



Methodology

Rating Global Film Rights Securitizations

JULY 2010

*Operational Risk Review section updated in methodology entitled
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Insight beyond the rating.

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Related Research:

Legal Criteria for U.S. Structured Finance Transactions
Operational Risk Assessment for U.S. ABS Servicers

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This methodology replaces and supersedes all related prior methodologies. This methodology may be replaced or amended from time to time and, therefore, DBRS recommends that readers consult www.dbrs.com for the latest version of its methodologies.



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Executive Summary

The securitization of film rights has grown in popularity in recent years. Since 2005, there have been at least 35 film-backed securitizations issued with aggregate par in excess of \$14 billion. The majority of these were co-financing transactions with major studios. As studios seek to diminish the impact film performance has on their balance sheets, they have increasingly sold all or portions of their owned film rights to independent investors. In turn, investors have often utilized the securitization markets as a source of long term financing of these acquired film rights.

Unlike financial assets that have long dominated securitization, film rights are operating assets (also referred to as future flow assets). As such, the impact of the operating company generating the assets (in this case the studio) on asset performance is significant. Any assessment of the credit risk associated with an investment in a film rights securitization must also consider the operating and financial strengths and weaknesses of the studio involved in the context of the transaction structure. In most cases, the studio maintains a long-term role in reproducing and promoting the film even after it has been produced and a fraction therein sold to third party investors. This role, one of maximizing the cash flow associated with the film rights, is referred to as “distribution”. In other cases, the rights to 100% of the film revenues and the associated distribution rights are purchased from the studio and the investor takes on all distribution responsibilities. Regardless of the structure, DBRS rates film securitization transactions based upon the expected and stressed cash flows to be produced from film rights by assessing, among other factors:

- a. The strengths and weaknesses of the studio producing the films (the “originator”)
- b. The portfolio of film rights being purchased and securitized (the “assets”)
- c. The strengths and weaknesses of the Distributor (the “servicer”) (as outlined in Operational Risk Assessment for ABS servicers dated June 2011); and
- d. The transaction structure and how it aligns the studio’s and the distributor’s interests with the securitization transaction.

In assessing a film rights transaction, DBRS models the liability structure based upon the waterfall described in the governing legal documents. Critical to assessing the waterfall structure is a complete understanding of the film rights being transferred to the SPV and the associated cash flow run through the waterfall. As a result, DBRS focuses on how expansive or limited the sources of revenue are in the transaction. For instance, film rights that include all potential sources of revenue, whether existing today or developed in the future is preferred over a structure that has carved out certain sources of revenue. Such limitations run the risk of weakening the alignment of interests with the film distributor. Additionally, DBRS strongly prefers the inclusion of caps on all amounts higher than the senior noteholder debt service. These higher priority payments, such as prints and advertising (P&A) spending, participations and residuals, and special purpose vehicle (SPV) operating expenses represent areas for material cash flow leakage and can reduce the likelihood of payment to the senior note holders to the extent costs become excessive. Finally, on revolving structures, the presence of triggers (both deal performance triggers and financial triggers tied to the studio and distributor) needs to be evaluated as part of the cash flow modeling / stressing process.

In this report, we introduce the basic mechanics of film rights securitizations and provide the analytical details of DBRS’s methodology for rating such transactions.

Introduction / Industry Overview

Movie studios have historically sought ways to reduce the impact film performance volatility has on their financial performance. All major studios, unlike the smaller production companies (referred to as “Independents”), not only produce the films, but also maintain film distribution companies that are necessary to exploit the value from the film rights. In many cases, the studio has gone the extra step of creating legal division between the production side and the distribution side of the business. It is the production function which is responsible for financing and making the film, while the distribution side of the business typically takes over once the film is produced or is “in the can”. Typically, the distributor charges a top-line fee as a percentage of gross revenues received and is responsible to re-produce, promote and distribute the film in all distribution channels. Like many other industries, film studios strive to de-leverage their exposure to asset (film) performance risk while maintaining the steady, more predictable stream of income associated with these servicing/management (distribution) fees.

To achieve this objective, one popular strategy for the studios has been “co-financing” (also called “co-production”). Co-financing, in concept is fairly straight-forward and involves the studio selling off a percentage of the film rights (and the associated upside or downside with the film’s performance) while maintaining the distribution rights (and associated fee income). The co-investor can be an arms-length third party or can simply be a separate company set up by the studio to remove some of the investment risk from the studio’s balance sheet. Co-financing can take a variety of forms. Some structures involve a single film while others include a large group, or “slate” of films. While Hollywood continues to attract investors in single films, the associated volatility in predicting a single film’s performance has led to slate investments as a more diversified choice of assets in which to invest.

In some slate arrangements, the co-investors are purely financial investors, taking a very passive approach to the film investment. In these instances, there are typically provisions that protect the investors from being subjected to adverse selection, the simplest being a requirement for the studio to deliver all films produced by the studio within a certain timeframe or a certain number of consecutive films, in either case that meet pre-negotiated criteria. There has also been an increased popularity with strategic co-investors. Typically, a company is established by one or more former studio executives to invest strategically in film rights. Often, the investor also acquires some portion of the film distribution rights (such as for a specific distribution channel or geographic region). The strategic partner takes a more proactive approach in picking specific films based on their risk tolerance and/or business strategy. One example would be where the investor acquires the distribution rights in their country and therefore targets movie genres that are more likely to succeed in that country. Another example might be a cable channel, setting up a co-production company to invest in film concepts that might do well when aired on their channel. In this instance, they would purchase, in addition to a percentage of the total revenue from the film, the cable distribution rights.

DISTRIBUTION CHANNELS

Theatrical Revenues: Theatrical rentals represent receipts arising from the exhibition of a film at movie theatres, net of the exhibitors’ share of total box office receipts. The typical window for the timing of theatrical revenues runs from four through twelve months following the film’s completion. Typically, the first three months following a film’s completion is spent with the studio/distributor promoting the film. Historically, films were released in the United States first and then rolled out sequentially in various major international markets. However, with technological advances and the associated increased piracy risk, the distributors have more recently released films simultaneously both domestically and internationally.

Home Video Revenues: Home video revenues represent gross “wholesaler” receipts arising from the sales and rentals of DVDs and videocassettes, net of returns, allowances and certain rebates. The retailer’s perspective is not part of this calculation. The home video release window typically begins almost



immediately after the theatrical window closes (and often begins domestically while the film is still in the theaters internationally) with video on demand which runs for, on average, eighteen months (though there is a small tail that can run for years, particularly for very successful films). However, the first 12 months of home video sales typically accounts for approximately 65-75% of the total video sales revenue.

Pay TV Revenues: Pay TV revenues represent receipts arising from the exploitation of a film on a pay television platform, generally a premium cable or satellite channel (such as HBO or Showtime), and may also include receipts arising from domestic pay-per-view television performance. The timing window for pay TV typically runs from about six months after the theatrical window closes. Most distributors have output distribution agreements with the major cable networks that govern the terms for which pay TV rights are purchased. Typically, the output distribution agreement dictates that a film right's purchase price is formulaically based on the film's theatrical box office figures. Some agreements calculate price on a film-by-film basis while others price groups of film in the aggregate.

Free TV Revenues: Domestic free TV revenues represent receipts arising from the domestic exploitation of a film on an advertising-supported television network (such as ABC, NBC, CBS or Fox) and basic cable networks (such as F/X, TBS or TNT), including shares of barter advertising revenue (such as Tribune). Pricing for Free TV purchase contracts works similarly to how the Pay TV contracts work. Timing for Free TV release typically is three to four years after the theatrical window closes.

