A GENERAL OVERVIEW
In 2001, we spent a record $812 million on 93 million movie tickets at one of 1,855 movie theatres. Australia’s average admissions per capita are among the top five in the world at 4.7 visits per annum.

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Australia has a thriving film industry. We have been movie-makers and watchers for more than a century.

The first movie screening in Australia was in Melbourne in 1896; Henry Lawson wrote one of our earliest screenplays in 1897; and The Story of the Kelly Gang, filmed in 1906, is reputed to be the first feature length film made anywhere in the world.

**Australians love the cinema.**

Going to the pictures is the most popular cultural activity for Australians, according to the Australian Bureau of Statistics (ABS). In 1999, 67 per cent of Australians aged 15 years and over went to the cinema at least once a year – that’s almost 10 million people.

In 2001, we spent $812 million on 93 million movie tickets at one of 1,855 movie theatres. Australia’s average admissions per capita are among the top five in the world at 4.7 visits per annum.

Australia has had two films in the all-time Australian box office top 10. Australian-made Crocodile Dundee is ranked number two (beaten to the number one spot by Titanic).

Australia won its first Academy Award in 1942 with Kokoda Line (Best Documentary Feature). Since then, Australians and their work have been nominated for over 90 Academy Awards and have won 30 awards in a myriad of categories.

In 2001, a record 13 Australians were nominated, and three awards were won (Best Art Direction and Best Costume Design for Moulin Rouge, and Best Cinematography for The Lord of the Rings: The Fellowship of the Ring).

At the Cannes Film Festival, Australians have won 14 awards since 1980, starting with Jack Thompson for Breaker Morant (Best Supporting Actor) and including Jane Campion in 1986 for Best Short Film (Peel), and the Palme d’Or for The Piano in 1993.

An early, significant success for Australia offshore was at Cannes in 1976 with The Devil’s Playground. Picnic At Hanging Rock (1975) and Cad Ole (1976) were both critically acclaimed. The following year, 15 films were presented at Cannes, with the first film accepted into official competition, The Chant of Jimmie Blacksmith (1978) followed by My Brilliant Career (1979) and Breaker Morant (1979).

To the end of 1985, the second top grossing film of all time was Australia was the local production, The Man from Snowy River (1982), which ranked almost as well as Hollywood’s ET blockbuster, the top grossing film until 1985.

Australians are able to produce the box office break-out – a film that costs a few million to make but generates millions upon millions of ticket sales worldwide. Crocodile Dundee, which cost around $US6 million to make, took $US289 million at the global box office. This represented a higher gross return on capital invested than the US film Titanic, released in December 1997, which cost $US211 million to make and took $US1.8 billion at the box office.

And we are also good at low budget steady-return films. Australians delivered The Piano, which cost about $US7.1 million but grossed but grossed about $US140 million globally; Shine cost around $US6 million but grossed $US91 million; Muriel’s Wedding cost about $US3 million but made $US60 million globally.

For a long time, Australia has produced world-class actors, recognised internationally for their integrity, talent, professionalism, originality and energy, including: Errol Flynn, Chips Rafferty, Peter Finch, Leo McKern, Mel Gibson, Nicole Kidman, Russell Crowe, Toni Collette, Heath Ledger, Guy Pearce, Bryan Brown, Judy Davis, Eric Bana, Portia De Rossi, Cate Blanchett, Geoffrey Rush, Hugh Jackman, Anthony LaPaglia, Naomi Watts, Francis O’Connor and Rachel Griffiths.

And Australian directors have made significant films: For example, Peter Weir; Picnic at Hanging Rock, The Truman Show, Green Card, Witness, Dead Poets Society; George Miller; Babe – Pig in the City, Mad Max 1, Mad Max 2, Mad Max 3 – Beyond Thunderdome, Lorenzo’s Oil, The Witches of Eastwick. Phillip Noyce; The Saint, Clear and Present Danger, Patriot Games, The Bone Collector, Rabbit Proof Fence, Baz Luhrmann; Romeo + Juliet, Strictly Ballroom, Moulin Rouge. Gillian Armstrong; Oscar and Lucinda, Charlotte Gray, Bruce Beresford; Driving Miss Daisy, Black Robe, Double Jeopardy; Jane Campion; An Angel at My Table, The Portrait of a Lady, The Piano, P. J. Hogan; My Best Friend’s Wedding, Robert Luketic; Legally Blonde. Fred Schepisi; Roxanne, The Russia House, Last Orders; Six Degrees of Separation. Chris Noonan; Babe.

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**TOP 10 FILMS IN AUSTRALIA OF ALL TIME (A$ million)**

<table>
<thead>
<tr>
<th>Film</th>
<th>Earnings</th>
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<tbody>
<tr>
<td>Titanic</td>
<td>$57.6</td>
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<tr>
<td>Crocodile Dundee</td>
<td>$47.7</td>
</tr>
<tr>
<td>Lord of the Rings: The Fellowship of the Ring</td>
<td>$46.7</td>
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<tr>
<td>Harry Potter and the Philosopher’s Stone</td>
<td>$42.3</td>
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<tr>
<td>Star Wars Episode 1: The Phantom Menace</td>
<td>$38.8</td>
</tr>
<tr>
<td>Babe</td>
<td>$36.8</td>
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<tr>
<td>Jurassic Park</td>
<td>$33.0</td>
</tr>
<tr>
<td>Star Wars Episode 2: Attack of the Clones</td>
<td>$32.7</td>
</tr>
<tr>
<td>E.T.</td>
<td>$32.7</td>
</tr>
<tr>
<td>Shrek</td>
<td>$32.0</td>
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</table>
Commercial Script
Investors providing capital for a film will want to ensure production starts with a commercial script. If the script is not right, it may be re-written. It should have broad appeal so that it will have the best chance of working in not only the Australian market but also in the international market.

