Green Hasson Janks

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2013 Independent Film and Television Industry Snapshot: *New Media*

The entertainment industry is on the threshold of a revolution with implications that reach to the core foundation of its traditional business model. In addition to the ongoing compression of profit margins, the industry is facing a dramatic transformation of technology, consumer behavior, and distribution channels. These changes will require companies to adopt forward-thinking, strategic, and well-organized approaches to their technology and business practices. The advent of broadband and technological advances including downloads, content streaming, and social media illustrate the shift from an entertainment industry based on commodity (CDs and DVDs) to one of immediate experience. The explosion of new media, or on-demand access to content via a digital device (television, computer, smartphone, tablet, or gaming console), has transformed the way filmmakers are doing business.

Independent production companies are no longer limited to making and distributing documentaries and art-house projects. Once considered renegades, many companies of this type are now well-established and well-respected industry players. While the characteristics of each independent production company are unique, there are common business practices and philosophies that distinguish this group from larger studios. Continued concern over the economy, increased opportunities for new media distribution, the need for quality content at lower production costs, and limited financial risk have made independent film production an attractive business model.

Green Hasson Janks recently conducted its first Independent Film and Television Producer Survey. The survey examined the perspectives of independent producers, and analysis reveals that while many are exploring opportunities in new media, many more have yet to tap this exciting avenue.

Results show that the independent film and television industry continues to make modest improvements with an overwhelming majority of respondents reporting anticipated increased revenue for 2013 although numbers of new productions are expected to remain level. Hollywood is considered the global entertainment and media capital, yet America's fiscal crisis has placed the industry in a particularly vulnerable position. As entertainment conglomerates have adopted a global strategy, financing and distribution options for mid- to low-

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budget productions have faced dramatic limitations. Home-entertainment revenues continue to decline with DVD sales becoming progressively marginal. Further, while distribution channels are multiplying, license fees, particularly for independent products, are decreasing.

The outlook for independent productions is promising. Research reveals that independent box-office revenues increased in 2012, thanks in part to the Lionsgate blockbusters The Hunger Games and The Twilight Saga: Breaking Dawn Part 2. It's uncertain whether the independent market will release multiple hits every year, thus it's no surprise that experts predict lower numbers for 2013.

Yet new opportunities have emerged for independent filmmakers. Radical changes in how consumers view media have led to sweeping changes in the marketplace. A film or television show is only as limited as its reach, making new media the ideal opportunity for releasing far-reaching productions. Yet some companies struggle to keep up with ever-changing digital distribution methods. Beyond the technology of distribution, the affordability and accessibility of production technology has further democratized the marketplace for the independent production house.

While a small number of survey respondents are anticipating slightly decreased revenues for 2013, others are more optimistic and predict growth. Respondents cite overall economic conditions, reduced funding sources, increased production costs, and new media as chief concerns for 2013. Angst over financing and cash flow continues to burden filmmakers as do concerns over distributor consolidation, the decline of DVD sales, and piracy.

Looking forward, nearly one-third of respondents who are not currently producing first-run Internet programming plan to do so within the next 36 months. Half of those who are already producing first-run Internet content plan to expand programming over the next three years.