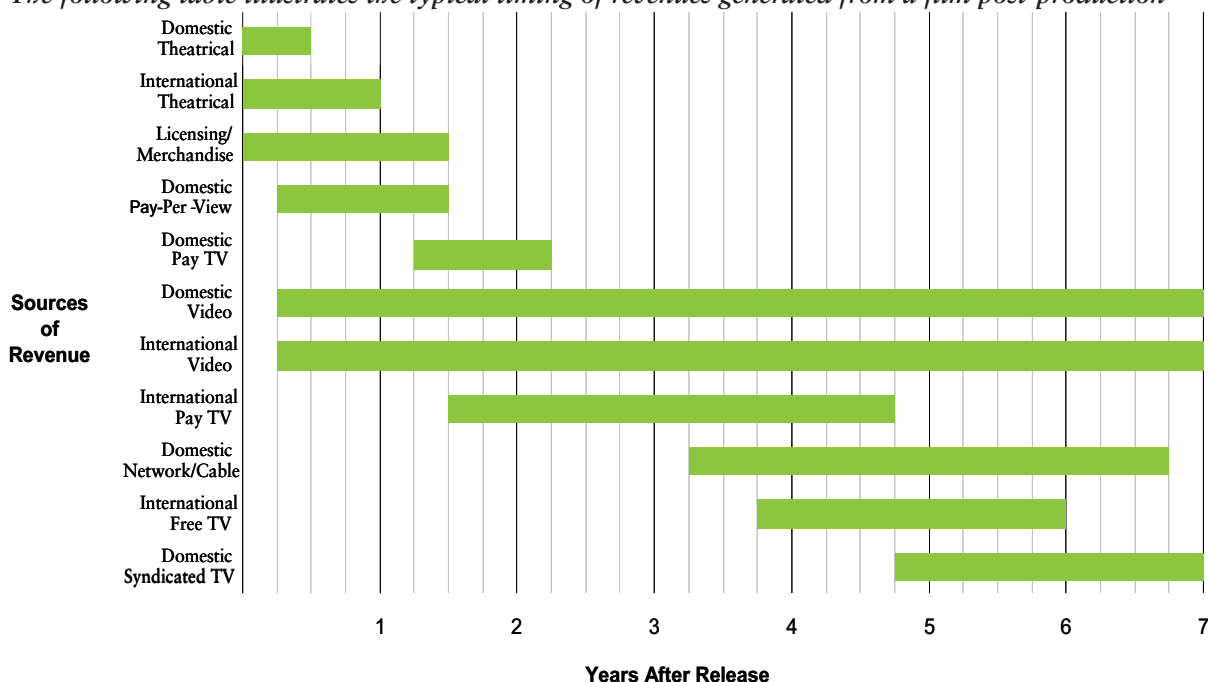
Licensing and Merchandising Revenues: Licensing and merchandising revenues represent receipts arising from both domestic and international exploitation of the licensing of music publishing rights associated with a film's musical score, physical sales of the film's soundtrack and licensing and merchandising of a film's brand-names, characters, themes and other associated intellectual property rights.

Allocation of Revenue Sources: For most films, the revenue received is typically allocated as follows:

	Theatrical	Video	TV	Merchandise/Other
% of Total Revenue	25 - 35%	35 - 45%	12.5 - 22.5%	0 - 5%

That said the revenue distribution can vary significantly from film to film. For instance, for some films, the merchandising revenue can be quite significant.

The following table illustrates the typical timing of revenues generated from a film post-production



Studios will vary the timing of release into the various distribution windows on a film-by-film basis to reflect specifics about the particular film such as pre-release audience anticipation, genre, budget, domestic vs. international appeal and concern over piracy risk. DBRS considers studio-specific and market conditions in evaluating any variances to the above timing on a deal-by-deal basis.

USE OF SECURITIZATION

As the popularity of film slate co-investing has increased, securitization has become an increasingly popular alternative for longer term funding (i.e., post-film completion). These structures do not typically take completion risk. Rather a film is transferred to the securitization only upon completion. Securitization is consistent with the overall strategy of moving some fraction of the film's performance risk off-balance sheet, whether it is from the perspective of the studio (who has created a subsidiary to co-invest) or for the third party co-investor. Securitization of film rights, from the perspective of the originator, is conceptually similar to that of most other securitized asset classes in that it allows for the transfer of the credit risk to the capital markets while retaining a steady stream of servicing cash flow (i.e., distribution fees). However, as opposed to financial assets (such as mortgages or credit card receivables), film rights are clearly operating assets. Unlike the contractual payments due under financial assets, operating assets derive their cash flow directly through the success of the operator. In the case of film rights, the performance of the distributor is far more critical in determining the future cash flow of the films. As with other securitized asset classes, therefore, identifying alignment of interests between the studio/distributor and investor/issuer is critical. An assessment of the operating strengths of the studio/distributor, as well as the alignment of interests with the transaction, plays a major role in determining likely cash flow from the film rights.

INDUSTRY ECONOMICS

While there has been much written on the subject of the predictability of film economics, the reality is there is no exact science to picking a film that will make money. If there were, studios would never produce a money-losing film. At the same time, there are some attributes that tend to improve the likelihood for a film's success. These include:

- *Whether the film is a sequel or prequel to a previously successful film:* Sequels/prequels to



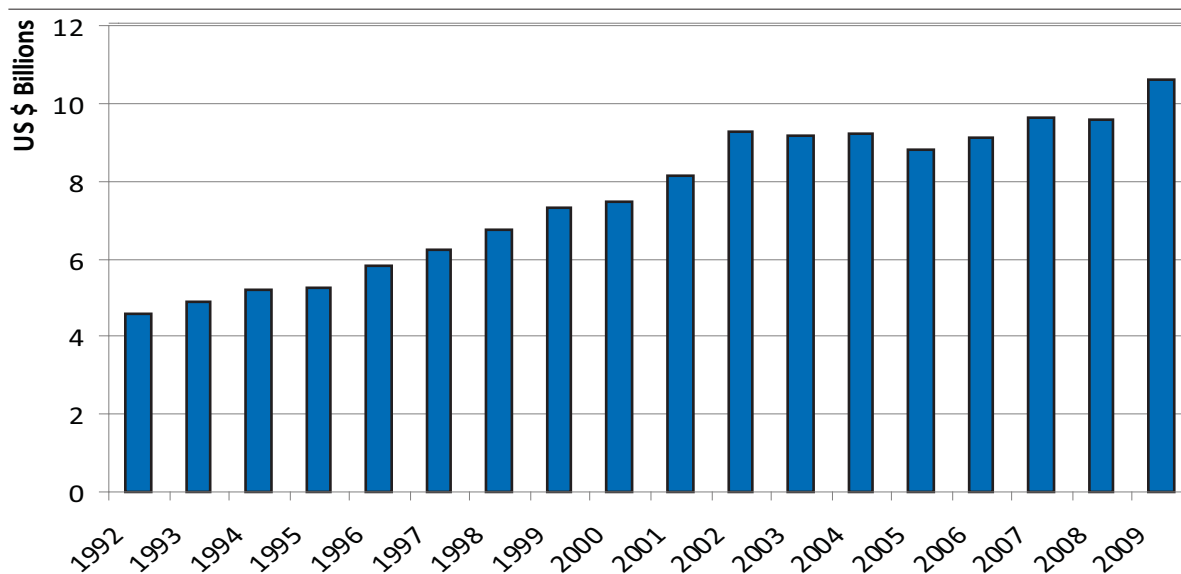
previously successful film have historically enjoyed a higher success rate.

- **The “star power” of the actors involved:** It is popular to debate whether the star actor who is paid a large sum, such as \$20 million per film, is worth it. While not guaranteeing success, films using actors with star power have demonstrated a lower rate of failure and tend to succeed more frequently.
- **The prior track record for success of the directors, actors and producers of the film:** Certain talent teams have a demonstrated track record of knowing how to produce successful films. However, even the most successful teams eventually produce a “clunker”.
- **Budget size:** While large-budget, block-buster films receive added attention when they fail; the larger budget films tend to fail less often. Of course, when they fail, even though the relative money lost may be small compared to the amount invested, the absolute dollars lost can be quite large. The success stories are dominated by the small budget films that do exceedingly well. Even though they may make a very healthy return relative to dollars invested, they do not tend to produce the same dollars in the absolute of upside as the block-busters.
- **Genre:** Comedies are believed to produce fewer disasters, from an absolute dollars’ perspective. This is true, not so much because of something innate to do with comedies, but the fact that their budgets tend to be lower and the studio can more easily control/reduce the budget if it senses a film will not succeed. This is particularly in contrast to action/thriller movies that tend to have very high budgets impacted by high special effects costs that cannot as easily be scaled back once a film’s production is underway.

The following information on the film industry’s historical performance comes from the Motion Picture Association of America (MPAA) as discussed in their “Entertainment Industry Market Statistics 2007” and “Theatrical Market Statistics 2008”.

