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# Is the slate deal going up in flames?

By John Hazelton in Los Angeles
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In a year rife with bad financial news, the film-finance world has seen its share of worrying portents. Though some financiers suggest that conditions have in fact been deteriorating for considerably longer, in the 12 months since the start of the global credit crisis the outlook has grown steadily worse for the kind of Wall Street-backed slate financing deals that have helped fund much of Hollywood's recent output. Word has been spreading of slate deals that have failed to attract investors or that are set to produce disappointing returns.

The latest development has been an apparent retrenchment by the investment banks that made many of the structured slate deals possible. And while financial experts differ over its precise significance, the banks' change in attitude puts a big question mark over the future of the slate-deal business, one that has pumped an estimated $12bn into Hollywood over the past five years.

The banks' role came into sharp focus last month with the collapse of a planned $450m slate deal involving Deutsche Bank and Paramount Pictures. Accounts vary, but the difficulty Deutsche faced in bringing other banks into the deal appears to have been the critical factor in the collapse.

After the deal fell apart it was revealed that Deutsche, which is also involved with slate deals at Sony and Universal, had parted ways with head film banker Laura Fazio, who had previously made rival bank Dresdner Kleinwort a major slate-deal player with deals at Fox, Paramount, Warner and Focus Features.

Fazio was not the only well-known film banker to leave the scene. In recent months, Michael Blum has left Merrill Lynch (which has major deals at United Artists, Marvel Entertainment and Summit Entertainment) and Christine Lavelle has departed Morgan Stanley (which set up a slate deal for Paramount Vantage).

A Deutsche spokesman said it is still interested in film industry deals and Merrill still has a film-finance unit, headed by former Blum team member Eric Alini (Morgan Stanley said it has not done a slate deal since its Paramount Vantage arrangement 18 months ago).

But finance insiders suggest banks that are pulling back now are unlikely to return any time soon. "I think they will be out of the film finance business for a long time," says Stephen Prough, founder of Los Angeles-based investment bank and wealth management firm Salem Partners.

How it all began

Banks got into the business of film-related structured transactions around 2004, when Wall Street hedge funds and private equity companies, flush with capital, started seeing the potential for high returns from the film industry, at the time buoyant thanks to DVD growth and other factors.

Hedge funds need to leverage their investments to achieve their target returns, so slate deals have typically included an element of equity (the riskiest investment, but the one promising the kind of returns sought by funds), an element of less risky mezzanine debt and an element of relatively safe senior debt. By committing to the entire amount of a slate deal, keeping some of the senior debt itself and selling the equity and mezzanine debt to other institutions in the financial market, a bank can earn a proportionally large fee for retaining a fairly small amount of debt.

The problem for banks is that in the current economic climate, the model has become more difficult to put into practice. With many financial institutions taking massive write-downs because of problems in other sectors, banks have become reluctant to take on new assets in the form of slate-deal commitments.

Add the fact that around half-a-dozen slate deals reportedly remain 'hung' (stuck on the books of an underwriting bank that has been unable to sell the debt to other institutions), and that the performance of existing slate deals has not yet been proven, and it is no surprise the banks are pulling back, in film finance and other sectors.

"The banks are not being as aggressive as they once were on structured finance transactions, and that's affected all transactions, including film transactions," says John Burke, partner and entertainment group head at law firm Akin Gump Strauss Hauer & Feld, which has worked on a number of major slate-financing deals. "They're doing fewer transactions because many of the major banks need to create liquidity within their own organisations and they're selling off assets as opposed to adding new assets to their balance sheets."

Pulling back, not bailing out

The pulling back does not necessarily mean an immediate end to slate-deal activity. Among banks that still appear to be active in the area is Societe Generale, which last April brought Premila Hoon, global head of film finance in the French bank's corporate and investment banking division, to New York from London to further develop US activities.