Crew
After the script, investors want a high profile cast and reputable crew. The director, who has the principal creative input, has to translate the screenplay from paper onto film. He or she has to have a vision for how the film will work and look. The producer must be able to bring together cast and crew, find money to finance the film and keep the budget under control. A producer is also responsible for organising distribution, often employing an international sales agent to sell the offshore screening rights to the film.

Distribution
Distribution is the lifeblood of the film industry. If you can’t get your film screened, then it won’t make money at the box office. Box office takings can have significant impact on the level of income ultimately derived from the various distribution channels, including video and DVD sales and rentals, pay TV and free to air TV sales.

Generally, more money comes back to investors from the sale and rental of videos and DVDs than is derived from box office takings. Australians might have purchased 93 million movie tickets in 2001 but almost nine out of 10 Australian homes have a VCR and Australians spent $1.56 billion on videos in 2001, including both rental and outright purchase. Australia has one of the highest rates of VCR penetration in the world at 88 per cent of metropolitan households, with 24 per cent owning more than one VCR.

But we are also early adopters of DVD technology. In the year to October 1998, fewer than 4,600 DVD players were sold in Australia. The following year, 30,000 were sold. By March 2001, Australians had purchased 400,000 DVD players, and there were a large number of DVD-capable computers, stereos and game consoles in Australian homes.

Budget/Deal
Productions must start with an appropriate budget, which should be stringently managed throughout the production process. The budget must not be padded with unnecessary costs or fees. Investors should be able to see their money on the screen.

Each deal for a film differs but a good deal should clearly set out how the gross income earned by the film filters down to investors. This is explained under “Cash Cascade”.

Robert Slaviero, Managing Director of Hoyts Distribution, says starting with a good script is crucial to getting box office returns. He tells the story of a first-time producer who brought a film proposal to Hoyts Distribution, seeking to lock in distribution rights before the film was made. This can offset some of the risk for financiers and investors as it guarantees that once the film is made it will be screened.

“The producer and director did not have a track record. But the film was packaged professionally and the director had a clear vision about how the project should proceed.”

“You could see that these guys had the right idea,” Slaviero says. “But the script was not tight enough.”

The script was sent to the US for some Hollywood re-writing and editing. $20,000 later the script was much better and the film had a good chance of doing well at the box office.

“Taking the time to get it right counts,” Slaviero says.
In 2001, American and European blockbusters including Shrek, Harry Potter and the Philosopher’s Stone, Moulin Rouge, What Women Want and Bridget Jones’s Diary boosted gross box office takings in Australia to $812 million, up 17.8 per cent from 2000.

How a film performs at the box office is not the end of the story for investors. But it does have some bearing on how much money a film generates over its long shelf life. Films can be sold many times over during their life to various platforms such as pay TV, free to air TV, video and DVD and any other new platforms such as digital or interactive that currently exist, or are invented in the future.

Throughout the long life of a film, usually these initial distribution licences will expire and the sales agent or the distributor can re-license and re-sell the film to these platforms again and again. We only need to watch pay TV and free to air TV to see many old favourites attracting a fresh new audience.

For example Australian films such as The Squatters Daughter from 1933 and Judy Davis’ High Tide from 1987 are still being screened on Foxtel, and Turner Classics have a dedicated channel running classic films from as far back as the 1920s. Disney classics like Bambi, Snow White and Cinderella, play over and over again; TV series such as I Dream of Jeannie, Bewitched and Hogan’s Heroes are all re-run on pay TV and free to air TV.

In 2002 promised even more with the release of the sequels to Star Wars, Men in Black, Harry Potter and Austin Powers, the first of the Lord of the Rings films, and new features such as Spiderman.

In a major report on the state of the entertainment and media industries published in May 2002 (Global Entertainment and Media Outlook: 2002-2006), PricewaterhouseCoopers (PwC) forecast industry growth at a compound annual rate of 5.2 per cent to 2006. PwC expects entertainment and media spending in the Asia/Pacific region will rise from $US215 billion in 2001 to $US279 billion in 2006. PwC estimate gross box office takings will increase from $A812 million in 2001 to $A1,011 million in 2006 in Australia alone.

DISTRIBUTION – AUSTRALIA AND NEW ZEALAND
Net distribution revenue from all sources earned by exploiting a film generally flows to investors until they have recouped their investment. Once investors have recouped, further net distributions are usually shared with the producer, often on a 50:50 basis.

Theatrical Release
The producer, director and cornerstone investors generally hold the copyright to a film. Once a film project is on track, they appoint a theatrical distributor to get the movie into cinemas. This is known as the ‘theatrical release’ and revenue starts to flow from the box office takings.

In Australia, the average admission price in 2001 was $8.78, $30 being the top price. A percentage of this box office is paid to the theatrical distributor, who then deducts their approved expenses such as the cost of P & A (making film prints and advertising the film) and also their commission for distributing the film. The balance, if any, after these deductions, is then forwarded to the investors.