Aggregate box office figures reflect fairly steady growth for the film industry since 1992 as shown below. From 1992 through 2008, domestic box office revenue grew by nearly 115%, for an annualized average growth rate of approximately 7.2%. Since 2001, growth was more measured, growing by 20.6% overall and approximately 3% per year:

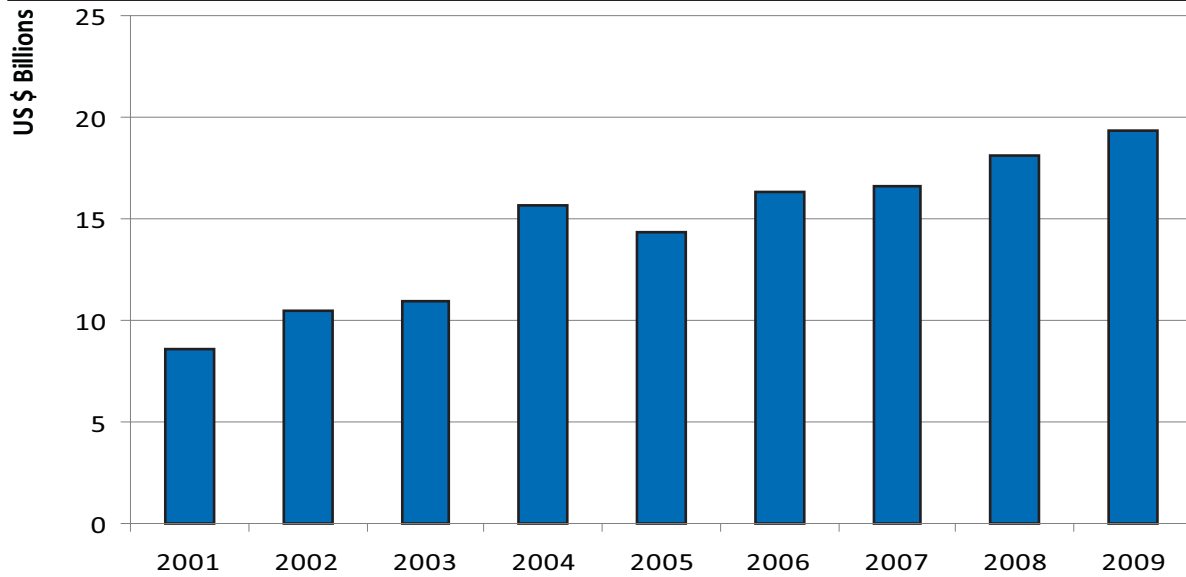
Domestic Box Office





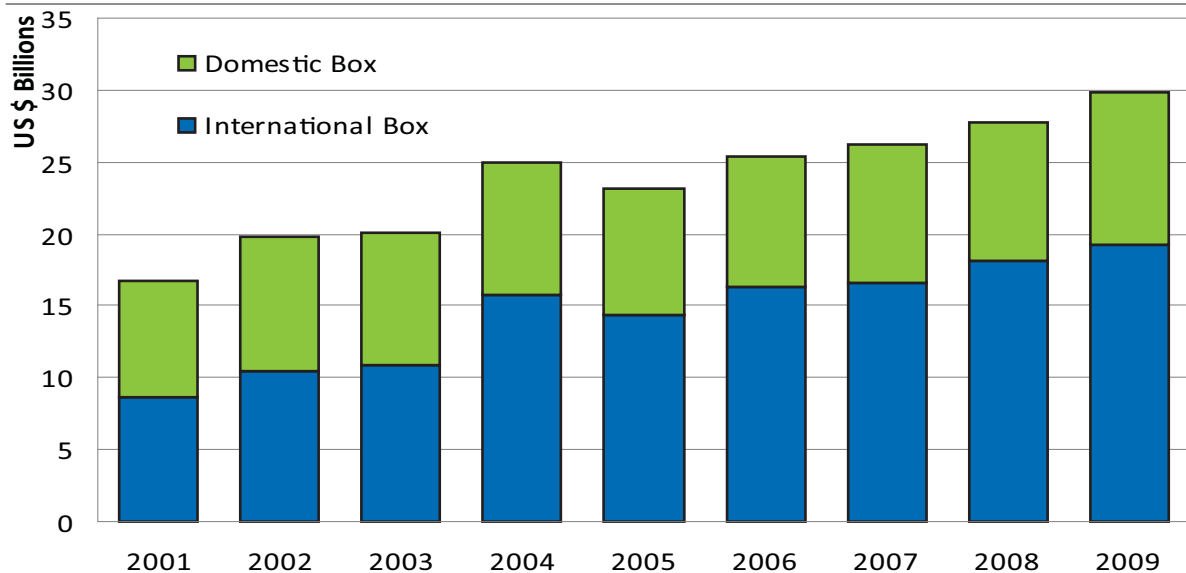
Internationally, the growth witnessed since 2001 for the film industry has been more pronounced, as reflected in the chart below. From 2001 through 2008, international box office revenue more than doubled and grew by an average annual rate of more than 16.0%:

International Box Office



In total, box office grew worldwide by 68% for the seven years from 2001 to 2008. At the same time, international became an increasingly dominant force in driving total box office, accounting for 65% of total world box office in 2008, vs. 51% in 2001.

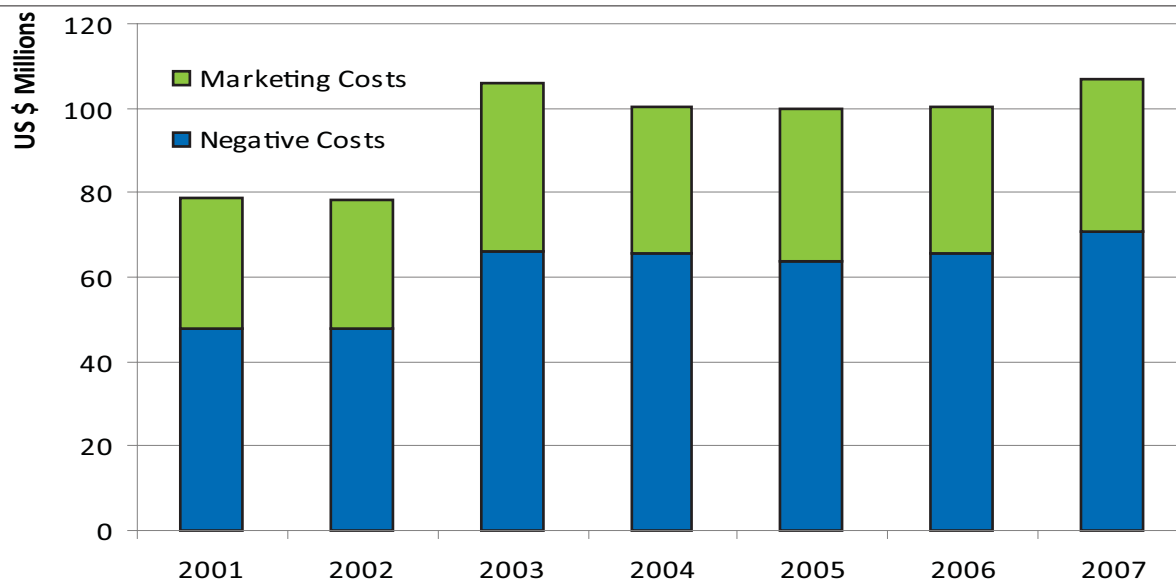
Total Box Office





At the same time as domestic box office grew at a modest rate, negative costs and advertising costs grew at a slightly faster pace. Total average US Theatrical Costs (Negative Cost plus advertising cost) grew by 35.5% overall from 2001 through 2007, though it has remained relatively stable since 2003.

Average US Theatrical Costs



IMPACT OF TECHNOLOGY

Historically, there has been an observable boost to overall film revenue for the industry with each new technological advancement. This has been witnessed throughout the 20th and 21st centuries, and includes the invention of the television, cable TV, VCRs, DVD and digital on-line streaming. In each instance, there was a measurable increase in overall revenue as each technological shift served to make movies more accessible and in most cases more affordable to a broader audience. At the same time, the digitization of film witnessed over the past few years (versus the prior celluloid approach) has served to: (1) reduce costs to re-produce films for mass distribution and (2) accelerate receipt of revenues as films can be distributed to a wider audience more quickly.

As each new distribution channel is created, the impact can be to cannibalize some of the cash flow from other distribution channels. For example, once cable TV was created, movie channels like HBO “robbed” business from the free TV networks. The development of on-line video rental hurt the more traditional video rental companies. The good news is that the studios have always controlled the technology used to produce the film and the format in which it is created. For years, there was discussion of creating films in the digital media; however, the studios did not begin digital production until they were confident they had the technology in place to control digital distribution. The fear was that digital media would make films easier for people to pirate with illegal downloading. The industry therefore did not begin to produce digitally until they were confident the proper security features could be put in place at the point of production. Improved digital downloading technology represents an opportunity to increase the rental window while, potentially, hurting the sell-through (hard copy) window.