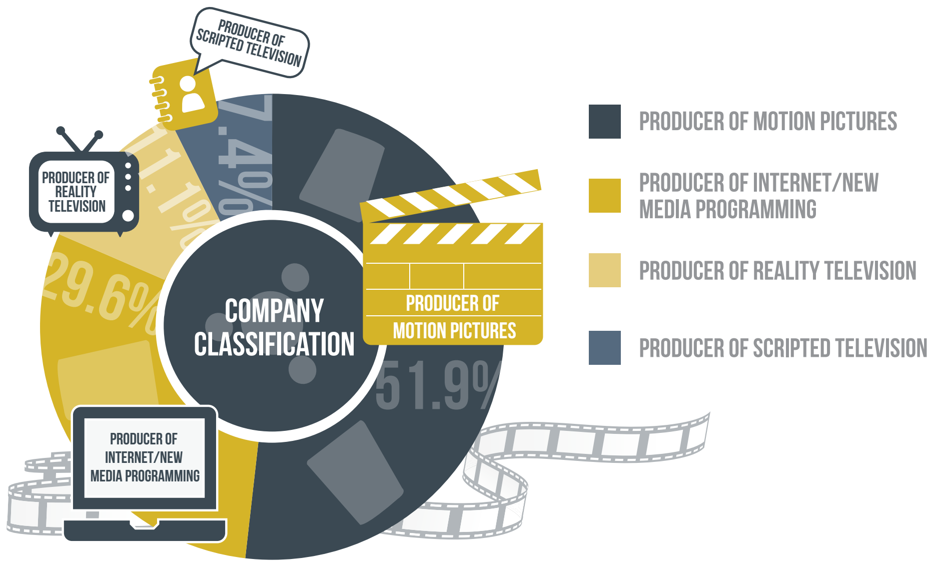
Independent film and television producers are on the precipice of unprecedented industry change. Producers and executives will need to take strong measures to ensure their growth in this tumultuous global economic climate. Careful strategic planning, financial analysis, and a commitment to getting and staying ahead of the technology curve are keys to ensuring the industry's success. This report presents key factors that affected the industry in 2012 as well as a providing an outlook on the industry for 2013 and beyond.

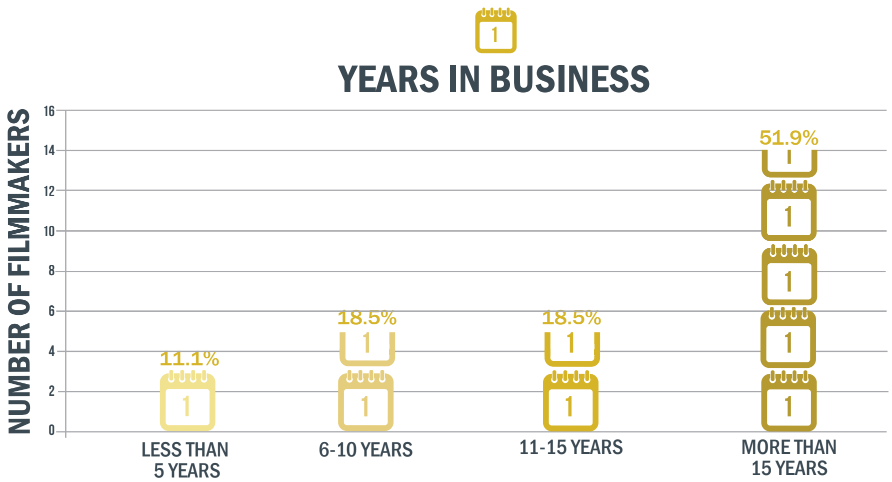
Green Hasson Janks would like to extend its sincere thanks to those who participated in the 2013 Independent Film and Television Producer Survey.