Video and DVD
Approximately four to nine months after theatrical release, films are usually released on video and DVD, where there is again an opportunity for a film to earn income for investors. Video and DVD exploitation can be substantial income generators for the film. Each video or DVD may cost the video rental store $25 to $100 to buy. Only a small portion of that represents the cost of making copies of the video or DVD for sale or rental.

Videos and DVDs are also sold in what is known as the ‘sell-through’ market. These videos are available for purchase by consumers and usually sold through retail outlets such as David Jones, Grace Bros/Myer, Target. They might bring in $20 in revenue for each video or DVD made. A portion of this revenue will remain with the video/DVD distributor and the balance will flow back to investors. Revenue can be substantial from these rights so it is important to negotiate the best deal terms with the video distributor to ensure that a good revenue stream flows back to the investors.
Sources of Income (continued)

Pay TV Rights
About twelve months after video and DVD release, the film may then be seen on pay TV. The pay TV channel licenses the rights to broadcast the film several times over a set number of years.

Free to air TV Rights
After pay TV, screening rights are then sold to free to air TV. Again the commercial TV station has the right to screen the film a number of times during a set period.

DISTRIBUTION – INTERNATIONAL
A further area of potential income is from international sales. To exploit these markets, an international sales agent is usually appointed to secure the same sales in offshore markets, such as the United States, United Kingdom, Germany, France, Italy, Spain, Latin America. The sales agent charges an agreed commission for this function and is also permitted to deduct a certain level of costs. The commission and costs are deducted from the international sales revenue and the balance then flows back to investors.

Babe, distributed by Universal Pictures and released in 1996, made DM52,478,518 at the German box office (gross). At the UK box office, it made GBP20,280,379 and $US63,658,910 in the United States. In Australia, box office was $36,776,544.

MERCHANDISING
And then there is merchandising. Children’s films are most frequently associated with merchandising rights. This includes character dolls and other toys featured in a particular movie such as Star Wars, Toy Story, Bananas in Pyjamas, Pokemon, Shrek and The Lion King. The release of a soundtrack may also generate income as does the sale of airline rights and non-theatrical distribution to hotels, motels and clubs etc.
Distribution

Unlike the US market, Australia has a very strong independent film sector. Producers are described as ‘independent’ if they are not directly employed by one of the big Hollywood-based studios, like Warner Bros or Twentieth Century Fox.

The independent sector is generally prepared to try something different and frequently operates on a much lower budget, but without compromising the films’ quality. Independent films are generally more leanly budgeted and run as there is no studio behind them to provide additional funding should the budget of the film blow-out. Sometimes, an independent will secure a distribution deal with a major studio to screen a film. The independent film sector has been so successful that large studios have bought into many independent companies. This was the case with Miramax and Disney, New Line and Warner Bros, and Working Title and Universal.

Getting the distribution right is as important as good casting and getting the film screened is crucial to successful returns. Hollywood-based studios frequently negotiate distribution deals with cinemas that can tie up screens and block out smaller films. For instance, a big budget film-maker might agree to provide a cinema chain with 10 blockbuster type movies a year. But the cinema owner will have to agree to show each film several times over several weeks.

Globally, studios sometimes work together to ensure that they do not launch big budget films at the same time. A blockbuster movie, like Spiderman, may be scheduled to start screening every 20 minutes in a multiplex cinema complex. Major distributors schedule movie releases to gain optimum screening times. For instance, animated family films will be released at the start of school holidays and box office blockbusters are rarely released at the same time because they could crowd each other out. According to Variety magazine, Scooby-Doo the movie did well at the box office in Hong Kong, and performed steadily in early screening sessions in the UK and France. “But the canine caper plunged in Spain, where Ice Age was a stronger draw.”

These factors may mean that the small, local, independent film-maker might have trouble securing any significant or worthwhile screening time for a local production.

One way of overcoming this problem is for the producer to seek a significant commercial industry player as an investor. The producer may then leverage off the industry player’s position in the market to negotiate attractive distribution rights and profit-sharing arrangements.

This may also assist development of relationships with distributors and ensure the film will be screened often enough and at the right session times to maximise gross box office takings.

Examples of industry players in Australia include Village Roadshow, Hoyts and Macquarie Bank Group.

Income flows to investors once costs are covered – these costs include the film’s total fees paid to the exhibitor, the distributor, the international sales agent including marketing costs, and P & A, which covers prints (actual copies of the film) and advertising. If investors hold their equity in the film through a fund, the costs of running the fund will be deducted as well.

Some film-makers may seek out pre-distribution deals that might involve a distributor advancing cash which may be cashflowed into the production of the film. If an advance is made, this is normally repaid from box office takings before funds flow back to investors.

Film production has typically interested investors because of the ‘blue sky’ potential, or what is known as a ‘break-out’ hit. A ‘break-out’ is highly difficult to predict. It occurs in the case of a film such as Crocodile Dundee, which cost $US6 million to make, and brought in a staggering $US289 million globally at the box office alone.

The cinema usually keeps between 45 and 75 per cent of box office takings. The distributor, who licensed the theatrical distribution rights, then deducts its distribution fee and redeems P & A expenses. Anything remaining will usually flow to investors until their equity is recouped. Once the film is in profit then this revenue will be shared between the investors and the producer.

As a hypothetical example, if a film generated $1 million, the cinema may keep $600,000. The distributor will receive $400,000 and deduct between $80,000 and $160,000 as a distribution fee. The balance (between $240,000 and $320,000) after meeting P & A, would be returned to investors.