In conclusion, while technological advances may impact the timing and sources of revenue associated with film distribution, the net impact has always been, historically, greater revenue to the studio. This, however, underscores the importance of any film financing having the rights to all revenue sources, whether currently in existence or developed in the future. That is the only way to insure alignment of interests with the studio industry as future technological shifts occur.



PIRACY RISK

The MPAA estimates that tens of billions of dollars are lost in the industry, each year, to piracy. Piracy typically takes on one of two forms: illegally sold copies of DVD's, and more recently, illegally downloaded copies of a film from the internet. The impact of piracy is reflected in the historical film performance over the past few years and is also factored in when studios project film ultimates. However, the additional question that needs to be addressed is whether the improved digital technology that makes it easier to download movies on the internet will motivate even more piracy going forward.

Based on our research and corroborated by discussions with industry executives, DBRS views this risk as manageable in its current form and is not expected to increase materially due to improved technology. In assessing piracy risk, we compared the film industry to the music industry for similarities and differences. Unlike the music industry, the film industry has carefully controlled the release of its content in a manner that would limit the incentive to illegally download. In music, the majority of people who stole music did so out of frustration that they had to buy an entire \$18 CD when all they wanted was one song. In film, there is no such frustration because people can readily rent both inexpensively and conveniently.

Finally, piracy has existed for years and is dramatically concentrated among individuals in the 15-25 year range and in certain countries. Furthermore, in regions where illegally sold DVD's is the greatest risk, studios have mitigated this by using the strategy of "Day and Date" releases. What this essentially does is release movies in theater simultaneously world-wide and also by releasing DVD's in the higher risk markets immediately (but in that country's language so that they are of no value in other countries).

ULTIMATE PROJECTIONS

Definition: An "ultimate" is a statement detailing the revenues, costs and related profit associated with a film's initial distribution cycle (the "First Cycle"). The First Cycle represents the initial exploitation of a film in domestic and international theatrical, home video, free and pay television, and other ancillary markets. The first cycle typically spans a ten-year period following initial domestic theatrical release during which a film moves through successive windows of market availability. The statement reflects all anticipated cash receipts ("Gross Receipts") generated from each market and all related expenses including production, distribution, overhead, and third party participation costs.

Studios initially create ultimates in order to evaluate the potential profitability of a film property for management's use in production approval or "greenlight" decision-making. Once a film has been produced and released, ultimates are used in financial reporting to determine cost amortization and studio profit. The process of creating ultimates is viewed as critically important to the studio and has historically been undertaken with a significant level of conservatism. It is the ultimates that are used as the basis for the studio's accounting of the production costs of a film on balance sheet. Subsequent adjustments to the ultimates lead to adjustments in the studio's financial statements.

The Process: Film studios undertake a formal process of calculating each film's ultimate profitability at regular intervals, both prior to production and on a continuing basis throughout the film's economic life cycle. As a film passes through each phase of its life cycle, and more performance data is gathered, the certainty of its net realizable value improves.

Domestic box office performance is the key driver and initial indicator of a film's ultimate revenue potential, and subsequent market performance is highly correlated to a film's domestic box office success.

Ultimates vary from film to film depending on genre, talent, timing of release, competition, and marketing campaign. Ultimates vary across the industry based on quality of product and each studio's unique worldwide output and/or distribution agreements.



Pre-Production: In order to determine whether a film should be “green lit” and scheduled for production, an ultimate is produced using “generic” market assumptions and is tailored based on available film-specific information including talent, genre, expected cost of production and contingent payment for talent and rights. The generic assumptions are typically culled from historical data related to similar product and are periodically reviewed and modified by operating unit management. Most studios will further tailor their ultimates projections to reflect the specific terms of their various contractual output arrangements and further to reflect the studio’s own experience.

An ultimate matrix is developed that identifies market specific revenue and expense information at varying levels of domestic box office sensitivity. Studios typically modify these generic models on a periodic basis as market conditions change and worldwide output deals are negotiated or renewed. This generic ultimate is used until more is known about the film such as the key talent, genre, premise, and expected cost of production and talent profit participation. Once these basic factors are determined, the generic ultimate becomes a “named ultimate” and is revised to incorporate specific market expectations and associated cost estimates.

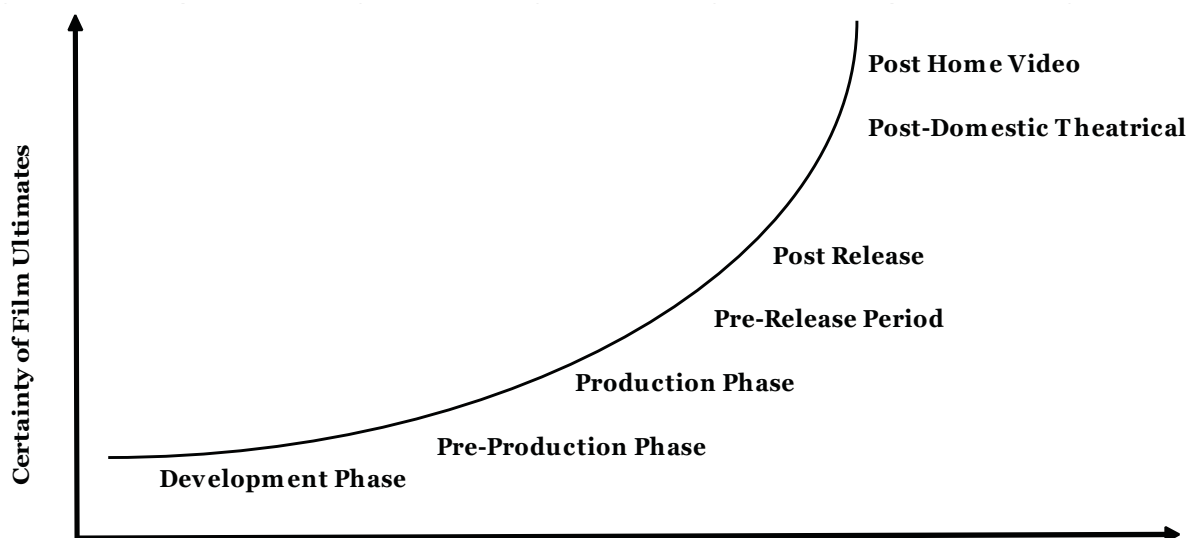
The named ultimate is vital in analyzing the profitability of potential film product. As a film enters the greenlight phase, marketing spending, production costs and talent participation deals are evaluated and modified. Senior management approves the film depending on the minimum domestic box office level that will achieve breakeven profitability.

Pre-Release: During the production and post-production phases, actual production spending is determined and the studio will continue to refine performance estimates using comparable film data and available market information. Management at both the studio and distributor will continue to evaluate revenue potential as they begin to see partial film product and begin monitoring competitive market activity. The results are then compiled and used to develop appropriate marketing spending levels and near-term forecasts for budgetary and financial reporting purposes. Prior to a film’s theatrical release, operating management will view the completed film and provide detailed market-specific performance estimates based on film quality and competitive viability. The timing of this viewing can be hard to predict, and is typically situational based. These estimates are consolidated into a pre-release ultimate and distributed to senior management for review and approval.

Post-Release: Ultimates are updated on a regular basis to reflect actual receipts and expenses as the film moves through its various market distribution channels. In addition, management periodically revises the forecasted results, remaining cash receipts and expenses to the extent necessary based on new film performance data, cash collected-to-date and market information. Significant changes to a film’s ultimate usually occur within the first several weeks following domestic theatrical release, as domestic box office is the primary driver of subsequent market performance.

Once the film is released, and domestic box office becomes certain, the estimates for each market are circulated back to the senior operating managers for modifications. International theatrical and worldwide home video estimates are revised based on domestic box office and output-driven television estimates are finalized. Foreign currency-related modifications are also incorporated in the ultimate.

Certainty of Ultimate: As reflected below, the certainty of projecting ultimates increases over time.



Immediately upon a film's initial general domestic theatrical release, box office information is reported and the ultimate becomes much easier to measure. By the fourth week following domestic theatrical release, domestic box office performance can be computed with significant certainty.

