In focus: Taking stock of the Wall Street shock

By John Hazelton in Los Angeles
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The US financial crisis may have come as a shock to much of the world, but in Hollywood it almost seemed like the inevitable culmination of a continuing trend. That is because the relationship between Wall Street and the Hollywood film-finance business - one that was hot and heavy just two years ago - has been cooling for at least the past 12 months.

"The film business is being impacted the same way as every other business in the US right now," says P John Burke, entertainment group head at Los Angeles law firm Akin Gump Strauss Hauer & Feld, of the effect of the Wall Street meltdown. But in the film industry, Burke adds: "Credit has been tightening for the last year. And the crisis we're seeing over the last couple of weeks is reflective of where we've been heading over the last year.

"A year ago we had maybe 15 different banks we could go to, to do deals. Now we're down to half that, and the half that are left are being very, very selective as to the deals they will do." The immediate impact of the crisis was on the share prices of the Hollywood studios' media conglomerate parents. Just like those of many other companies, the conglomerates' stocks dived when the crisis kicked in on September 15, bounced back when the Bush administration proposed its plan for a $700bn bailout of bad debts, and dipped again this week when the plan was questioned by Congress.

Dramatic shakeout

What is potentially more significant for the film-finance business, however, is the dramatic shakeout among independent investment banks and other financial institutions that has taken place over the past two weeks.

Among the Wall Street firms that have been hardest hit so far, investment bank Lehman Bros, whose bankruptcy filing was the largest in US history, was not a major film-finance player, though it did recently participate (along with other banks) in a $500m financing deal for Warner Bros-based Alcon Entertainment. Insurer American International Group (AIG), which was bailed out by the US government, has not been involved in film finance for a number of years.

Merrill Lynch & Co, the investment bank that has agreed to a hastily arranged sale to commercial bank Bank of America, has been a significant film-finance player, though its operations appear to have been partially curtailed over the past year.

Three years ago, Merrill co-arranged the $525m debt facility that helped launch Iron Man producer Marvel Entertainment. And 18 months ago it led the consortium of investors that gave Summit Entertainment access to $1bn to relaunch itself as a production and distribution company.

Last year, Merrill secured $500m in financing for United Artists (with participating institutional investors from the US, Europe, Asia and Africa). It also provides credit facilities for Regent Media, has participated in slate financing deals for Disney and Paramount and is a backer, along with private-equity fund Rizvi Traverse, of talent agency ICM.

Through a spokesperson, Summit this week stuck to its assertion (first made because of Merrill's apparent pull-back from the film sector) that it is "able to access all of our funds that have been committed to us by our investors". A statement from a Marvel representative, meanwhile, says Merrill served only as "placement agent" for the company's debt facility and "provides only a very minor portion of Marvel Studios' overall financing structure".

The fate of the United Artists fund appears less certain, partly because of the recent departure of chief executive Paula Wagner and the studio's slow start in production, partly because of Bank of America's takeover of Merrill.

The Goldman Sachs effect

While Merrill has found a new commercial bank parent, Goldman Sachs and Morgan Stanley, two of Wall Street's other leading independent investment banks, have been granted a new status as bank holding companies. That status will allow the companies to launch their own commercial banking arms, giving them the protection of their own deposit bases but also making them more heavily regulated.

Morgan Stanley (part of which is being sold to Japan's Mitsubishi UFJ Financial Group) was once fairly active in film finance but has not done a major deal since it created a $150m co-financing fund with Paramount Vantage 18 months ago.

Goldman Sachs, though, has a significant film-industry profile and its industry partners will now be eager to see if and how the bank's new status and its vote-of-confidence $5bn investment from Warren Buffett's Berkshire Hathaway affects its activities. Among those partners is Canada's Alliance Atlantis Communications, acquired in January 2007 by CanWest Global and a Goldman Sachs affiliate.