A distributor in Australia might also arrange for the film to be put onto video and DVD, and sold to pay TV and free to air TV.

A sales agent, who arranges the sale of the film offshore, will usually negotiate an initial lump sum sales price with a distributor in each territory. The sales agent then deducts their commission and costs from this lump sum and the balance then flows back to investors.

The initial purchase is recouped by the distributor against theatrical, video, DVD, pay TV and free to air TV revenue in the territory and once it is recouped additional revenue will flow back to the investors.

Generally speaking, the director and producer hold a portion of the copyright of a film. An early investor, or an investor who takes a large stake in the film, would generally hold the balance of the copyright and entitlements to income from all future sales of the film in any jurisdiction. This may include a group of investors who acquire interests in the copyright in a film through a fund.

Distribution is the lifeblood of the film industry and getting a screening slot for your film can mean the difference between cinema life and death.
Money In/Money Out

The capital structure of any film, just like the financing of any major asset, is complex and dedicated to detail.

There are always many more projects on the drawing board than are ever made; the competition for funds is intense and the funding structures unique to every project.

“In any year we might review upwards of 300 film scripts but only invest in three to six projects,” says Jennie Hughes, co-executive producer of Dirty Deeds, and Executive Vice President of Macquarie Filmed Investments.

Once a producer has pulled together a final draft of the script and the director has expressions of interest from key cast members, they work on a detailed budget and start discussions with distributors. The producer also begins the hunt for funds.

Funds may come from the government in the form of grants, subsidies, an equity stake, grants in kind, or from the private sector.

Government funding may come from state or federal bodies. The Film Finance Corporation of Australia, a federally funded body, often takes equity stakes in projects, which means that over time they seek to recoup their investment, along with a share of the profits.

State government bodies, such as Queensland’s Pacific Film and Television Commission, Film Victoria or New South Wales Film and Television Office, may provide a small equity investment of up to $400,000 for eligible productions, but also may offer film-makers free locations, presentations and surveys for green-lit productions, and other incentives to shoot in their state such as exemption from state payroll tax and, for example, a Cast and Crew Salary Rebate for Queensland crew.

Private sector investors may buy into a film project through a public offer or via a small, closed and private syndicate, not subject to the rigours of regulation. The producer or others involved in the film’s production may also invest, taking an equity stake.

The Macquarie Nine Film and Television Investment Fund launched in March 2002, made a public offer, issuing a prospectus to raise funds, and outlining a plan to invest in a number of TV and film projects.

Another source of funds is the pre-sale of the film or sale of distribution guarantees which are cashflowed into the film’s production. Investors should note this latter form of funding involves a third party assuming some of the patronage risk of the film, and as a result if the film is a success the investors’ returns will be lower than otherwise would be the case.

Pre-sale agreements can cover screening rights for a film in set territories. The rights sold may include theatrical exhibition, video and DVD, pay TV and free to air TV for a jurisdiction like the United Kingdom.

The sales agent may secure a sale with a UK distributor for an initial licence fee payment which is off-set against future revenue of the film. Whilst the licence fee flows back to the investors, any further revenue is subject to the film’s performance at the UK box office and subsequent recoupment of the initial licence fee. Whilst additional revenue can be forthcoming from major territories such as the USA, substantial revenue associated with a ‘break-out’ film can be limited.

A distribution guarantee or initial licence fee payment involves a distributor agreeing that a film will generate a minimum income, for example $1 million, in a particular market. Some producers will use a distribution guarantee to help finance the film.

For example, the distributor could provide the producer with a letter of guarantee, which could be presented to a bank. If the bank accepts the risk, it lends that amount of money to the producer who then draws down the cash to help fund production of their film.

At the agreed date, the distributor pays $1 million to the producer, usually upon delivery of the film, who repays the bank. In return for this guarantee, the distributor may take a larger percentage of the sales revenue in its territory.

Both pre-sale and distribution guarantees provide funds early in the life of a film project. But they may also compromise returns to investors in the long term. They represent revenue that would otherwise be available to investors. Rights in international territories that remain unsold until after domestic release offer good untapped revenue sources from which investors can benefit.

Nevertheless each project is different and there are no hard and fast rules in financing a film. Each potential source of funding needs to be evaluated having regard to risk sharing, potential upside, alternative source of funds and expectations for the film’s performance in different markets and mediums.
This soft tax regime drew tens of thousands of private investors into the industry, sometimes to finance films just to access very generous tax rebates.

In 1983, the Hawke government reduced these concessions to a 133 per cent deduction and 33 per cent income exemption. They were reduced again in 1985 to 120 per cent and 20 per cent. The concessions were to apply only to those films certified “Australian”; that is, films made with Australian content and inside Australia.

10BA was designed to induce private investors to invest in the industry. In 1979-80, private investment in film was about $2 million; in 1984-85 it grew to about $186 million. In 1985-86 it was estimated 30,000 investors put a further $130 million into film.

A further inducement at this time was that film producers tended to offer guaranteed returns of around 40 per cent over the life of the project regardless of whether the project was a success or a flop. Producers were able to do this by securing pre-sales and distribution deals.

For example, in 1983, a high-income earner who paid 61 cents in the dollar tax could have invested $1,000 in a film and received a 133 per cent deduction, a benefit of $811. With a 40 per cent return, the investor gets back $357. Total return on the investment is $1,168, or 16.8 per cent. If the film made a profit, then this was a bonus.