Subsequent market film potential is primarily driven by domestic box office performance. Once a film's domestic box office is known, future receipts and associated costs can be more accurately estimated due to the high correlation of domestic box office to performance of a film in the international theatrical and worldwide home video markets. A high correlation of home video revenue to box office performance is supported by industry-wide historical data. Additionally, a majority of the revenue earned in the worldwide television markets is contractually determined based on domestic box office performance. Studios have contractual license fee "rate cards" under output agreements with the major pay and free television providers around the world that require the licensee to pay a pre-determined amount for the right to exhibit each film. The license fee amount is based on either domestic or local box office; the television licensees typically must accept all films the studio releases.

Studios constantly review the correlation between a film's early box office results and its ultimate degree of financial success. Based upon these early indicators, the distributor can tailor their advertising and promotion campaign accordingly. It is believed that film ultimates are generally correlated to box office results. This is supported by internal studies performed at each major studio and further by The Salter Group¹. According to The Salter Group, domestic TV receipts typically display a fairly strong degree of correlation as a percentage of domestic box office (though the lowest grossing films can show more variance). Similar observations are supported for international TV (although with slightly greater variance to the upside due to the growth in TV penetration witnessed internationally as markets expand and countries develop). Similarly, home video receipts also exhibit a strong, but not quite as direct correlation to box office receipts. The higher performing films in the box office almost always produce higher video receipts. Generally, The Salter Group observes domestic video receipts as a higher percentage of domestic box office receipts, than for the international side, reflecting the lower penetration of DVD technology internationally in less developed countries.

1. The Salter Group is a leading independent financial and strategic advisory firm specializing in providing business and intangible asset valuations, financial opinions, financial and strategic analysis, forecasting, and transaction support covering a broad spectrum of industries and situations on behalf of early stage, middle market and Fortune 500 companies and capital market constituents.



CONSERVATIVE NATURE OF ULTIMATES

As a general rule, studios tend to under-predict, rather than over-predict ultimates of a film. As previously discussed, the studio reports their ultimates up to the parent company which is usually a highly-rated public company (for the Majors). These ultimates serve as the basis for the public company’s accounting of both cost amortization and revenue recognition. It is for this reason that studios tend to initially underestimating a film’s ultimates.

Ultimates by Market: The following chart outlines the key markets and the primary and secondary factors used in building the ultimates data. Since every distribution window is strongly influenced by domestic box office performance, these results represent the primary source of information used to measure future receipts and costs.

Revenue Window	Primary Driver	Secondary Driver
Domestic Theatrical	Domestic Box Office	Initial P&A/Budget/Genre
International Theatrical	International Box Office	Domestic Box Office
Domestic Home Video	Domestic Box Office	Genre / Competition
International Home video	International Box Office	Domestic Box Office
Domestic Pay Television	Domestic Box Office	Initial P&A/Budget/Genre
International Pay Television	International Box Office	Domestic Box Office
Domestic Free Television	Domestic Box Office	Initial P&A/Budget/Genre
International Free Television	International Box Office	Domestic Box Office

FILM PROFITABILITY

The Salter Group’s professionals have forecasted and valued film assets and other entertainment and media assets and businesses for a broad range of purposes over the past twenty years, and have extensive experience in assessing the performance of film slate securitization transactions by reviewing varying film-level performance outcomes by cash-on-cash ratio, studio, genre, budget size and by the year of release. Cash-on-cash is measured as the ratio of total expected revenues (ultimates) of a film divided by the total cost to produce and exploit the film (production costs plus P&A costs).

Based on The Salter Group’s extensive analysis of publicly available and other information, the average cash-on-cash ratio for the industry (Majors) overall has maintained a fairly tight distribution, ranging from approximately 1.15x to 1.20x. At the same time, each major studio has maintained a similar level of consistency. Further, the frequency each year of the most profitable films (>1.5x) has generally ranged from 10.0% to 17.5%. However, the yearly frequency of the worst performing films (those <0.75x) has been more volatile (ranging from approximately 5% to 35%). Generally, the lesser performing films have been the smaller budget films whereas there is a disproportionate number of larger films in the top performers. As a result, the weighted average, from one year to the next, has maintained consistency.

Role of the Distributor

The distributor typically is involved in the film project from the beginning, at least in a consultative role. Most studios require the distributor, as well as the individual responsible for each distribution window, to sign off on their role in the green-lighting process. As the strategy for the film concept is discussed, input from the distributor as to “what can sell” is critical. However, once the film is completed, the distributor becomes far more active. The distributor’s responsibility is the physical creation of the theatrical release elements (film prints and advertising (P&A)) of the film. Costs associated with this function are referred to in the industry as P&A costs and these costs are viewed as critical to the success of the film’s



exploitation. In assessing any securitization structure, it is critical to gain comfort that these P&A costs can be adequately funded – be it directly by the distributor or through the deal’s structure. Since changing distributors is not as simple as transferring servicing for financial assets, the financial stability of the distributor is important to view in the context of the transaction structure as well as from the perspective of how far into the distribution process the films are. Also, all distributors maintain strong relationships with the various distribution channels and these relationships can help significantly to maximize cash flow even from a less successful film. The later it is in the film’s cash flow cycle the simpler it becomes to transfer distribution in a worst-case scenario. If a film has already completed its box office release and has begun selling through video, the other distribution channels become governed by the output distribution agreements, and therefore the distributor’s financial survival becomes less critical.

OUTPUT DISTRIBUTION AGREEMENT

One of the greatest advantages to working with a larger, more established studio as the distributor is that they have strong relationships in all the major film output channels. The stronger these relationships, the better able the distributor is to market even the weaker-performing films. Most of these relationships are contractual and require the output channel to purchase all films that meet certain criteria at a price typically based on the film’s box office performance. The stronger the studio’s track record has been the better the terms of these agreements since output channels have a strong desire to work with the better studios.

USE OF PRE-SALES

One fairly common film distribution strategy will call for a sale of one or more of the distribution markets and/or channels ahead of time to a separate investor. As an example, the studio or the distributor may elect to sell the rights to distribute a film or films in Australia or could sell the rights to distribute the Pay TV rights. Often this decision is made during the development or pre-production process (or even earlier) while establishing the film’s budget. It represents a way to reduce the film’s performance risk to the studio, and hence the risk to a co-investor who purchases a share of the studio’s rights to the film. Essentially, some of the upside in the film has been exchanged for earlier and definitive cash proceeds thereby reducing downside risk. Typically, all proceeds from pre-sales are either shared as gross receipts between the studio and the co-investor or are applied to reduce the price paid by the co-investor for the film right.

USE OF TAX CREDITS

Many U.S. and international jurisdictions offer tax credits to the studio as an inducement to produce a film in their territory. These tax credits can have a material impact on the profitability of producing a film. Tax credits are typically applied against the Direct Negative Cost (direct, out-of-pocket, production cost) of a film, thereby reducing the price paid by a co-investor for the film rights. Timing of the tax credits can be an issue that makes it difficult to give credit to in cash flow modeling exercises since they may not be paid for one to three years. Studios also maintain relationships with investors who purchase these tax credits depending upon their local tax jurisdiction.

Alignment of Interests

There are many ways the studio and/or the talent can make money from a film even when the film itself is overall a money loser. Below lists various areas where the transaction can protect itself from an alignment of interests’ perspective:

Production: The studio typically charges a producer fee and also has the ability to reimburse themselves for overhead expenses and financing costs (during the production period) in the film’s budget. The



stronger production arrangements, from the co-producer/issuer's perspective, limit the producer fee to a small amount (and therefore not significant enough to incentivize the studio to produce poor films) and often allow this fee to be "clawed back" in the case of poor performing films. In the case of overhead expenses, these amounts also need to be either excluded when calculating the co-producer's acquisition price or capped and based on true out-of-pocket, versus soft expenses. Financing costs need to be based on the studio's true costs and should not allow for a profit margin. Depending upon the transaction structure, film selection process can be critically important to minimize adverse selection and insure the transaction performance is consistent with the studio's overall track record and prospective performance.

Distribution: The studio/distributor typically charges a distribution fee as a percentage (typically 10% – 15%) of top-line film revenue and an incentive distribution fee based on true profitability. Most well-structured distribution contracts limit the former and seek to maximize the latter. Also, since the distributor is responsible, in most deals, to advance the P&A costs, the deal documents must be reviewed to ensure only true out-of-pocket, third party expenses are being reimbursed by the deal.