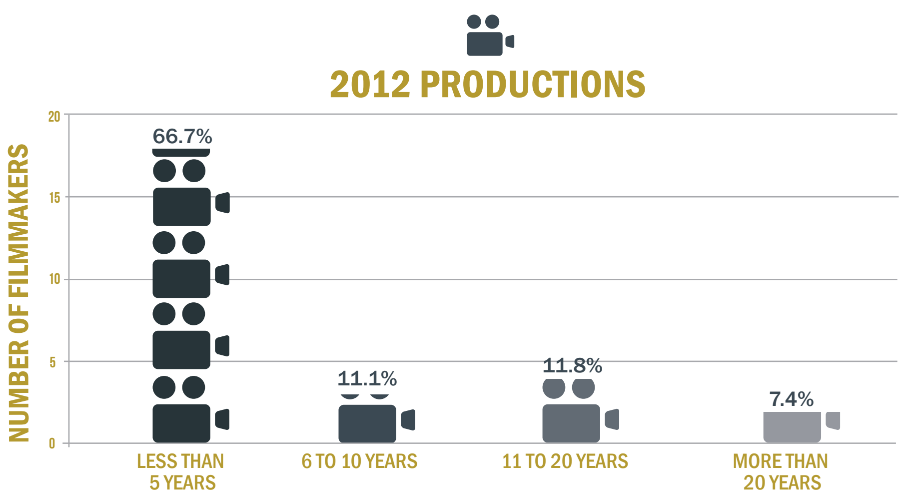
ABOUT THE RESPONDENTS

Green Hasson Janks' 2013 Independent Film and Television Producer Survey respondents came from four key segments of the industry with the overwhelming majority of companies based in Southern California. Most respondents were senior executives or above with the majority representing CEOs and presidents. Producers, directors, and creative directors also participated in the survey.

Respondents report impressive corporate longevity with more than half in operation for more than 15 years and 90 percent operating for more than six years. Most represent smaller production companies with more than half (52.2 percent) reporting fewer than 10 full-time employees. Two-thirds of the filmmakers completed fewer than five productions in 2012 although representatives of larger organizations reported more than 20 productions last year. Survey participants predict identical numbers in 2013. Eight out of 10 (81.3 percent) indicated that the average cost per project in 2012 was less than $5 million. Nearly a quarter (23.1 percent) of executives report that the average 2012 cost per production exceeded $20 million. More than half (61.5 percent) of respondents cite 2012 gross revenues under $10 million, with 77 percent indicating administrative costs of







10 percent or less of 2012 gross revenue. An impressive 26.9 percent grossed more than $50 million in 2012.

BACKGROUND INFORMATION

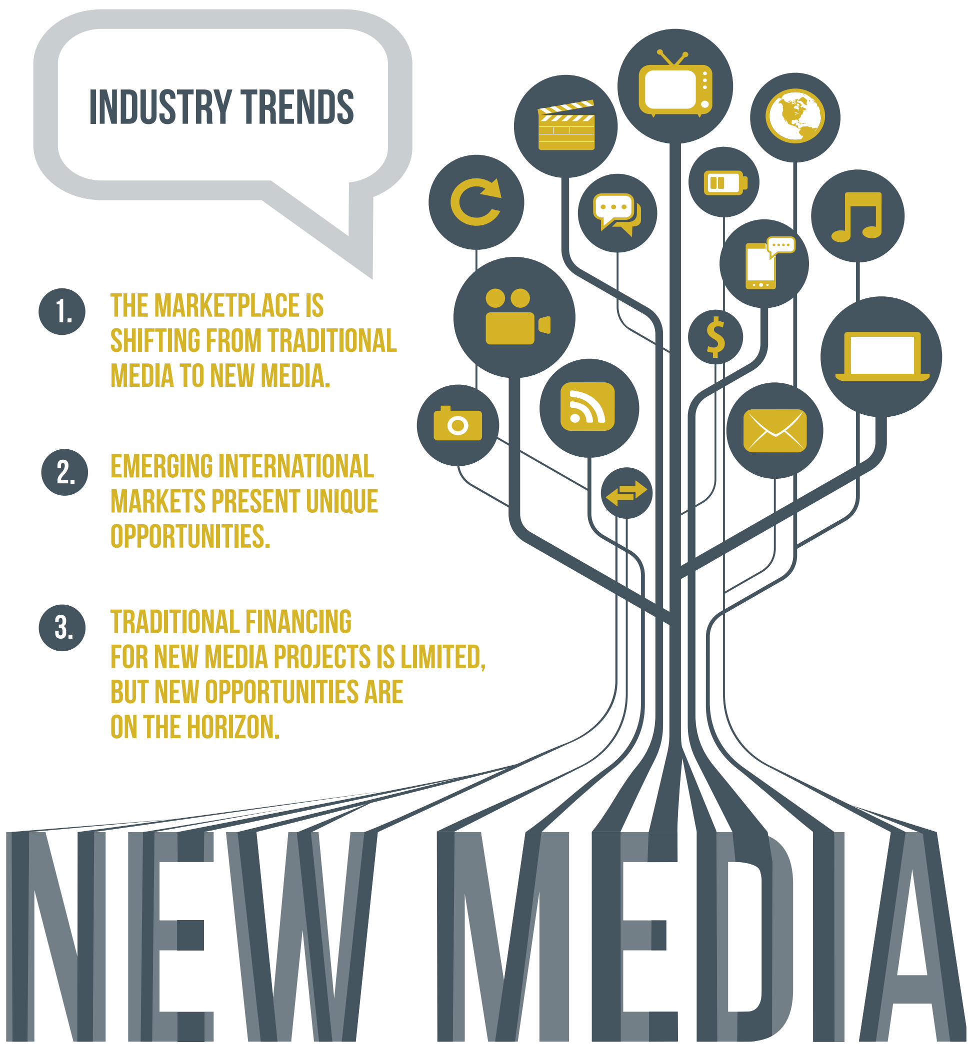
The production and distribution of motion pictures and television programs is one of the nation's most valuable cultural and economic resources, according to research conducted by the Motion Picture Association of America. The MPAA also reports that while unemployment concerns plague most of the country, direct industry jobs generated $43.1 billion in wages and an average salary 38 percent higher than the national average. Further, related jobs and businesses involved in motion picture and television distribution number 365,000. The industry has local, state, and national impact, increasing the tax base by $16.7 billion in sales tax, state income tax, federal income tax, unemployment, Medicare, and Social Security.

