Show Them the Money!

The strength of the independent film scene here and abroad promises continued strength for film bonders.

By Josh Chetwynd

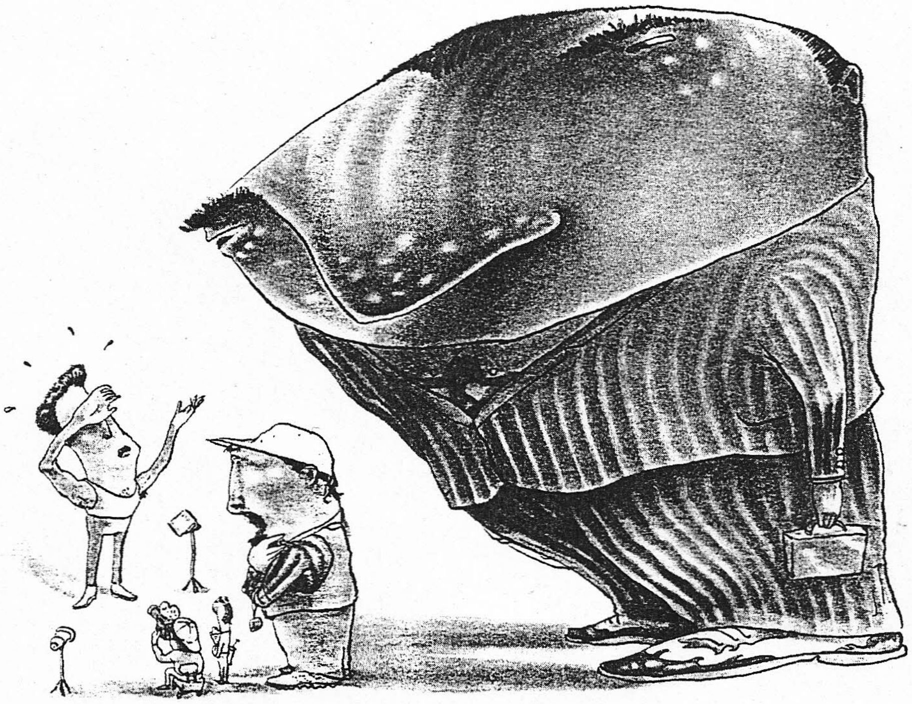


ILLUSTRATION: J. T. STEINY

Stable and *mature* are the two best words to describe the current environment in the completion-bond industry. And with the industry coming off a banner year for the independent film scene, the future looks bright for the sector's money-hugging heavyweights, even if the hustle for new business is as alive as ever.

"The industry is more stable now not just in terms of the actual business but in terms of the companies that are doing the business," says Lionel Ephraim, president of West Coast operations for the Motion Picture Bond Co. (MPBC) "All four that are in the business (MPBC, Cinema Completions International, Film Finances and International Film Guarantors) seem to be doing OK without unduly treading on each other's toes."

Last year's much-hyped "Year of the Independents" saw a healthy supply of midbudget films from midsize production companies, the core of the bonder's business. Epitomized by Academy Award juggernaut "The English Patient," these films — just under the radar of the self-bonding studios and just above the no-budget scene — have begun to prove that their boxoffice strength can match their traditional critical kudos. That in turn promises to increase the number of players in the independent-film marketplace and the amount of money available to fund them — both of which mean good times ahead for completion bonders.

With more players, of course, come more opportunities for risks. But 1996 saw only one significant bonding crisis, Fine Line's "Love! Valour! Compassion!" when a late change in the lead role (Jason Alexander stepped in for Nathan Lane) caused delays in production.

And unlike in past decades — when a bonder might set pricing by looking a producer in the eyes to gauge his reliability — companies today are increasingly using more sophisticated ways of performing due diligence.

"What is happening is that companies are becoming smarter and using more market intelligence to make determinations," says David Davis, senior associate in the entertainment and communications media group at Houlihan Lokey Howard & Zukin. "In the past, some companies have used the law of averages, but now most are using science and quantitative analysis to determine pricing."

Still, as the preparation becomes more complex, two simple questions remain paramount in the industry: Where are the emerging markets, and how can we rustle up new business?

The good-news answer is that gap (or bridge) financing remains a popular and growing source for financing films. With a reduced flow of capital funding for lower-budget projects, independent filmmakers have been forced to rely on banks to lend the "gap" between the amount of money the producer has and the amount he or she needs to complete a movie. Expected revenues from unsold territories are then used as collateral. Banks may cover up to 30% to 40% of what is needed to make the film, but the borrowers are charged a significantly higher up-front fee than they are for sales-backed loans and must cede a share in the project's adjusted gross sales.

