years. As noted, this will cause investors of all profiles to seek to acquire interests in libraries of entertainment properties instead of investing in individual projects. In addition to altering the financing approach, this trend is likely to drive industry consolidation. Well-financed production companies with established distribution channels will more frequently look to acquire entertainment libraries that can collectively produce a relatively steady and predictable stream of income that can be used to capitalize subsequent acquisition of film and television projects.

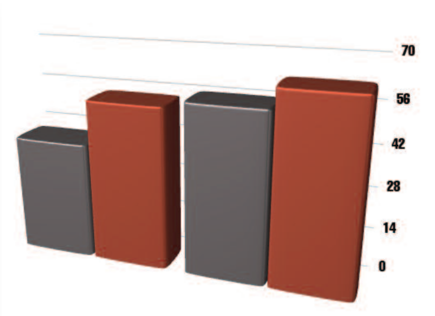
Figure 9: "Very" or "extremely" significant key factors impacting the business	Today	In 3 years
Piracy resulting in meaningful loss of revenues	15.6%	57.4%
Profit splits	16.3%	20.6%
Ownership of intellectual property	59.6%	75.2%
Availability of insurance/bonding	20.6%	28.4%
Strikes interfering with production	6.4%	5.7%
An inability to keep up with technology	9.2%	32.6%
Contractual disputes	14.9%	9.9%
Ownership of rights in products that spin off from productions (i.e., ancillary rights)	31.9%	54.6%
The cost of on-screen talent	53.8%	63.1%
The cost of off-screen talent	14.2%	13.5%
The ability to arrange for co-production opportunities	11.3%	16.3%
Social networking in promoting a production	21.3%	32.6%
3-D technology	16.3%	39.7%
The need to develop new/complementary sources of revenue	86.5%	91.5%

"For individual projects to be successful, it will be necessary for production companies to focus on generating early 'buzz' surrounding the venture to engage key demographic target groups and garner media exposure. Creating a social media strategy remains an underutilized tactic, but one that is rapidly increasing in popularity. Because the impact can be difficult to quantify, production companies are more frequently engaging marketing specialists to support development and implementation," said Mr. Hutchison.

The inception of 3-D programming has the potential to be a game-changing development for the film and television industries. Demand for content already outpaces supply among movie theaters and newly launched television networks. Just how fast this segment of the industry will grow will be determined in part by how quickly the new technology is adopted by American consumers, many of whom have already invested heavily in HD equipment. While this may slow deployment, the trend toward 3-D technology itself seems irreversible, as the unparalleled success of recent event-driven film releases suggests.

Again, having the right actors, directors, producers and writers is always a goal for the integrity of each project, but will take on increasing importance when projecting domestic revenues and expanding into foreign markets (Figure 10).

Figure 10: Name talent is "very "or "extremely" important



	Today	In 3 years
In opening up foreign markets	39.0%	53.9%
Impact on domestic revenues	56.0%	62.4%

"Access to name talent is tremendously important to the success of foreign distribution. For independents, the success of the entire project is often directly linked to revenues from foreign distribution. Because of their capital restrictions, however, these producers are less likely to land a big star in a leading role. With pre-sale business declining, many foreign buyers are waiting to see if a film is successful in U.S. markets before electing to invest in overseas distribution," said Mr. Flynn. "Those productions that are able to sign name talent obviously enjoy a competitive advantage in securing international distribution. However, other companies have achieved similar results by involving international creative talent to appeal to foreign demographics."

Choosing Location

Shooting on location has both advantages and drawbacks that must be given serious consideration by producers and production companies before making a commitment. Today the most important factor is to what degree a specific location will cost the production in terms of housing, catering, per diems, permits and other related expenditures (Figure 11). Next, production companies analyze the kinds of subsidies and incentives they will receive from states, countries and local merchants relative to the overall budget. Looking ahead, those items are expected to be even more important, as is the strength or weakness of the dollar relative to the local currency of a proposed location.