Independent film has grown dramatically since its inception. In 1993, independent films comprised 29 percent of the North American box office. By 2002, they represented 35 percent of the box office and have maintained a share of 34 percent or better since that time. [1]

INDUSTRY TRENDS

1. ***The marketplace is shifting from traditional media to new media.*** Today's tech-savvy consumer demands immediate access to content. Experts predict that by 2015 Americans will have more than 850 million Internet connected devices, up nearly 25 percent from 2012. Studies show that new media

is especially popular with millenials who are watching 10 hours less of television each week and 2.5 times more Internet content. This explosion of ad-supported content streaming is evident in the growth of YouTube. In just 12 months, viewership increased 50 percent and advertising is expected to increase by 20 percent by 2014.[2] Consumers are increasingly rejecting paid at-home entertainment experiences for online varieties. In the last year, DVD and Blu-ray sales fell 5.5 percent and rentals dropped 13 percent. However, paid downloads, video on demand (VOD) and subscription services climbed 28 percent in 2012.[3] The growth is expected to continue at a remarkable pace. Experts predict that VOD demand will triple by 2017, with traffic equivalent to the sale of 6 billion DVDs per month.[4] Yet while the demand for new media is clear, the ability to monetize this distribution channel is not proven.



2. ***Emerging international markets present unique opportunities.*** Exploring business outside U.S. borders can be intimidating, especially for small- to mid-sized independent production houses. However, the reward could certainly be worth the risk, according to industry experts. In China, daily online video views doubled in the first half of 2013, making the country an attractive prospect for U.S. new media. China boasts 591 million Internet users, the most in the world, and numbers continue to climb. Mobile Internet usage climbed 20 percent in just 12 months and American movies and television top the list of viewing choices for the Chinese consumer. The Chinese equivalent to YouTube, Youku Tudou, saw a 30 percent climb in revenue during the first quarter of 2013 and boasted 14 million unique daily visitors in June 2013.[5] Naysayers cite an unpredictable Chinese entertainment market as a barrier to international distribution. However, new media enjoys certain benefits including the lack of a quota system, fewer bureaucratic challenges, and lessened logistical issues. Adrian Ward, senior vice president of the Entertainment Industries Division of Pacific Mercantile Bank, agrees that the international marketplace presents growth opportunities. "While there are still macroeconomic issues that cause a cloud, we are seeing improvements in Asia, Latin America, and Russia," Ward reports.