Although this type of financing has been around since the 1980s, its popularity had diminished until recently because of the failure of some general entertainment deals underwritten by Credit Lyonnais. In the past few years, however, banks have turned more frequently to this lending option, which means there is a greater number of independent films for bonders to cover.

"Gap financing is continuing to grow," says MPBC's Ephraim. "It is probably the biggest single thing to happen to the industry."

So bonders must grapple with the added intricacies of complex financing.

"(Gap financing). has definitely increased opportunities," says Joan Stigliano, president of International Film Guarantors (IFG). "But it makes bonded delivery more challenging because you have to make certain assumptions about the deal that you don't have to make" when a filmmaker doesn't have to rely on unsold markets to cover the cost of the film or if there is a single source of funding.

The international market is another strong area for bonders. Each of the major companies has worked to branch out into bonding foreign films. Even with the supply of government-backed subsidies that often go into the making of those movies, most see overseas opportunities as a valuable way to increase bottom lines.

"The film industry is a global village," says Tekla Morgan, executive vp and COO for Cinema Completions International (CCI). "The basic features of the film-financing structure don't change much regardless of the foreign element involved."

Business outlook: Big-budget TV miniseries such as NBC's "The Odyssey" (left) represent new opportunities for bonders, while the success of indie film "The English Patient" (above) shows the strength of bonders' core business.

The small screen remains an intriguing long-term source of business as well, both from increasingly popular big-budget event miniseries such as NBC's "The Odyssey" and from the cable industry, where programmers hungry for viewers are looking to put hundreds of millions of dollars into original productions that can have an afterlife in syndication and home video. Both markets represent a small but significant slice of the overall bonding pie that has potential to boom.

"There are a lot more channels, and each of those channels is ordering movies" that bonders can cover, says Steve Ransohoff, executive vp for Film Finances. According to figures assembled by The Hollywood Reporter at the National Cable Television Association convention last March, major cablers expect to spend in excess of $1.6 billion on original programming.

Other once-promising new markets seem to be going nowhere.

Big-budget, live-action interactive games — heralded only a year ago as an emerging market for bonders — have not panned out as expected.

"We got more inquiry on interactive stuff last year than this year," says IFG's Stigliano. "I don't see that the market has matured yet to need the type of financing (we offer)." Adds Ephraim: "The interactive markets are emerging now, and it keeps being possible. But it is not moving as fast as one might have thought." And even if the interactive game market does grow to the point of needing completion guarantees, it doesn't appear that it will become a big moneymaker unless budgets increase. Currently, most computer-game budgets run between an estimated $1 million and $1.5 million. Until games become more complicated, which should lead to higher costs, bonding interactive work will not prove to be a valuable profit generator.

But the discouraging prospects for the interactive-game market are not the only source of disappointment. The bad news for bonders is that, overall, the movie market doesn't seem to be growing, and profit margins are actually ebbing. "In all areas of the film business, there has been a squeeze on profit," says analyst Davis. "[Though] there was a 30% return on profit as a whole 10 years ago, now it is lower than 10%."

Even with these current hurdles the four major companies are each optimistic about their spot in the world of completion bonds. Following is a look at each of these companies and how they approach what Davis refers to as still a highly competitive marketplace.

Cinema Completions International

One could argue that CCI's mantra is that bigger is better. Instead of focusing on guaranteeing a broad slate of smaller-budget films, CCI has bonded a small number of big-budget movies — a total of 18 films whose combined budgets total just under $500 million over the past two and a half years. Among the big-name movies for which CCI has guaranteed completion are the Oscar-winning "The English Patient," "Marvin's Room" and "Flirting With Disaster." CCI has not had a single claim to date.

"The market is certainly not growing," says CCI's Morgan. "The number of projects has diminished. But to the extent you can (bond) the bigger films, you can still make your numbers."

Morgan estimates that if her company bonds several $75-million projects, it brings in the same amount of money as it would doing six $12-million movies. The difference is that by doing fewer movies the company

Tekla Morgan
Cinema Completions Intl.

Steve Ransohoff
Film Finances

Lionel Ephraim
Motion Picture Bond Co.

Donna Smith
Entertainment Coalition

has less exposure to loss. The company has done only a handful of films budgeted at $3 million and below.

The main reason why the company can take on big pictures is its hefty backing.

