Hedge Funds Boost Hollywood Budgets

By Lindsay Palmer

10-12 minutes

Despite huge differences in genre, budget, and profit, *Avatar* and *The Devil Wears Prada* have one key thing in common: Wall Street hedge funds footed at least part of the bill for James Cameron's 2009 science fiction hit as well as David Frankel's 2006 fashion flick, pointing to a financial trend that started with the entertainment industry's corporate mergers of the '80s and '90s and exploded in the first decade of the 2000s.

To be sure, investment methods in Hollywood films have changed over time, shifting from traditional financing deals that initially operated on a movie-by-movie basis to a new set of strategies geared toward funding entire slates of Hollywood films, each with varying levels of potential profitability. Wall Street investors have not only cultivated a deep relationship with Hollywood that officially dissolves the distance they famously kept until the 1980s, but they have become major players in many of Hollywood's most current big hits.

What led this group to invest their time and money in one of the riskiest of businesses? More importantly, do these risks pay off, and for whom?

Here are five things you need to know about Hollywood hedge funds:

1. Hollywood hedge fund "slate financing" developed in the 1990s when Wall Street investors were seeking new markets and studios were seeking new funding sources.

2. Slate financing supports a group — or "slate" — of films, which are usually a mix of sure-fire hits and less likely successes, and the investor receives a cut of the profits of each film in the slate.

3. Slate financing has significantly impacted the structure of Hollywood.

4. While slate financing has become a norm, its efficacy has proven inconsistent.

5. Hollywood hedge funds have diversified the types of investors in Hollywood productions.

1. Hollywood hedge fund "slate financing" developed in the 1990s when Wall Street investors were seeking new markets and studios were seeking new funding sources.

Corporate buyouts of the Hollywood studios in the 1990s set the stage for shifts in Hollywood financing tactics. When media conglomerates Viacom, Time Warner, and NewsCorp rushed to purchase the major movie studios, the result was a changed environment for moviemaking. Movie studios became small sections of enormous corporations, only minimally profitable and therefore less regarded than more lucrative arms of these expansive media companies. Corporation executives pressured studio bosses to generate hits but refused to provide the growing amount of funding necessary to produce and market a blockbuster movie. Studio producers needed to find new funding sources.

Around the same time in the late ’90s, interest rates were low and the stock market was sluggish, so hedge fund guardians were seeking new markets in which to invest money that was otherwise going nowhere. Wall Street investors began to look into the possibility of diversifying their portfolios by channeling more of their increasing capital from hedge funds into Hollywood. With the assistance of private equity firms, this new generation of financiers began guiding studios toward slate financing arrangements, which, for investors, maximized investment potential and minimized risk. For studios, slate financing meant more films would now be funded and made.

Further reading:

Schatz, Thomas. “Film Industry Studies and Hollywood History.” In *Media Industries: History, Theory, and Method*. Edited by Jennifer Holt and Alisa Perren. Oxford: Wiley-Blackwell, 2009.

Sear, Edward. “Why Hollywood Turned to Securitization.” *International Financial Law Review* 25.4 (2006).

Young, S. Mark, James J. Gong and Wim A. Van Der Stede. “The Business of Making Movies.” *Strategic Finance*(February 2008): 26-32.

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Rather than footing the bill for one movie at a time as per traditional financing, hedge funds can provide enough money to help support a range of films, which are put together in a slate. A slate is usually comprised of at least one potential blockbuster, plus several other films of varying profit potential.

Relativity Media Logo

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After a slate of films is selected, investors contribute funds with the understanding that the studios take a 12 to 15 percent distribution fee before splitting the profits with their financiers. Studios also typically retain worldwide distribution rights. Both of these factors ensure that such co-financing deals will still be profitable for studios, though investors were also protected in a few important ways: For one, investors can be less concerned about box office flops; since they were backing entire slates of films, each film can perform on its own merit without risking the entire investment amount. Secondly, investors receive a cut of the actual profits brought in by each film on the slate. Even if this share is substantially smaller than that raked in by the studio and its parent corporation, there is always potential for considerable investment gains, especially with blockbusters.

