Hollywood investors wary of economy, past mistake

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By Sue Zeidler - Analysis

LOS ANGELES (Reuters) - Investors seeking riches in Hollywood are finding out why the movie capital is called Tinsel Town -- all that glitters is not gold.

After pouring $15 billion into recent film deals, some investors have taken losses and many are demanding that film studios change how they structure the projects. Roiling credit markets have scared many away from untraditional investments, while some investors say studios treated them shabbily.

In recent years, hedge funds flush with cash were drawn to Hollywood deals amid projected double digit returns. But both Hollywood and banking executives say several of the deals over the past few years wound up costing investors hundreds of millions of dollars in losses.

"A lot of hedge fund money has come into Hollywood in the last two years and some deals haven't panned out," said Eileen Burke, a managing director at investment firm D.B. Zwirn & Co.

The funds, partnered with big investment banks, often backed studios in transactions known as movie slate financing deals, taking on some risks formerly absorbed by studios in return for a share of profits from films in the slate.

By 2006, many studios such as Sony Corp 6758.T, Viacom Inc's <VIAb.N Paramount, Time Warner Inc's (TWX.N: Quote, Profile, Research) Warner had lined up these deals.

"In 2004, slate financing really began in earnest and has met with a variety of results. With every kind of transaction, there are lessons learned. It's an evolving model," said Laura Fazio, managing director at Deutsche Bank.

But after some films flopped, investors complained that studios were tilting terms to favor themselves over the funds and putting less than certain projects in the slates, while keeping sure hits to themselves.

Bankers and financial experts say new film financing deals will carry more stringent terms to better protect the backers.

"The credit crunch is making people more reluctant to risk money. You'll see stiffer terms presented to studios," said Harold L. Vogel of Vogel Capital Management in New York.

Fazio agrees changes are ahead.

"We're at the brink of a different type of model. There's recognition there needs to be some additional strategic angle for investors to achieve the returns desired," Fazio said.

In some cases, studios such as Sony have adjusted terms to please investors.

Sony reconfigured the terms of its revenue sharing arrangement with investors after some films such as "Stranger Than Fiction," part of a $600 million slate deal known as Gun Hill Road I, did not meet expectations at the box office.

"We made adjustments and gave the investors some relief to make it work economically better and faster in the spirit of the partnership with a goal toward a long-term relationship," said Bob Osher, chief operating officer at Sony's Columbia Pictures Motion Pictures Group, who noted there were also several films that exceeded expectations in the Gun Hill Road 1 slate. He also said the studio subsequently entered into another long-term slate deal.

With respect to new deals, Osher said the basic economics have shifted slightly in terms of risk and awards.

Investors in other slate deals have demanded audits or threatened to sue. Stephen Prough, founder of Salem Partners, which advises on entertainment deals, said there are various ways to engage studios to improve investor returns and create longer term relationships between investors and studios.

"We often advise investors who have been disappointed with the performance of their investments," he said.

"We try to address structural issues with the financing and distribution arrangements and, potentially, arrange a way for investors to exit the transaction," he said. "There are definitely ways to bring about a win-win solution as far as both the investor and the studio are concerned."

Bankers believe more deals will look like Dune Capital Management's deal with News Corp's (NWSa.N: Quote, Profile, Research) 20th Century Fox, which provides capital for all Fox films rather than some, ensuring the hedge fund shares in hits as well as flops.

Bankers also said deals can be structured better to combine slate financing with investments on other assets such as film libraries and broadcast properties.

Financing firm Relativity Media, which has structured more than $4.5 billion in slate deals, including the Gun Hill deal, recently signed a new deal with General Electric Co's (GE.N: Quote, Profile, Research) Universal that gives Relativity more of a say in green-lighting films and other aspects of production, a spokeswoman for the company said.

Burke noted that banks historically charged unused commitment fees ranging from 50 basis points to 75 basis points for revolving credit facilities offered to movie companies.

"Now I'm hearing that those fees are rising to anywhere from one to three percent," she added.

(Editing by Andre Grenon)