Film Talent:

- **Participations** expenses represent expenditures arising from profit participations paid to talent (actors, directors, producers), as an economic interest in the performance of a film. Participations are either structured on a gross or net basis and vary widely depending on the talent involved in a film. Participations are typically paid after the release of a film contingent on certain performance statistics such as box office receipts and these participations are distinct from advances or salaries paid to talent during production which would be included in the negative cost of a film. Obviously participations can vary considerably on a by film basis, based on the overall performance of the film and whether talent is participating on a gross or net basis. The Salter Group has observed participations generally ranging from 3-5% of gross receipts, with home video at a 20% royalty. When talent has exchanged some or all of their guaranteed salary for a larger participation, this represents a powerful alignment of interests.
- **Residuals** expenses represent expenditures arising from contractual obligations that talent (actors, writers, directors) receive under collective bargaining agreements with various guilds (i.e. Screen Actors Guild, Writers Guild, Directors Guild, etc.) from television receipts (typically 12.4% of 100% all television receipts) and home video receipts (typically 18.1% of 20% of video receipts). Unlike participations, residuals are fairly formulaic and therefore do not represent an active decision on the part of talent to forgo guaranteed salary for upside. However, since the better the film performs, the greater the residual payments, this still represents an additional area where interests are aligned.

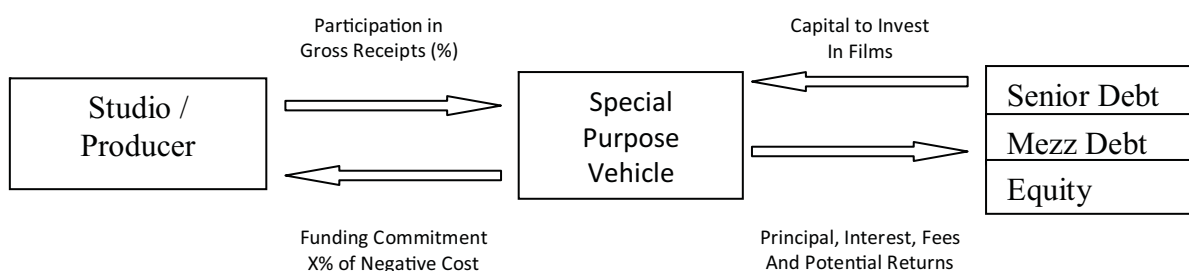
Transaction Structures

In the typical co-financing film slate structure, the initial owner of the film rights (referred to as the film's producer) is usually a major studio or an Independent. The producer has the responsibility to finance and produce the film. The direct production costs, including certain development costs and salaries of key talent but excluding allocated production overhead, capitalized interest and other such charges, is referred to as negative costs. Once the film is completed, the producer sells a portion of the intellectual property rights to a third party investor (referred to as the co-investor). The transfer price mechanism can vary but is typically based either on Negative Costs or on the total, pre-approved budget. To the extent the transfer price reimburses the producer for overhead and capitalized interest, payment of these amounts, this essentially weakens the alignment of interests with the producer.



At the same time the film rights are sold, the producer will retain the full distribution rights or transfer a portion to the co-investor. If the producer is an independent without distribution capabilities, the producer will contract with a third party distribution company. The distributor will be paid a distribution fee equal to a percentage of top line revenue (Gross Receipts) plus an incentive fee based on bottom line profits or even based on net cash flow after repayment of debt.

There are a variety of ways the co-investor can finance the acquisition of their share of the film rights and securitization represents an attractive option. As with other asset classes, securitization allows the borrower the ability to transfer the risk of performance to the capital markets and also may reduce the borrower's cost of funds. A typical securitization structure could be simplified as follows:



The film rights are transferred to the bankruptcy-remote, special purpose vehicle (SPV) so as to reduce the risk to the transaction of a bankruptcy of the Studio / Producer. It should be noted that most securitizations have not included a true sale opinion governing this transfer. It is fairly common, mostly to insulate the studio from legal liability associated with film production, that each film is owned by a separate SPV set up by the Studio and then interests in these rights are transferred directly to the securitization SPV. In either case, to the extent the transfer to the transaction's SPV is not viewed in a bankruptcy of the studio as a true sale, the transfer is also backed up by security interests filed in the intellectual property rights. For further details on the legal structure, see "Legal Considerations" herein.

There are two basic types of co-financing arrangements. In the simpler model, the investor purchases a closed-end portfolio of film rights from the studio/producer. The portfolio can vary in terms of the stage of release, and in some instances (referred to sometimes as "Library Acquisitions") the investor has purchased a slate of film rights where each of the films was released years earlier. This type of program lends itself well to a straightforward term securitization structure. At the other end of the spectrum, there are programs established to purchase rights in future film projects that may not yet have been identified or may only be loosely described. Typically, these programs have fairly specific investment criteria that need to be met (such as minimum and maximum budget, minimum number of screens upon release, minimum P&A spend and allowable ratings from the MPAA – such as not allowing NC-17 or G rated movies as an example). These programs are typically funded with a revolving securitization structure that allows for new films to be acquired so long as there remains capacity in the funding structure and so long as deal performance triggers have not been breached.

TYPICAL WATERFALL

In the typical film securitization, Gross Receipts (the investor's contractual share of the gross revenues for the transferred film rights) are run through the transaction waterfall as follows. Transaction waterfalls can vary depending upon which of items 2-4 are advanced by the Distributor or Studio and which are advanced by the transaction:

1. Pay the distributor the top-line distribution fee (sometimes subject to a cap) and any incentive distribution fee (if applicable)
2. Reimburse the distributor for P&A spent (subject to negotiated caps)
3. Reimburse the distributor or studio for participations and residuals (subject to negotiated caps)



4. Pay SPV operating expenses (subject to a cap)
5. Pay senior interest
6. Pay senior principal (for a term structure) or acquire new film rights (for a revolving structure, to the extent investment conditions are met)
7. Reimburse capped amounts above
8. Pay mezzanine debt and equity, pay incentive distribution fees

In assessing a film rights transaction, DBRS models the liability structure based upon the waterfall described in the governing legal documents. Critical to assessing the waterfall structure is a complete understanding of the definition of Gross Receipts that have been transferred to the SPV and run through the waterfall. As a result, DBRS focuses on how expansive or limited the sources of revenue are in the transaction. For instance, a Gross Receipts definition that includes all potential sources of revenue, whether existing today or developed in the future is preferred over a structure that has carved out certain sources of revenue. Such limitations run the risk of weakening the alignment of interests with the Distributor.

Additionally, DBRS strongly prefers the inclusion of caps on all amounts higher than senior noteholder debt service. These higher priority payments, such as P&A spend, participations and residuals, and SPV operating expenses represent areas for material cash flow leakage and can reduce the likelihood of payment to the senior note holders to the extent costs become excessive.

Finally, on revolving structures, the presence of triggers (both deal performance triggers and financial triggers tied to the Studio and Distributor) needs to be evaluated as part of the cash flow modeling / stressing process.

STRUCTURED EXITS

Many film securitizations employ a Structured Exit feature. The Structured Exit essentially acts like a put right back to the studio and allows the SPV to put the film rights back to the studio based on a pre-defined valuation formula. The put value is typically based on ultimate projections from one or more third party valuation firms. The ultimate projections are essentially cash flow projections for the remaining distribution channels on a film by film basis, based on cash flow realized to date in the earlier distribution channels. So long as the Structured Exit is an optional put that cannot create a loss for the senior note holders, this feature is viewed as a positive. However, in assessing the likelihood of the put being successfully exercised, DBRS also assesses the financial strength of the studio as counterparty. This feature simply shortens the expected life of the transaction and is not viewed in any way as credit support.

TRANSACTION DOCUMENTS

In addition to the typical securitization transaction documents, there are several legal documents that are specific to film securitizations. The two most critical are the cost-sharing agreement and the output distribution agreement. The cost-sharing agreement governs how the costs of production and distribution are born by the studio, the co-investor and the distributor. The output distribution agreement spells out the existing relationships that the distributor maintains with the various output channels which drive the distribution economics. The terms for both of these documents should be understood thoroughly before the transaction is modeled to insure that the modeling assumptions match the business arrangement.

Key Variables Impacting Film Rights Securitizations

There are several key variables impacting film rights securitizations including the operating company, asset quality and transactional structural features as well as the alignment of interest in the transaction. The sections below discuss the items DBRS reviews with regard to these items when rating a film rights securitization.



OPERATING COMPANY FEATURES

Studio/Producer: Track record, financial strength, retained risk, strategic importance

Distributor: Track record, financial strength, alignment of interests, strategic importance

SPV: Some transactions employ a manager on behalf of the SPV and in other instances the equity holders play an ongoing, active role. Responsibilities may include: (1) monitoring film performance and adherence to deal reporting requirements; and (2) actively selecting films to be included in the transaction.