Since the early 2000s, most slate financing has loosely adhered to a 50/50 split: a hedge fund supplements approximately half of the production costs of a slate of films and the studio finances the rest. Another type of deal, such as the high-profile effort launched by Relativity Media with Sony and Universal in 2006, allocated a set amount of capital that was split between two studios and two sets of slates.

Further reading:

Cones, John W. *Dictionary of Film Finance and Distribution*. Spokane: Marquette Books, 2008.

Epstein, Edward J. *The Big Picture: The New Logic of Money and Power in Hollywood*. New York: E.J.E. Publications, 2005.

3. Slate financing has significantly impacted the structure of Hollywood.

Not only has slate financing enabled the production of films that may never have hit theaters otherwise, what's become a complicated network of collaborative filmmaking has fundamentally changed the structure of Hollywood, introducing a number of new independent studios that are now producing lucrative films.

One example is Catch 22 Entertainment, a production, distribution, and marketing company fully independent of the major studios and launched by long-time financing consultant Anthony Millan. Catch 22 is partially financed through hedge funds, but it also benefits from Millan's considerable prior experience consulting for studios such as Lionsgate, Voltage Pictures, and Relativity Media. Similarly, Relativity transformed itself into an independent studio after years of advising the big studios on how to optimize Wall Street capital and offering its own financial muscle. Argonaut Pictures, Mimran Schur Pictures, and Overnight Productions are also among the ranks of hedge-fund supported independent studios. These studios have set their sights on lower-budget films much like those successfully produced and marketed by the major studio independents, such as Fox Searchlight.

Further reading:

Gardner, Eriq. "How to Beat the Indie Financing System." *Hollywood Reporter* (September 23, 2010).

King, Geoff. *Indiewood USA: Where Hollywood Meets Independent Cinema.* London: I.B. Taurus, 2009.

"New Shingles, Fresh Fixes: Fledgling Firms Rewrite Rulebook for Film Funding." *Variety* (November 7, 2010): A1.

4. While slate financing has become a norm, its efficacy has proven inconsistent.

The rise of the new independent studios points to the complicated ways in which outside investment in Hollywood has been both a failure and a success. For the big studios, slate financing has helped increase capital and reduce risk. But it can also diminish their returns on films as more investors receive portions of the profits. The deal structured by Relativity Media in 2006 that allocated $400 million to Sony and $200 million to Universal did not result in a higher box office performance for Universal, so Relativity ended up losing around $20 million in revenue and Universal did poorly that year overall. Still, Relativity's net gains have been such that it has remained a leader in this new era of film financing, now producing its own films and even developing a coveted formula espoused to predict a film's success.

Significantly, the 2008 financial crisis hit Wall Street investors and the movie business hard, resulting in a mass exodus of hedge fund investors from Hollywood. Still, the failure of some slate deals has led to the success of others, as more and more slate deals are being sold to new investors at a discount. Similarly, the newer, ambitious independent studios are comfortable producing smaller budget films, which have the potential to yield huge returns.

Further reading:

For a look at the effect of the recession on hedge fund fanancing read this story on stockmasters.com

5. Hollywood hedge funds have diversified the types of investors in Hollywood productions.

Even as some hedge fund holders withdraw from Hollywood or sell their deals at a discount, other Wall Street investors are bolstering the efforts of the successful independent studios, as well as setting their sights on fresh aspects of the entertainment business. Some have begun putting their money into talent agencies, attempting to capitalize on performers' earnings, rather than losing money on their failed films. In turn, talent agencies themselves are diversifying, financing films or operating as corporate consultants, such as for tie-in products, or financing. Consequently, hedge fund managers now seem to believe that agency investments offer better and more consistent returns than motion pictures themselves. There has also been a surge in financing flowing into Hollywood from investors based in nations outside the U.S. and Western

Europe: A rich source of film financing during the past decade has come from investors based in India, Abu Dhabi, and Dubai. In other words, the financing of Hollywood productions is becoming remarkably varied, raising intriguing questions about who "owns" Hollywood, where Hollywood now "exists," and how this increasing diversity of players will impact movie-going in the years ahead.

Further reading:

Arango, Tim. "Abu Dhabi puts More Cash on the Line in Hollywood." *The New York Times* (September 3, 2008): C1.