3. ***Traditional financing for new media projects is limited, but new opportunities are on the horizon.*** Ward advises that funding for the entertainment industry as a whole has tightened, with dramatically fewer opportunities for new media projects. "The number of banks funding entertainment has decreased," Ward says, "and traditional lenders aren't funding new media because the projects don't meet minimum loan requirements." Additionally, lower-budget projects may have difficulty securing the completion bonds that are essential for debt-based financing. However, new media has brought a surge of non-traditional funding. For example, distributors may offer

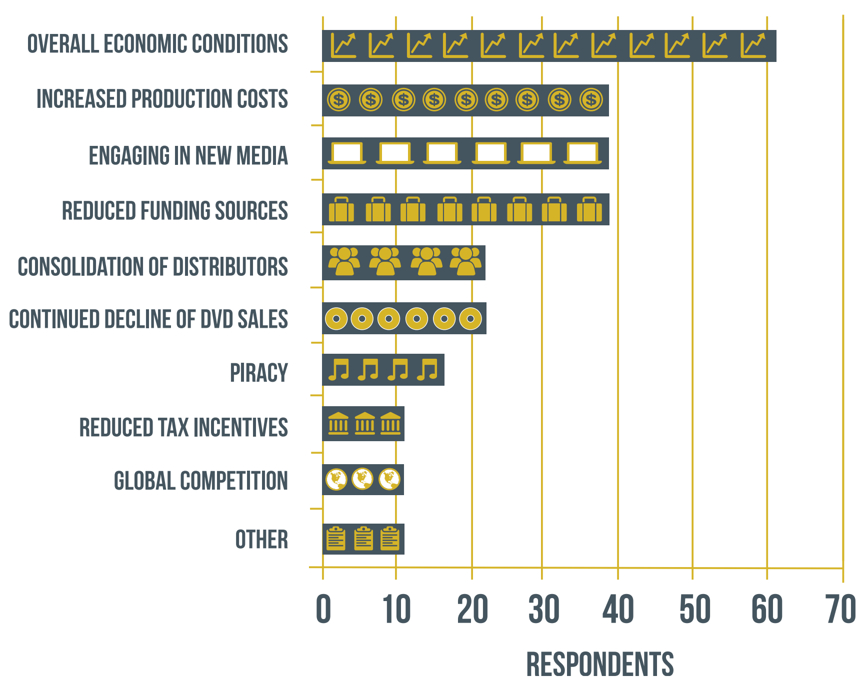
advances to independent producers. At the 2013 Toronto International Film Festival, Vimeo announced that it will offer independent filmmakers a $10,000 advance for direct distribution rights. While this amount won't impact multi-million-dollar productions, micro-budget projects may find new life. New to the marketplace is crowdfunding or collective equity investors solicited online. Crowdfunding sites generated $2.7 billion for more than one million projects during 2012 and the industry is expected to grow to $5.1 billion in 2013.[6] This form of angel investing can supplement the more traditional equity investors, which are often enthusiastic supporters of independent productions. While requirements and opportunities can be difficult to recognize and track, tax incentives may be available for new media productions, according to Marco Cordova, vice president of Entertainment Partners, a firm that specializes in production incentives. "We are seeing increased opportunities for U.S. tax credits specifically in the area of new media," Cordova says. "More and more states are expanding their definition of production for tax credits, and new media falls into many of these expanded areas," he advises.

KEY FINDINGS

Engaging in new media production could lead to company growth. Although industry experts predict that new media will continue to grow at a remarkable rate, not all respondents have not jumped on the technology bandwagon. Supporting the decline of at-home entertainment, 90 percent of executives report stagnant or declining DVD sales. With 70 percent of respondents reporting that their companies have not yet produced first-run Internet programming, there is much room for growth in this emerging industry sector. Of those non-Internet content companies, less than 30 percent (28.6) plan to expand new media offerings within the next three years. Of those respondents who are already producing first-run Internet content, half will expand production over the next 36 months. New media appears to be a category entered into by newer companies. Two-thirds of the respondents with a corporate life of less than five years are currently participating in new media production. While not all companies are pursuing Internet content, nearly all recognize the importance of online marketing. Ninety-five percent of respondents increased online marketing efforts in 2012 and plan to further expand online advertising, web presence, and social-media efforts through 2013.