Unfortunately, many films with little commercial (or artistic) merit were made during this period. Some in the industry believed that the too generous tax breaks gave the Australian film industry a bad name because it fuelled the production of bad films.

Since then, tax rules have changed again. State and federal governments still provide funding to film-makers through various bodies. And investors and film-makers can access tax breaks. But the film must appear to be commercially viable; it must be properly and tightly budgeted and, for all intents and purposes, look like it will make money at the box office. Under current legislation, investors’ money must also be at risk otherwise no tax deduction is allowed.

Chapter editor Diane Collins states that from 1914 to 1928, film was no longer considered ‘just entertainment’. “…(It) became not only the leading entertainment of the age but also an industry remarkable in its influence and organisation”.

In her book, Cinema in Australia a Documentary History, Ina Bertrand documents the development and importance of the movies to Australians. Chapter editor Diane Collins states that from 1914 to 1928, film was no longer considered ‘just entertainment’. “…(It) became not only the leading entertainment of the age but also an industry remarkable in its influence and organisation”. A startling 25 million pounds was invested in the industry to 1928 and it employed 20,000 people.

The industry has continued to prosper partly because successive governments decreed film could be part-financed from federal coffers. Many believed that if a film had cultural significance, it should attract government financing. To some extent, this is still the case today.

In the 1970s most Australian feature films were funded through government agencies such as the Australian Film Commission, the NSW Film Corporation and the Victorian Film Corporation.

Malcolm Fraser’s government debated whether film should have commercial as well as cultural merits before attracting government funding. Film was deemed ‘commerce rather than culture’ and had to exhibit a probability of market acceptance before receiving government funds.

Tax incentives then became a more predominant part of the industry, designed to partly replace outright subsidies. In 1978, the government allowed a reduction in the write-off period for capital investment in films, from 25 years to two years.

In 1980 the Fraser government amended the Income Tax Assessment Act, specifically Division 10BA, to allow film investment, until then a high-risk venture, to be used as a tax shelter for generally high-income earners.

The government granted a 150 per cent tax concession to film investors. This meant that for each dollar invested in an eligible film project, investors could write off $1.50 against their income. And, the first 50 per cent of income an investor earned from a project was tax exempt.

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The two companies were licensed to raise up to $40 million in concessional capital over two years with initial investors eligible for an upfront tax deduction of 100 per cent of the amount subscribed for shares in the company. The companies then invest in a number of productions rather than just one film. This results in diversification and spreads risk for investors.

Macquarie Film Corporation Limited is managed by Macquarie Filmed Investments Pty Ltd. Its first project was the $10 million gangster film *Dirty Deeds*, starring Bryan Brown. It has invested in a further seven films. These are: *The Nugget*, *Crackerjack*, *Horseplay*, *Take Away*, *Danny*, *The Wannabes*, and *Bad Eggs*.

Content Capital, formed in 1999, has structured, documented and partially underwritten the financing of a $12 million animation *Old Tom* from animation houses Yoram Gross-EM.TV and Millimages. Amongst other projects Content Capital also funded the program *The Animated Leunig*.

### 12.5 per cent Offset
In September 2001, the government announced tax breaks for what are known as ‘runaway films’. Runaway films are generally big budget productions that might normally be filmed in Hollywood.

Films qualify for an ‘offset’ tax break if more than $15 million has been spent in Australia during production. The offset is worth 12.5 per cent of qualifying Australian expenditure. The benefit is offset against tax liabilities, with any remainder refunded directly to the company. If claiming this tax offset, producers are unable to use concessional capital (under 10BA or 10B) or seek government funding for the same project.

In recent years Australia has attracted a number of runaway productions, including the *Matrix* trilogy, the *Star Wars* prequel *The Phantom Menace*, *Moulin Rouge* and *Scooby-Doo*. The 12.5 per cent Offset legislation was designed to assist promoting Australia as an attractive destination for producing such high budget films into the future.

In 2002, there were four sets of legislative provisions covering the provision of tax concessions to the industry.

### Division 10BA
Under 10BA investors acquire an interest in the copyright of new, qualifying Australian films and receive a 100 per cent tax deduction. For example, if an investor invested $50,000 in a 10BA certified film in January 2000, the investor could reduce his or her taxable income by $50,000 in the 1999/2000 year.

The Australian Film Commission (AFC) says the aim of 10BA is to encourage private investment in “culturally relevant, high quality Australian film and television productions.”

To qualify, programs must be made wholly or substantially in Australia, be Australian, significantly Australian, or an official co-production.

### Division 10B
Division 10B tax concessions are also available on completion of a project and again apply to qualifying Australian films (which may include certain television productions). The concession applies from the time copyright comes into existence and the film starts to generate income. 10B is relevant to a greater range of productions than 10BA. Tax deductions for amounts invested in qualifying productions are claimed over two years, 50 per cent in the year the copyright was first available for use and 50 per cent the next year.

### FLIC
In December 1998, the federal government passed legislation to allow the establishment of a new pilot investment scheme known as FLIC (The Film Licensed Investment Corporation Act). FLIC was also designed to encourage broader private sector investment in the industry.

FLIC companies (and in 2002 there were two – Macquarie Film Corporation and Content Capital) invest in qualifying Australian film and television productions, such as films, mini-series, children’s drama, animated programs and documentaries.

The government introduced the offset to attract foreign film-makers to Australia and to create more certainty for film-makers after the Australian Tax Office (ATO) rejected applications for a series of 10B productions.
A film that does well at the box office may continue to generate income for investors for some years.