ASSET QUALITY FEATURES

Definition of Gross Receipts: The more inclusive the better. Ideally, the definition should include not only all cash flow from existing distribution channels but any new sources of cash flow developed in the future. It is important to assess the definition very closely, as the more exclusions (either stated or by omission) from Gross Receipts transferred to the SPV, the more difficult it becomes to ensure proper alignment of interests with the studio. Cash flow that is indirectly attributable to the films, such as tax credits for production in certain tax-advantaged jurisdictions, can be significant. These amounts should either be included in the Gross Receipts definition or applied to reduce the cost paid by the SPV to acquire the film rights.

Film Selection Criteria for future films: Criteria should be thoughtful from a credit perspective (maximizing diversification and positive attributes while minimizing riskier attributes) and safeguard against adverse selection. In considering film selection criteria, the SPV's rights to Gross Receipts (see above) should be taken into consideration. For example, if the SPV does not own a percentage share of all Gross Receipts related to a film, but rather a more narrowly defined interest (such as a limited geographic region), the film selection criteria should reflect films which are more likely to succeed relative to the specific rights owned. If the SPV owns the international rights to a film only, it is important that the films selected are expected to do well internationally. At the same time, limiting the rights which the SPV owns relative to the entire film rights increases the risk for adverse selection and the selection criteria need to be reviewed closely in that context.

Historical Film Performance for existing films: The more films that have already been completed prior to evaluating the transaction, the easier it is to forecast future transaction performance. Historical film performance can be viewed in two contexts. First, the more consistently the existing films have performed to date, the easier it is to predict future film performance. Second, the studio's previous ultimate projections should be reviewed against the films' actual performance to evaluate how accurate the studio's projections have historically been.

Studio Ultimate Projections for existing film: Prior to a film's completion, ultimate projections represent not much more than an estimate by the studio. However, the use of pre-sales as well as the existence of a distributor-favored output distribution agreement can materially increase the predictability of future cash flows. Once the film has been completed, and the more time that has passed since its initial theatrical release, ultimate projections become increasingly formulaic and straight forward to estimate.

TRANSACTION STRUCTURAL FEATURES

Covenants and Triggers: For transactions that fund future films, DBRS views favorably those transactions that have performance and financially based triggers that can terminate future funding and cause the deal's waterfall to revert to a rapid pay structure. However, these features are not often found in film-backed securitizations, as their inclusion tends to make the equity and mezzanine debt far more difficult to sell. In a revolving structure, the senior debt holders will want to stop funding new films as soon as possible if the transaction is under duress. This maximizes the protection provided by the deal's equity and mezzanine debt (since these fund new film purchase first before senior debt is drawn down). At the same time, the equity holders do not want to cut off new film purchases when the first few are under-performing. Rather, the equity holders typically want to fund as many more films as possible with



the hopes of accumulating a diverse slate with some successes. For this reason, many revolving structure deals may not have the triggers in place that DBRS would find necessary to rate those structures. In certain instances, there may already be a very strong library of completed films in the transaction which serves to mitigate this risk to the senior debt. For example, the earliest films may have been so successful, as to insulate the senior debt from even the worst performing films in the industry going forward.

Waterfall: DBRS reviews the costs which are paid out ahead of senior note interest and principal. To the extent items are paid ahead of senior debt, these items should be capped at a market acceptable, sensible level. The caps should not be so low as to be inadequate to cover the cost of essential services which could jeopardize deal performance.

Liquidity: Sufficient liquidity is expected to be available for critical ongoing transactional expenses, rather than a strict reliance on the Studio or Distributor to cover all necessary payments which may include a reserve fund or other arrangement. To the extent the transaction relies upon the sale of the film library prior to debt maturity, it is important that the structure provides the SPV with the proper rights, resources and timing necessary to sell the library as contemplated.

Reporting/Audit Rights: DBRS considers the frequency and detail of reporting as important components when analyzing the risk in a film transaction. Of equal importance to DBRS is recognizing the reliance on the studio and/or the distributor for the integrity of this information. Third party auditors should be employed to safeguard against misapplication of film gross receipts as well as fraud in the budgets of the films being transferred. Even a transaction that is structured with good alignment of interests can fail to live up to expectations if the studio and distributor are receiving profits that are not underwritten in the transaction. Therefore, DBRS expects outside auditors to diligently review film accounting.

ALIGNMENT OF INTEREST

As discussed previously, it is critical that the interests of the studio and the distributor be properly aligned with the transaction. A thorough understanding of each of the operating documents that govern cost-sharing and distribution is critically important. Historically, the poorest performing co-financing transactions have failed to have strong enough alignment of interests with the studio/distributor. Studios were able to adversely select which films were sold to co-investors, the latter of whom were anxious to become involved with the glamorous film industry. Consequently, rampant spending on both the production and distribution end went unchecked in certain transaction structures.

As a result, most transactions today have incorporated the appropriate safeguards. Film selection criteria either:

- (1) give the investor the right to choose any/all films from those offered by the studio, or
- (2) require the investor to purchase interests in all films produced by the studio during a set time period.

Ideally, investors purchase film rights for direct negative, rather than total production, cost (meaning only direct, out of pocket costs are reimbursed to the studio). If the investor reimburses for production period financing costs, these are limited to the studio's actual cost of funds. In some instances, the investor also pays the studio for a portion of the studios overhead allocable the particular film; however, these amounts should be limited to pre-negotiated levels. Production budgets and P&A spending typically must adhere to pre-approved parameters or else they will not be reimbursed by the investor. These protections and others described in this methodology are to be viewed as a continuum - few transactions have all the possible alignment of interests' features but transactions that are typically highly rated have some aspect of each potential risk protected.



Cash Flow Modeling Approach

DBRS models and stresses the transaction cash flows as follows:

LIABILITY MODELING

- 1) The liability structure is modeled to include all contractual payments in the waterfall. Items with a higher priority to senior debt service are assumed to be at their cap if one exists. Otherwise, stressed case assumptions are made consistent with the desired rating level.
- 2) Floating rate payments are subjected to standard DBRS interest rate assumptions unless adequately hedged.

ASSET MODELING

- 1) In certain transactions, detailed existing film ultimates and studio-specific historical film performance are provided directly to DBRS from the studio or the co-investor involved in the transaction. In transactions where DBRS receives less detailed film-level information directly it may be able to analyze existing and future film performance by utilizing industry financial experts to help generate greater detail based on public and other approved information.
- 2) For existing films, DBRS reviews film ultimates. Stress assumptions are established on a film-by-film basis and depend on where in a film's life cycle each projection is made. Haircuts are applied to the revenue side of each future distribution channel (e.g., domestic home video, international TV, etc.). Corresponding reductions to the expense side are made consistent with the haircuts on the revenue side. For example, to the extent video sales are haircut, video production costs are reduced accordingly to reflect less videos being reproduced. Similarly, to the extent revenues are reduced, participations and residuals (both of which are formulaically driven by revenue) are proportionately reduced as well.

Cash flow which is formulaically determined and contractually owed based on the distributor's output distribution agreement is haircut by an appropriate factor which considers the counterparty risk and the geographic market of the output channel obligor. For example, larger, more diverse markets have multiple competitors for the film's rights. If one counterparty were to default, there would be others to make up the potential lost cash flow. On the other hand, small markets may have no other potential outlets. Balancing this risk is that these smaller markets do not account for significant cash flow.

Cash flow projections which remain subject to a film's performance are haircut by an amount which takes into account both studio-specific and industry-wide volatility.

- 3) For future films, DBRS applies a Monte Carlo modeling approach to randomly generate future film performance based on a data set of historical film performance. Ideally, the Monte Carlo data set is specific to the studio's historical performance and has been further filtered to reflect selection criteria specific to the co-investment transaction. At the same time, the desire to have a relevant data set needs to be offset against the need to have a broad set of statistically significant data. Accordingly, DBRS often endeavors to use a broader data set, further filtered to reflect deal-specific selection criteria. DBRS then models future film cash flows to a confidence level consistent with the desired rating.
- 4) For films not yet completed but at varying stages of development, DBRS may employ a hybrid approach that considers both studio projections and a Monte Carlo analysis.