Unique opportunities exist outside U.S. borders yet the industry is cautious. Survey results indicate that respondents are not taking advantage of the international market, perhaps in anticipation of major houses opening non-U.S. doors. While production levels are expected to remain constant for 2013, half of the executives who filmed in international locations in 2012 plan to continue this effort in 2013. Two-thirds of the respondents have no plans to participate in the Chinese theatrical-production market. Experts agree that Chinese investors are eager to participate in Hollywood and nearly 20 percent (18.8) of respondents plan to co-produce a domestic product with a Chinese-based company. A small percentage (6.3) plan to partner with a major studio to increase international opportunities. While filming in international locations may present unique challenges for smaller production houses, new media distribution could open the door to consumers worldwide.

2013 CHALLENGES



Funding concerns are top of mind for the future. Nearly 40 percent (38.9) of respondents cite reduced funding sources and increased production costs as top concerns for 2013, reflecting an overall concern for the general economy. In 2012, operating cash flow reinvestment, equity investments from institutions, and bank loans topped funding sources, with more than one-third (36.4 percent) of executives citing those sources equally. Respondents expect bank-loan funding to increase in 2013, with 40.9 percent of executives reporting it as a key funding source. Executives also expect funding from production tax credits to grow in 2013, with 36.4 percent of executives citing it as a funding source versus 31.8 percent in 2012. Funding from individual equity investors is expected to climb nearly 7.1 percent in 2013, perhaps reflecting expanded participation in new media productions. While respondents anticipate additional funding from banks, Ward says the traditional route may be difficult for lower-budget productions. "Banks require a completion bond for funding," Ward advises, "and there are currently only two bonding companies and both are less focused on small budgets." It is possible to leverage new media contracts toward equity funding. "Companies are able to monetize deals with Netflix or Amazon and can come to banks on the back end to generate cash flow for their next project," Ward suggests. But for corporate loans, companies should be prepared to produce numbers for at least three years, and that can be difficult for new media startups. Increased government regulation is posing further lending challenges that can restrict available funds. "In addition to three years of financials, lenders may ask potential customers to put up a personal guarantee," Ward warns. The industry is hopeful that the finance industry will catch up to the entertainment industry, recognizing the value of new media production.

GREEN HASSON JANKS STRATEGIES FOR SUCCESS

Companies that want to thrive in the dynamic and volatile independent film and television industry need to commit to four key strategies. While these strategies may require additional resources in terms of time and finances, companies can expect success when they: ***1) Strategic planning 2) Accurate financial records; 3) Use of consultants; 4) Benchmark against others***

1. **Strategic planning.** It is essential to create short-term (six months) and long-term (three to five years) plans. In addition to defining a company's purpose and vision, a strategic plan identifies specific corporate objectives and resources as they relate to the marketplace. While the specifics of a strategic plan may be dynamic, adjusted as situations change, the plan should address high-level initiatives that drive every division of the company. Plans should be reviewed regularly to ensure compliance and allow adjustments as needed.
2. **Accurate financial records.** Incomplete or inaccurate financial statements can lead to decisions that may detrimentally affect the bottom line in addition to restricting or eliminating funding from traditional lending sources. In addition to providing critical operational information, accurate statements are essential for financing.
3. **Use of consultants.** The use of experts when and where appropriate can help organizations reach their goals. Technology consultants can aid in website development, social media integration, and data analytics. Marketing consultants can help develop strategies for branding and advertising. Industry experts can offer up-to-the minute advice on constantly changing production incentives. Financial consultants can assist with strategic planning, budgeting, risk management, financial reporting, and taxes. Additional information on government compliance, including

Patient Protection and Affordable Care Act (PPACA) requirements, will be essential to industry executives over the next year. Tax experts may provide cost-saving advice on maximizing tax credits for research and development as well as hiring from a variety of qualified groups.