CCI was launched in 1994 as a joint venture between Aon Entertainment Ltd. (now known as Entertainment Managers Insurance Services, Inc.) and CNA Insurance. Last year, it became the third leg of a new management company, Entertainment Coalition (EC), though it operates independently under the EC umbrella. Aon Corp., which is the parent company of Entertainment Managers Insurance Services, Inc., is a $3.5-billion insurance and financial services holding company, and CNA is a $60-billion commercial lines insurer. CCI has the autonomy to bond any film with a budget up to $75 million.

Although the number of high-priced independent features appears to be decreasing in recent years, Morgan is confident that CCI will continue to snag enough of the big-budget features to keep her company on solid ground. "Because we've proved ourselves on quite a few bigger (films)," Morgan says, "we are firmly established."

Film Finances

Taking the opposite approach from CCI, Film Finances' executive vp Steve Ransohoff believes that more is better. Ransohoff estimates that of the 350 movies (give or take 10%) worldwide that require completion bonds each year, Film Finances bonds about 225 of them.

The company, which is the oldest of the top four companies, with 1951's "The African Queen" being one of its first films, generally handles projects in the $4-million to $10-million range. It also does a number of films with budgets of up to $45 to million. In fact, in recent years, Film Finances has increased the high end of budgets it can cover and is now capable of bonding film budgets of up to $60 million.

International markets, which make up a substantial part of Film Finances' work, have been "robust," says Ransohoff, who oversees offices in Italy, France, England and Canada. Television has also proved to be a growing area for the company. Ransohoff estimates that Film Finances is doubling its business on TV miniseries and movies each year. At this point, he says, the company is doing about $100,000 in budgets a year.

An area that has proved somewhat disappointing is interactive games. Last year, Ransohoff estimated that there could be as many as 700 to 800 interactive projects a year 10 years from now. He now believes that projection was premature. "It's not going as quickly as we had hoped," he says. Still, Ransohoff remains cautiously bullish on the multimedia market. Thus far, Film Finances has done four projects and has three in the works, including a couple in the multimillion-dollar range. He posits that if Film Finances can get seven or eight projects bonded a year, then as the budgets of interactive games rise it will "become a considerable business." Adam Moss, a vp at Film Finances, is "plugged into the community," says Ransohoff, giving Film Finances a strong beachhead should the interactive industry experience growth.

International Film Guarantors

For IFG, the most important element to success is cultivating loyalty. Although IFG's Stigliano estimates that up to 25% of her business comes from truly independent filmmakers with no backing from a studio, it is the other 75% that will assure the company will survive in lean years.

"It is a very good time right now, but it is never sustainable," says Stigliano. "There is always something that is going to happen."

Whether that something is a loss or a dearth in the number of completely independent productions, the way to survive is having good relationships with established moviemakers.

"What we try to do is negotiate for a block of business with a client who has the means to produce more than one film a year," she says. A perfect example of this strategy has been IFG's relationship with Morgan Creek. IFG has covered everything that company has produced since 1993.

IFG has the flexibility to cover just about anything because the company is backed by Fireman's Fund, which allows IFG to bond films with budgets up to $75 million. Still, most of IFG's business is within the $10-million to $30-million range.

In considering the overseas market, Stigliano calls the United Kingdom "a very exciting market," where IFG has been active. With money from that country's lottery being used in part to fund the arts, there are more movies to bond. Also, unlike in the United States, where studios will bond themselves, "the industry is not self-bonded by virtue of the fact that there are no studios there," she adds.

The Motion Picture Bond Co.

A solid domestic slate and an aggressive attitude toward overseas markets have been key in MPBC's approach to the industry.

The average movie bonded by the company is in the $10-million to $15-million range, with a majority of its work being on films with budgets of less than $30 million.

West Coast president Ephraim says the company doesn't have a specific cap and would go up into the $40-million range if the project were right, but he adds that the situation would have to be ideal.

"It is part of a comfort level," Ephraim says. "In the bigger pictures there are sometimes attachments, like if there were a lot of experimental special effects, that would make it less comfortable for this bonder. That is why it is on a picture-by-picture basis."

To augment business, MPBC has worked hard to be a strong player in the international market. It has done business in Australia, the Pacific Rim and Europe. Recently it enhanced its presence in the United Kingdom by bringing in Ian Lewis, an experienced producer who is the head of that country's Guild of Film Production Executives, to run its United Kingdom office.

"The world seems to be opening up," says Ephraim. "There are productions everywhere now." MPBC has even bonded a number of Chinese films.