Revenue starts at the box office and cascades through to video and DVD, pay TV and free to air TV and then merchandising, including sales of the soundtrack in Australia and concurrently, the rest of the world.

Screening rights are usually sold in set jurisdictions for a limited time and rights revert back to the copyright holders – usually the producer and cornerstone investors.

In the following example, we assume that there are no pre-sale agreements or distribution guarantees.

For every dollar collected at the box office, the cinema generally takes between 45 and 75 per cent. The balance goes to the distributor. This is known as the ‘theatrical rental’. This percentage can vary, depending on the film and the distributor’s ability to negotiate competitive exhibition rates. If the film is in demand by exhibitors then the distributor can negotiate better rates. Generally a film that takes most of its box office in the first few weeks will mean that the distributor will receive a larger share of the box office takings than a film that might take a number of weeks to reach the same box office amount. Usually the longer a film continues to play at cinemas the bigger the percentage the exhibitors take of the box office.

After theatrical rentals, the distributor takes out ‘costs’ which include the cost of film P & A. Prints are actually copies of the film which are supplied to the cinemas. The advertising budget and the marketing strategy is generally agreed and capped well before the film’s theatrical release. Between $1 million and $2 million might be spent promoting an Australian film to the local market, if the film is mainstream and commercial.

The distributor then takes a fee for distributing the film for theatrical exhibition. This may be 15 to 40 per cent of the theatrical rental.

The remainder of the box office takings, if any, goes back to investors until they have recouped their investment. Further returns, if any, are then shared between the producer and the investors, typically on a 50:50 basis.

If the movie is a ‘break-out’ film (comparitively very high returns at the box office compared to its budget) significant profits could flow back to investors just from theatrical exploitation.

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Approximately four to nine months after screening on the big screen, video and DVD rights are sold, on either a profit-share or royalties basis. (Royalties are calculated as the number of units sold multiplied by a royalty fee). According to Jennie Hughes, “If a film performs well at the box office, 30,000-45,000 videos or DVDs might be sold to video rental stores at approximately $50 a copy. And a further 10,000-50,000 videos or DVDs, known as ‘sell-through’ products, might be sold to supermarkets or department stores, for sale rather than rental, at approximately $20 each.” Income from these sales initially goes to the distributor, who takes a cut before it is passed on to investors. Once investors have recouped their capital and if the film makes profit, the income is shared with the producer.

Movie-makers see huge growth potential in the DVD market. Mark Gareton, the Managing Director of Warner Home Video, named DVD as the biggest Australian success for his company in 2001, and Chris Chard, the Managing Director of Roadshow Entertainment, saw the emergence of DVD specialist retailers and DVD release patterns as significant industry issues for 2002.

DVDs cost much less than videos to make. And they open up multiple income channels for film-makers. DVD allows film-makers to release special editions with interactive endings. A ‘standard edition’ DVD might be followed six months later by the release of a ‘director’s cut’ collector’s edition DVD.

And, just like the music industry’s shift from vinyl to CD, the move from tape to DVD has revitalised the sale of old titles. The Australian Film Commission believes that more than 20 per cent of DVD titles purchased by consumers are movies that are more than five years old.

Returns from videos and DVDs may flow from six months after the movie closes at the box office. Six to nine months after video and DVD release, screening rights may be sold to pay TV and free to air TV. At this time, funds should again flow back to investors.

According to Macquarie’s Jennie Hughes, revenue can be substantial from both free to air TV and pay TV if the box office exceeds $10 million.
Cash Cascade (continued)

Investors may also benefit from a ‘guaranteed minimum TV licensing fee’. In the early days of production, when funds are being raised, a media company may agree to buy screening rights to the film for a set minimum amount. This gives the TV station screening rights. It also means that the film will generate at least this amount in TV rights for the owners and investors. These agreements usually include a clause that allows for higher screening charges if the film turns out to be a box office blockbuster.

Films may also earn their owners profits once they are sold into offshore markets. An Australian film would most likely be sold offshore shortly after the Australian box office launch. If the film has done well at the local box office, it stands a better chance of attracting buyer interest from offshore markets.

Usually under studio deals which are likely to cover multiple territories, if a film makes a loss in one territory, losses may be recovered from another offshore territory. This is known as ‘crossing’. Most Australian films will be distributed in different territories by different local distributors and therefore crossing is not the norm for most Australian films.

DVD and video rights are often sold offshore along with pay TV and free to air TV rights.

Generally, the sale of screening rights is for a limited amount of time. Once that period expires, the rights either revert back to the sales agent or the copyright holders who can sell the rights to exploit the film again and again. Subsequent sales after the expiration of the initial theatrical distribution licence would not generally include further theatrical exhibition, but usually would include re-run sales to pay TV and free to air TV.

Movie Talk

Above and Below the line costs
Movie-makers refer to costs as being ‘above the line’ and ‘below the line’.

Above the line costs include the cost of the story and script, development, producer’s fees, director’s fees and principal cast fees.
Below the line costs include the cost of production management and accounting, assistant directors, camera crew, sound, lighting and grips, still camera crew, wardrobe staff, make-up and hair, technical advisers, the art department and the set construction department, editing staff, casting, and some allowance for overtime.
The budget will also cover the cost of stand-ins, doubles and extras, music, stage rental, location fees, special effects costs, film and lab costs, editing, camera equipment and storage, travel and transport, hotels and catering, insurance, publicity and other expenses.