"Currency fluctuations will remain a relatively consistent consideration in project finance over the next three years, and producers have become very adept at managing these concerns. Most production companies purchase currency contracts to hedge against risk," said Mr. Hutchison. "A more volatile factor in the cost of location is the availability of production talent. Film and television productions are specialized endeavors requiring an experienced and certified workforce. The ability to secure a qualified workforce that meets union requirements can be further restricted if several productions are simultaneously drawing from the same regional talent pool."

Figure 11: "Very"or "extremely" important factors in determining location shoots

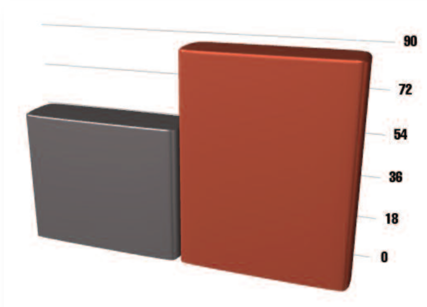
	Today	In 3 years
Incentives	61.1%	57.4%
Subsidies	63.8%	82.3%
Currency fluctuation	46.8%	48.9%
Cost of location	84.4%	87.9%

Personal Financial Returns

More than half of the executives surveyed said that maximizing the personal financial returns of their company's productions is important and will be even more so in three years (Figure 12). Despite that perspective, fewer than 10% are currently employing tax strategies to enhance the value of their investment in the production company, indicating an unmet need and suggesting an area for further exploration (Figure 13).

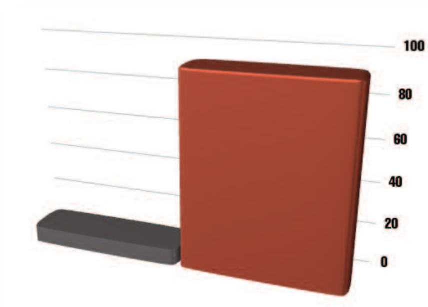
"One effective tactic for maximizing the value of the investment is the use of leverage in project financing. Though leverage ratios have drawn increased scrutiny, leveraged investment in film finance is often the smart money. Equity represents the first money in and the last out, a scenario that is not optimal, particularly for investors seeking greater liquidity. Securing leveraged finance requires a smaller initial investment and creates the potential for superior returns. However, this dramatically alters the risk profile of the investment," said Mr. Flynn. "Sophisticated investors are often comfortable with this trade-off. Their investment in production finance represents a small portion of a diversified portfolio that has been structured to support long-term financial objectives. Working with a family office provider appeals to many high-net-worth individuals involved with entertainment industry risk exposure because of the unified approach advocated."

Figure 12:
The ability to maximize the personal financial returns of productions is "very" or "extremely" important



Today 56.7% In 3 years 87.9%

Figure 13:
Using personal tax strategies to maximize the value of the production company



Yes 7.8% No 92.2%

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About Rothstein Kass

A full-service certified public accounting and advisory firm, Rothstein Kass offers audit, accounting and tax services, and a full array of integrated services, such as strategic business counseling, SEC advisory services and family office services, through its Commercial Services Group. The Firm advises organizations, including public and private middle-market companies, private equity funds, investment advisors and other entities looking for financing / investment opportunities, as well as those looking to restructure as a business strategy.

Recognized nationally as a top service provider in the industry, Rothstein Kass also provides audit, tax, accounting and consulting services to hedge funds, fund of funds, broker-dealers and registered investment advisors through its Financial Services Group.

Rothstein Kass Family Office Group offers a wide range of financial, wealth planning and lifestyle management services to family offices and high-net-worth individuals. Composed of seasoned financial professionals and certified public accountants, Rothstein Kass Family Office Group applies proven expertise with the utmost discretion and attention. Clients include business owners and members of the financial services, entertainment and sports communities.

Rothstein Kass has offices in New York, New Jersey, California, Colorado, Texas and the Cayman Islands.

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