Ephraim observes that, as in the United States, creating long-term relationships with foreign producers is the best way to maintain overseas business. He believes that his company's long-standing involvement with foreign film gives MPBC an advantage.

"If you have worked with a director or producer overseas before and you have a good relationship," he says, "they will be in a position to tell others how good you are." ❑

Risks & Rewards

Insurers look to new coverage schemes to ensure the show goes on.

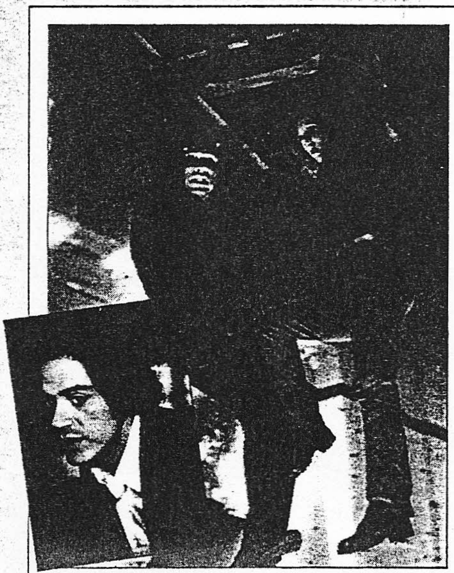
Film insurance normally covers on-set accidents or weather damage, but now add jail time and drug use to that list. And in an effort to continue to service the needs of the industry, insurers are coming up with specialized policies to assure that the cameras roll with the artists the filmmakers want to use.

The plight of actor Robert Downey Jr. serves as the example of how far insurers are willing to go to help out studios. After multiple drug-related arrests, Downey sought treatment and was back on the set for several low-budget films, including "Two Girls and a Guy" and "The Gingerbread Man." But when it came time to do his first big-budget studio film, Warner Bros.' "U.S. Marshals," a sequel to 1993's "The Fugitive," a special policy had to be fashioned in case Downey got in trouble with the law again.

The Entertainment Coalition, a management company coordinating insurance services for CNA and Entertainment Managers Insurance Services, Inc., was willing to take on that responsibility. The expensive policy, which reportedly cost in the low to mid six figures, protects against another arrest — drug related or otherwise.

"The background with Robert is he has to become rehabilitated from the court's point of view," says Donna Smith, a former studio exec who is the president and CEO of the Entertainment Coalition. "But we believed he was somebody insurable for a high amount."

This was the second time recently that Entertainment Coalition stepped up to create a unique policy to cover a star. Courtney Love, who had a history of drug use, was also insured by the company for an estimated $750,000 for her work on last year's "The People vs. Larry Flynt."



Insurers are doing their best to work with filmmakers to allow them to choose the actors they want. New digital technologies, while promising to reduce risks on stunt work, have yet to make an impact on insurance rates.

Although the risk is higher in such situations, Smith says it is important to get involved "because we are here to help the motion-picture industry, and we want very much to make sure an artist can work."

These health and life-style issues are nothing new to Hollywood insurers, who have always been concerned with the health of older stars. Burt Lancaster is one who lost the starring role in "The Old Gringo" because he was considered too old to get insurance, and Walter Matthau, who has a history of heart problems, had to pass a series of medical tests before he was covered for this summer's comedy "Out to Sea." But as tough as they may have been, insurers are adapting to the changing landscape of filmmaking.

"Insurance companies and bond companies are trying to be part of the Hollywood community, and they have become more sensitive to the particular situations that talent can be involved in," says David Davis, a senior associate at Houlihan Lokey Howard & Zukin. "Insuring a particular client to not only go on with their career but also get rehabilitated shows sensitivity."

Of course, the bread and butter of insuring actors — especially on larger studio films — is when stunt work is involved. Though safety wires and other measures taken to ensure a stuntperson's safety on the set can be used and then, in postproduction, erased by the filmmaker with the new digital technologies, all the insurers polled agreed that such measures are not really having an effect on the bottom-line price of personal-injury insurance. If you get hurt, you get hurt. Though it may be less likely now, the risks still exist.

For the future, a recent Price Waterhouse report predicts that high-tech "synthespians" — the computer-generated actors already being used as stunt doubles in physically impossible sequences for such films as this summer's "Batman & Robin" — will soon become a Hollywood force, ushering in a risk-free age in moviemaking. But most insurers are skeptical about such a future, and most filmmakers will readily assume the "risk" of real actors to get the rewards.

—J.C.