4. **Benchmarking.** Benchmarking enables companies to compare business processes and performance, recognizing best practices from success stories or failures. Benchmarking may take place during a seminar, conference or smaller peer-group gatherings. Information may also be garnered by reading trade periodicals. An open dialogue with competitors can help expose emerging trends, underserved markets. Areas benchmarked may include processes, finances, performance, products, strategy, and operations.

Benchmark your processes and performance by creating an open dialogue with competitors to expose emerging trends.

SUMMARY AND CONCLUSION

In the rapidly expanding industry of independent film production, filmmakers are cautiously optimistic. The dramatic growth of new media has opened doors for an increased demand for independent projects. Companies that have not jumped on the new media bus need to embrace new technology and distribution methods or risk being left behind. In addition to delivering relevant content that keeps pace with the desires of today's consumer, companies need to ensure that their business practices and financial record-keeping will allow for financing when it is needed most. Further, by employing the aid of specialized consultants, companies can navigate the complex areas of tax incentives, regulations, and contract negotiation. The entertainment industry is one of hope, and the outlook for its future has never been brighter.

"The dramatic growth of new media has opened doors for an increased demand for independent projects. Companies that have not jumped on the new media bus need to embrace new technology and distribution methods or risk being left behind."

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2. Helft, Miguel. "How YouTube Changes Everything." Fortune (2013): 53-60. Print.

3. http://www.bloomberg.com/news/2013-01-08/u-s-home-entertainment-spending-dips-1-5-on-falling-dvd-sales.html

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Ilan Haimoff

Ilan Haimoff has over 18 years of accounting experience in public accounting and private industry serving clients in the entertainment and other industries. Ilan leads the Entertainment Practice and his specialty includes profit participation audits on behalf of talent, investors and co-producers at both the major and mini studios. Ilan currently oversees participation audits at various studios as well as the royalty and litigation support department.

Prior to joining the firm, Ilan was the Chief Audit Executive at large private companies where he oversaw companywide anti-fraud programs and the execution of annual internal audit plans, including third-party audits. Ilan's public accounting experience includes Big Four firms where he assisted organizations with performing risk assessments, internal audit reviews and process-improvement projects. He has worked on various forensic accounting, due diligence, and other agreed-upon procedure engagements on behalf of banks and investors, providing financial due-diligence analysis in connection with mergers and acquisitions. Ilan has written various articles and is a regular speaker focusing on internal controls, anti-fraud, profit participation and royalty.

Ilan leads the Entertainment II ProVisors group and is a member of the Professional Advisory Committee of the Motion Picture and Television Fund, the Advisory Board to the Los Angeles Chapter of the Licensing Executive Society, the Beverly Hills Bar Association Entertainment Division, the California State University Chancellor's Advisory Council on the Entertainment Industry, the Institute of Internal Auditors, and the Association of Certified Fraud Examiners and the AICPA.

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Steven is an attorney, CPA, Certified Fraud Examiner and Certified Financial Forensic. He has been a featured speaker at the California Society of Certified Public Accountants and New York CPA Foundation, as well as the UCLA and USC film schools. His published works include Profit Participation in the Motion Picture Industry, Los Angeles Lawyer, April 1989; Participants in the Motion Picture Industry, Entertainment, Publishing and the Arts Handbook, 1987; and Movie Money: Understanding Hollywood's Creative Accounting Practices, 1998 (2nd edition published in 2006).

About Green Hasson Janks

Founded in 1953, Green Hasson Janks is one of the oldest independent accounting firms on the west side of Los Angeles. Ranked as a top-20 largest accounting firm on the Los Angeles Business Journal's Book of Lists, the firm has 13 partners and approximately 100 staff members that serve over 3,000 clients.

The firm is a member of the American Institute of Certified Public Accountants (AICPA), the AICPA Governmental Audit Quality Center (GAQC), the California Society of CPAs, the California Association of Nonprofits (CAN), and the Public Company Accounting Oversight Board (PCAOB).

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