Additional ‘fringe’ costs include the cost of the completion guarantee, and some legal, finance and administration fees.

Above and below the line costs are broken down to the lowest level to ensure the budget is realistic.

Every cost is budgeted and tracked. Funds are generally raised well before work on the film starts to provide certainty that the film can be made.
Investment Risks

Hollywood has produced more than just screen legends. Tinsel town has also delivered 'Hollywood accounting', a concept that sees investors put their money into films to see it evaporate.

An Australian film might make $7 million at the box office, but if the producer and management team fail to lock in good deals, there might be little or no money for investors.

Everyone has heard the tales of Hollywood largesse: the star who demands a trailer-load of champagne daily; the director who employs a small army of staff; the producer who charges the rent on his entire office block directly to the budget of one movie production.

All these costs, and more, can eat up movie profits. Making movies to make money requires a set of checks and balances. It means having creative people focus on the movie-making and experienced money people working on the budget and costs.

One of the biggest investment risks in the movie business is that the movie flops. But what makes a flop a disaster is, for instance, where there is a blow-out in the budget or the distribution deal secured is uncommercial.

In industry parlance, this is referred to as 'Hollywood accounting'. If left unchecked, Hollywood accounting may soak up profits very quickly, leaving investors with no return on their investment.

The key to getting it right is ensuring costs stay under control and there is no ‘leakage’ in the budget. One way of doing this is ensuring investors’ interests are well represented.

In the past, the producer who raised cash to make a movie might also have been responsible for splitting profits with investors. But the producer’s focus may have been on the creative side of movie-making at the expense of good distribution deals and compiling and sticking to a tight budget.

For instance, a distribution deal where the distributor takes a hefty commission for distribution, plus substantial ‘out of pocket expenses’, erodes profit for investors.

If exhibitors take more than their fair share of the box office and distributors add in costs that don’t relate to the film, income for investors may disappear.

A company that is a cornerstone investor may demand weekly production meetings where executives see what has been filmed each week, what costs have been incurred and expended and whether the film is on track in terms of the budget, script and timetable.

During the production of the film, there should be a clear and regular reporting regime that allows investors or their representatives to match cash flow against budgets. Funds should only be drawn down as agreed milestones are reached.

Sales agents should be monitored once the film is ready for international distribution.

Investors should be sure of the intellectual property rights for each film. And they should be sure where they rank in the queue for income and the timetable for returns.

Investors should ensure they have invested through a company that checks costs and expenses.

This section highlights just with some of the specific risks associated with investing in film.

"As an investor, you have to know the risks. Every film is a risk. Industry knowledge is all about knowing the risks. It is not a science; the movie business is crazy. You stand a better chance of making money if you surround yourself with people who know what they are doing."

Robert Slaviero, Managing Director of Hoyts Distribution
They have close contact with the film-makers throughout the production, trying to resolve issues as they arise. In Australia, this has in the past included the removal of a cameraman from a set, and the replacement of a department head.

But at the end of the day, if the film looks like going over budget or over schedule, the guarantor can step in and take over the entire project to make sure it is finished on time and on budget. The bond company has industry resources it can call on to finish the film. Another alternative is that the bond company may pay investors out.

Movies that run over time in the production phase will perhaps run over budget. And this can have serious implications for revenue.

Completion Guarantees

Movies that run over time in the production phase will perhaps run over budget. This and other unforeseen factors can significantly increase the cost of making a movie.

One way of ensuring movies are finished on time and on budget is to take out a ‘completion guarantee’, a form of insurance that guarantees this will happen. Completion guarantees are industry standard insurance-type contracts that help minimise some of the risks inherent in film production.

Two bond companies provide this service in Australia: First Australian Completion Bond Company Pty Ltd and Film Finances, Inc.

These companies describe their work as a ‘reality check’ for investors. They typically spend a lot of time before production starts making sure that a film has a viable budget and schedule.

They might look at the length of the script and make sure it matches the running time for the film. If the film is expected to be 90 minutes long but the script will produce a movie of 120 minutes, this creates budget and financing pressures.

They may also look at department heads, cast and crew and other key personnel to ensure that they have the right skills and talent to make the film.

And they would look at locations, especially remote or weather-affected shoots. The head of one bond company said: “Movie casts and crew have broken droughts in arid regions.” This could have serious implications for the shooting of a movie.

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Attracting big name film productions means local crews get exposure to international best practice. All this means Australia has the right environment to produce good films. It needs investment to get those films onto the big screen. Australia has a long history of various levels of government support for the film industry. State and federal government agencies can provide funds for films, such as grants that must be repaid as the film produces income. Private investors also invest their money in the hope that their capital, plus interest, will be returned once the film starts taking money at the box office. Whether early returns go back to investors, distributors, the government or other parties involved in the production depends very much on how each film deal is structured.

Investors should make their own enquiries about the parties involved and the structure of the deal before making an investment.

Film stalwarts agree that Australia has a vibrant movie industry. We have produced a disproportionate number of standout actors, directors, producers, costume and set designers, make-up artists, cameramen, special effects technicians and editors.

We have recently produced standout films such as The Castle, Looking for Alibrandi, Rabbit Proof Fence, Chopper, Two Hands, The Dish, The Bank, The Man who Sued God, Lantana and Moulin Rouge, which have all received critical international acclaim.