And the downturn probably will not be mirrored among the film industry banks that specialise in making single-picture loans against pre-sales to US and overseas distributors. "I don't think the credit crunch has affected our business at all," says David Hutkin, managing director of ICB Entertainment Finance. "We're plenty busy."

The current climate might actually benefit banks that remain in the business and still have the resources to do major deals. One example is JPMorgan, the long-time leader in entertainment finance that has mostly avoided slate deals but recently agented a $340m credit facility for Lionsgate and is reportedly arranging $500m in debt for DreamWorks' new venture with Indian group Reliance.

The pullback will almost certainly have consequences, though, for the studios, producers and larger independents that have taken advantage of Wall Street's recent enthusiasm for Hollywood.

Most of the studios already have slate deals in place that will provide them with risk-offsetting outside production finance for at least the next couple of years (after the collapse of its deal with Deutsche, Paramount said it will work more with Hollywood co-financiers such as Spyglass Entertainment).

Although there are doubts some of the deals will pay off for investors, some are expected to deliver decent returns. And, thanks to the inclusion of mega-hit The Dark Knight, the kind of sure-fire blockbuster that studios often hold back from their slate co-financing arrangements, the current Legendary Pictures slate deal at Warner Bros could produce strong results.

New slate deals, however, are likely to be few and far between. Besides the aborted Deutsche/Paramount arrangement, the only other studio slate deal to have emerged so far this year involves Universal Pictures and Relativity Capital, a partnership between Relativity Media, whose principal Ryan Kavanaugh is the most active middleman between Wall Street and Hollywood, and hedge fund Elliott Associates.

In announcing the arrangement, the partners said Relativity Capital underwrote the capital structure of the deal without using an outside bank. Sources suggest, however, Elliott has been trying to sell senior debt in the transaction without much success, indicating how tough it is in the current climate to pull off the kind of deals that were fairly common a few years ago.

How existing arrangements will be affected

Producers and independents that already have deals with banks and other Wall Street funding sources probably have little to worry about - for the time being at least.

To finance its relaunch as a full-service production and distribution operation, Summit Entertainment signed a deal with Merrill Lynch and a consortium of investors in April 2007, when Wall Street financiers were still eager to work with Hollywood. Though Wall Street's ardour has since cooled, and Merrill has since retrenched, Summit appears confident its arrangement - which turns on the company's distribution activities more than a particular slate of films - will not be adversely affected.

A spokesperson for Summit said Merrill "has been a great partner in both the launch of Summit as a full-service studio and to our ongoing business. Summit is in a strong position as the financial markets evolve and change, as we are able to access all of our funds that have been committed to us by our investors."

Groundswell Productions signed its five-year, $205m slate financing deal - consisting of $70m in equity from private-equity investment company TPG-Axon and $135m in debt from a syndicate of banks led by Comerica - at around the same heady time. Producer and Groundswell CEO Michael London says the changing film-finance climate has not made him worried about the availability of those funds: "I stay in touch with our primary investor, but it's not the kind of relationship where the ups and downs of the marketplace change the nature of our deal or their aggressiveness about the movies we're making.

"Most people with independent slate-financing deals talk very regularly with their investors about where they should be spending their money right now. I certainly do."

The concern, London explains, is not about whether the money will continue to flow but about "how we make movies that make our financial enterprise make sense".

In the end, the effect of the credit crisis and the bank retrenchment on film financing may only become really clear in a few years' time, when studios and independents with expiring deals return to the financial marketplace in search of new backing.

At that point, independents will need to have a strong track record to show potential investors, suggests Salem Partners' Prough: "The independents are going to have to be successful with their first slate of films because they're not going to get another bite of the apple."

And studios will probably need to accept less favourable terms in their new deals with Wall Street financiers. "When the current round of deals runs through the system, it's going to be a different discussion that the studios have with Wall Street," says financier Ben Waisbren, president and CEO of Continental Entertainment Capital. "Because there's just too much empirical evidence of the lack of demand for the way those deals were structured. Too much evidence that they weren't such great deals after all."

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