- 5) Liquidity is stressed to consider the servicing requirements that determine the potential number of days the SPV's cash flow is held by the studio, as well as the studio's rating, and could therefore be subject to bankruptcy stay risk.
- 6) Cash flow timing is stressed to reflect the state of the films in the transactions. For films, the greatest delay typically occurs when production is delayed and/or when the studio delays release of the film for marketing reasons (such as the desire not to go up against a competing strong film). Therefore, DBRS assumes a delay in film completion and release for new production facilities. However, for existing films, there is typically no delay in cash flows as the timing windows are contractually dictated to protect both the studio and the distribution channel.
- 7) For transactions which allow the SPV to sell the rights to the remaining film cash flows (also referred to as "Library Value"), DBRS models the Library being sold within realistic and stressed market timeframes and using appropriate discount rates. An important consideration in assessing the ease and likelihood of the senior notes directing a Library liquidation is the financial motivation of other parties in the transaction (such as the studio, the mezzanine and the equity investors) to pay off the senior debt in order to avoid a distressed liquidation. For example, if the senior note holders have the right to force a liquidation of the Library at a time when the Library Value is thought to significantly outsize the senior note balance, it is likely one of these other parties would pay off the senior notes rather than losing their excess value.

CREDIT ENHANCEMENT SIZING

Base Case: In order to assess the proposed level of credit enhancement for a particular rating, DBRS first establishes a base case. For *Completed Films*, the base case is founded upon the studio's ultimate projections (i.e., "management case"). As noted previously, using the studio's ultimates is generally conservative as studios have historically underestimated a film's ultimates earlier in the film's distribution cycle. For *Future Films*, the base case is derived utilizing two different approaches: (1) a repetition of the films produced to date, and (2) the 50th percentile results under the Monte Carlo analysis described above. Before the Monte Carlo analysis is performed, however, it is first important to make sure the data set used reflects the selection criteria present in the transaction. (For example, if the transaction allows for only films with a budget of at least \$20 million, films with lower budgets should be removed from the Monte Carlo data set).

Stress Case: DBRS applies a stress to the base case described above consistent with the desired rating level. For *Completed Films*, the appropriate stress varies based upon the point in each film's distribution cycle and further based upon the cash flow received to-date as compared to the studio's ultimates for that film. Contractually sized payments based on earlier distribution windows receive a smaller haircut than less "known" payment windows. Also, a studio's specific track record in accurately predicting ultimates is considered and haircuts can be decreased or increased to account for historical stability/volatility. Finally, to the extent one or more third party appraisal firms have reviewed the studio's ultimates, the haircut will be sized to reflect the outside firm(s) opinions. For *Future Films*, cash flows are generated at different Monte Carlo confidence intervals reflective of the desired rating. Stresses are run both in terms of performance of films selected and also the number of films completed each year. In the context of building stress cases, whether for completed or future films, DBRS considers historic performance of the co-production company, the studio and the industry in assessing the proposed credit enhancement levels.

EXAMPLE OF CREDIT ENHANCEMENT EVALUATION

The following charts are provided for illustrative purposes. The actual haircuts and confidence intervals used to analyze a specific transaction should be viewed as a continuum to reflect the relative strength/weakness in various factors discussed in Key Variables Impacting Film Rights Securitizations above.

As an example, assume a film transaction includes both an existing, previously completed slate of films plus funds the acquisition of future, to-be-completed films for a studio. The assets would be modeled



separately for these two distinct components and then the cash flows would be aggregated and run through the waterfall structure.

Existing Slate: The net cash flows (i.e., cash flow available to the issuer) for the existing films would be based on DBRS applied haircuts to each component revenue source in the studio's ultimates on a film-level basis and for each distribution channel. The net effect of DBRS haircuts results in a reduction to cash flow available to the issuer generally consistent with these ranges:

Film Status	Base	BBB	A	AA	AAA
Completed, Not Released ¹	0	15 - 35%	25 - 40%	40 - 50%	50% +
Theatrically Released within past nine months	0	7.5 - 20%	12.5 - 25%	20 - 30%	30 - 40%
Video Released and more than nine months since Theatrical	0	5 - 15%	7.5 - 20%	15 - 25%	20 - 30%

1. Mostly theoretical, as studios rarely provide ultimates to transactions until after the film's studio release

Future Films: The cash flows for the future films to be completed will be generated by using a Monte Carlo simulation, drawing films randomly from an appropriate database of films. As discussed, the database will likely be either an industry-wide, or studio-specific database of historical films filtered to reflect the transaction-specific eligibility criteria. The films produced by this simulation corresponding to the confidence level for the desired rating will generate the cash flows to be run through the waterfall:

	Base	BBB	A	AA	AAA
Confidence Level	50%	78 - 85 %	95 - 98%	99.1%	99.995%

STUDIO RISK

In assessing the credit riskiness of the notes being rated, the relative credit strength of the distributor must also be taken into consideration relative to the transaction structure. Most transactions will not be rated higher than DBRS's assessment of the credit risk of the studio/distributor for the term of the transaction; however, for transactions where the studio/distributor risk is minimal, DBRS may assign a rating higher than that represented by the studio/distributor. For example, a transaction with a very seasoned library of completed films has very little, if any, reliance on the financial strength of the distributor. Conversely, transactions where future films will be delivered face significantly greater studio and then distributor risk. Furthermore, transactions which rely on a put back to the studio in order to pay off the senior debt prior to the stated maturity can be rated no higher than DBRS' assessment of the studio's credit risk.

Legal Considerations

Most of the key legal criteria elements outlined in "Legal Criteria for US Structured Finance Transactions" (September 2009) need to be present in a film securitization as well. The issuer must be created as a bankruptcy-remote, special purpose vehicle (SPV) in a manner consistent with DBRS criteria. Standard enforceability opinions and/or officer certificates are expected to be issued. However, unlike in typical securitizations, transfer of the assets, for film transactions, is governed by a pledge agreement rather than a true sale opinion. Similar to other securitizations, the SPV is granted back-up security interests in the event the transaction is viewed as a secured borrowing, rather than a sale.

It is important to bear in mind that the "assets" transferred to the SPV are not the intellectual property associated with the films, but rather interests in these film rights. These film rights typically represent passive investments in the films, entitling the SPV to receive a contractual percentage interest in net cash flow (after deducting for certain expenses) from the films. These rights do not allow the SPV, typically,



to terminate the distribution agreement with the studio whereby the studio is exploiting or “servicing” the asset.

Since the film rights represent the major asset of the studio, in a bankruptcy of the studio, the creditor’s primary focus would be to ensure distribution continues unimpeded. Any steps taken by the creditors would be to maximize the cash flow of the film rights. Typically, if the studio is intending to emerge from bankruptcy, the distribution will continue and all resources of the studio will be focused on first distribution for existing films and then production of new films. If the studio is in a liquidating bankruptcy, the creditors’ primary focus is to find a new studio that will purchase the bankrupt studio’s film and distribution right (often referred to as “library acquisitions”). In discussions with senior management with several major studios, each indicated a strong appetite to purchase film distribution rights as it allows the distributor to further leverage its infrastructure without much additional cost.

In the case of a revolving structure, an additional bankruptcy risk must be analyzed - that of the legal status of the cost-sharing agreement. To the extent this agreement is viewed as an executory contract, it is possible that under a studio bankruptcy, the receiver for the debtor (studio) could reject the contract. In this event, the studio could stop selling future films into the SPV. However, since most revolving transaction structures allow the SPV to stop purchasing new films upon a bankruptcy of the studio, this isn’t a risk to the transaction. In most cases, it will be in the SPV’s best interest to stop funding new film production for a bankrupt studio.

Additional bankruptcy/operating risk exists to the extent, as in most film securitizations, the studio co-mingles collections from the film assets. Since the Studio acts as distributor for both the SPV and itself, and since the film rights are usually distributed fractionally (rather than split by different revenue sources), it is practically impossible for the studio as distributor to keep the SPV’s cash flow from the assets separate from its own until it distributes the SPV’s share of cash flow to the SPV. This creates potential liquidity risk, to the extent SPV funds being held by the distributor are subjected to a bankruptcy stay. Ultimately, counsel believes these funds would be viewed as belonging to the SPV; however, this additional timing delay is considered by DBRS in stressing the transaction cash flows.

Accordingly, DBRS views film transactions as having significant operating risk and will not typically rate the securities higher than the studio’s issuer rating; however, DBRS reviews each transaction’s mitigants to operating risk on a case by case basis to determine the appropriate rating. These may include:

- Film libraries that are very seasoned and have little or no further operating requirements of the distributor.
- Transactions using reserve accounts, cash sweeps and lock-boxes to minimize co-mingling risk.
- Transactions that are significantly over-collateralized based upon very strong performance of earlier, completed films.

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