“Audiences go to the movies to see something that will move them,” says Miramax Film’s Victoria Treole. “Successful Australian films are not budget-driven; they are story and character-driven. It does not matter what the genre is; Australians go to the movies to be entertained, to be provoked and to laugh.”

Hoyts Distribution managing director Robert Slaviero says Australian films that do well have a “feel good factor and broad appeal.” Classic examples of such successes have been Crocodile Dundee, Babe, Strictly Ballroom and Priscilla Queen of the Desert however Australia can also produce successes that are not comedies, but that audiences still enjoy, such as Shine and Lantana. “Lantana bought together all the elements of good film making,” he says. “It had a great cast, director, the camera and technical work was superb.” Lantana, which starred Anthony LaPaglia and Kerry Armstrong, was made for $7.6 million. It took $12.3 million at the Australian box office and has sold very well in the international market including UK and USA.

And Australia has become a popular destination for film-makers. The number of major, or runaway, films made here each year is increasing because Australia has world-class crews and creative talent, spectacular and diverse locations, an abundance of natural light, increased studio space in Sydney, on the Gold Coast and in Melbourne, and world class post-production services.

The Australian-US dollar exchange rate means that it is relatively inexpensive for US film-makers to shoot here and Australia has a very efficient cost base.

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Lights, Camera, Action: Success

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<table>
<thead>
<tr>
<th>Title</th>
<th>Production Costs $US million</th>
<th>Global Box Office Revenue $US million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crocodile Dundee</td>
<td>6.0</td>
<td>289.0</td>
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<tr>
<td>Babe</td>
<td>25.0</td>
<td>245.0</td>
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<tr>
<td>Crocodile Dundee 2</td>
<td>15.0</td>
<td>229.0</td>
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<tr>
<td>The Piano</td>
<td>7.1</td>
<td>140.0</td>
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<td>Shine</td>
<td>6.0</td>
<td>91.0</td>
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<tr>
<td>Mad Max: Beyond the Thunderdome</td>
<td>8.6</td>
<td>69.0</td>
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<tr>
<td>Muriel’s Wedding</td>
<td>3.0</td>
<td>60.0</td>
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<tr>
<td>Strictly Ballroom</td>
<td>2.6</td>
<td>27.0</td>
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<tr>
<td>Young Einstein</td>
<td>4.3</td>
<td>25.0</td>
</tr>
<tr>
<td>Man from Snowy River II</td>
<td>5.0</td>
<td>22.0</td>
</tr>
<tr>
<td>Priscilla Queen of the Desert</td>
<td>3.1</td>
<td>21.0</td>
</tr>
<tr>
<td>The Dish</td>
<td>5.0</td>
<td>13.0</td>
</tr>
<tr>
<td>The Castle</td>
<td>0.6</td>
<td>6.25</td>
</tr>
<tr>
<td>Moulin Rouge</td>
<td>50.0</td>
<td>172.0</td>
</tr>
</tbody>
</table>

* Note: these figures represent gross box office takings, not what equity investors received as a return on their investment.
International Sales Agent: Sells the screening rights to individual distributors in each territory worldwide.

Independent Producer: A producer not linked to a big US studio. In Australia, independent producers are attached to most films.

Principal Photography: This occurs after pre-production and is the stage when the film is shot.

P & A: Prints and Advertising. Prints are actual prints made of the film and advertising is the money spent promoting the film.

Post-Production: This starts once principal photography is complete. This includes editing, special effects, sound, animation and music.

Pre-Production: This involves co-ordinating a large number of elements such as cast, crew, wardrobe, locations and special effects. For a feature film, this process might be spread over six to nine months. At this stage all elements of the production are finalised, including cast, crew, locations, facilities, film laboratories, clerical, accounting, banking and insurance.

Producer: Raises funds to finance the film, prepares budgets and has overall responsibility for making the film including selecting the director, and with the director selecting the production crew.

Production Schedule: A very detailed document that sets out every scene to be filmed in a movie.

Theatrical Release: This is when a movie screens in a cinema.

US Runaway: A film which would normally have been made in the United States but which is made offshore, such as Scooby-Doo, made in Australia on the Gold Coast and Matrix and its sequels, made in Sydney.

Above the line costs: Lead actors, director, executive producer, producer and development costs.

Below the line costs: Key creative personnel, sets, wardrobe, props, film stock, camera hire, financing and administration charges, the vast majority of the budget.

Box Office: Gross cinema ticket sales.

Break-out film: A film that generates revenue in large multiples of the cost of production.

Cast: Actors who appear in the film.

Chain of title: The chain of ownership rights in intellectual property for a film. (It details the intellectual property rights or how the producer has acquired the rights.)

Completion Guarantee: A bond akin to an insurance policy taken out by film financiers to help ensure that the film is delivered on time and on budget. If this is not possible, the bond company may provide compensation.

Crew: Includes cameramen, sound and lighting technicians, make-up, set and costume designers.

Development: This means writing the script, which also involves re-writes, editing and fine-tuning to get it right. Development of the script is very important as it provides the foundation of the film. Development also involves securing the copyright.

Director: The person responsible for taking the screenplay and making it work on film. This includes ensuring the film has the right cast and crew and post-production work.

Distributor: This is the company appointed to sell the film through various mediums in each territory.

Executive Producer: Arranges finance for a film and assists in the negotiation of deals with distributors and agents.

Exhibitor: This is the cinema chain, or the company that owns the cinema where the film will be shown.

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