The bank is also involved with European movie mogul Tarak Ben Ammar, who is trying to build a European distribution network based on his own Italian distribution company Eagle Pictures and the Alliance Atlantis-owned distributors Momentum (in the UK) and Aurum (in Spain), and with MGM, which recently retained Goldman Sachs to "explore enhancements" to its long-term capital structure.

With The Weinstein Company (TWC), Goldman Sachs has a long-standing relationship that dates back to the company's 2005 launch. The bank provided TWC with its initial debt-financing commitment, was part of its $490m private placement of equity (and remains a minority partner, with a stake believed to be 5% or less), and structured and placed the company's $285m fund for Asian-themed films.

TWC co-chairman Harvey Weinstein appears confident Goldman's new status will only increase its strength. "Goldman Sachs and Morgan Stanley will both be stronger than ever," Weinstein told Screen International this week. "They will be the two strongest and the most liquid banks in the world."

Weinstein also seems bullish about the future of the relationship between Wall Street and the film-finance world: "Capital will be scarce from the investment banking funds for a while but I think it should recover by the end of the year. Some of the hedge funds that normally finance movies will also be having to look again at various positions. "But overall the motion-picture business compared with banking looks like a very solid investment. Those people who put their money in movies did a hell of a lot better than those people who put their money in the banks."

Still making deals

Questions remain, however, about the strength of Wall Street's post-crisis appetite for film-related business. Financing arrangements announced - somewhat surprisingly - this week by Relativity Media and Media Rights Capital (MRC) suggest deals are still possible and that some banks and hedge funds are staying active in the sector.

MRC's deal (see News Digest, p5) saw longtime film industry lenders JPMorgan Chase and Comerica lead a $350m revolving credit fund for the independent production company, while Relativity's announcement saw hedge fund Elliott Associates investing a reported $1bn in the company behind a number of studio slate deals.

Smaller senior debt deals - like the $150m facility just arranged by JPMorgan for Entertainment One, the Canadian owner of distributors including the UK's Contender, Canada's Seville Pictures and Europe's RCV - may also be relatively unaffected. And single-project lending, though it might be more expensive and involve less gap finance, should also go on in spite of the crisis.

"I don't think it's a doomsday scenario for the single-picture world and for a lot of the borrowing-based deals in the slate world," says Paul Hanson, COO of W producer QED International, which does single-picture deals with Comerica Bank and the UK-based Aramid Entertainment Fund. "So much of the debt is predicated on paper from international or studio distributors, the vast majority of which are fairly credit-worthy."

The slate slowdown

What might become more tricky are larger ($200m and above) slate deals requiring the participation of a number of banks besides the lead arranger and financing arrangements for start-up companies. Insiders are already watching to see how JPMorgan Chase does with its attempt to raise as much as $700m of debt for the new DreamWorks backed by India's Reliance ADA Group.

"In terms of new deals, there's going to a be huge impact," suggests Neil Sacker, president/COO of The Film Department, which obtained its initial fund raising last summer, just before the financing climate began to change.

"In terms of senior debt facilities and mezzanine debt, it's going to be extremely tight. Right now most of the institutions are trying to focus on not going bankrupt, never mind doing new business."

And, the Elliott/Relativity deal notwithstanding, there is also doubt about whether hedge funds, some of which are believed to have been hurt by short selling the stocks of financial institutions during the crisis, will still be as active.

That doubt may extend outside US film financing to territories such as the UK, which has its own hedge fund-backed film investors. "As far as those funds are concerned there's a lot of speculation about their current state, let alone what might happen to them in coming months," notes Heather Mansfield, chief executive of London-based risk analysts Mansfield Associates.

The post-crisis uncertainty could lead to increasing interest in finance from international strategic partners, foreign investors from rising economies such as Russia and India and sovereign wealth funds, such as the Abu Dhabi-based Imagenation, which just created a $250m fund for Hollywood independent Participant Media.

"I think you'll see a fallback to Hollywood's reliance on those groups," suggests Stephen Prough, founder of Los Angeles-based investment bank and wealth management firm Salem Partners. "Because those groups get something out of the business other than pure financial return."