5 WAYS TO INCREASE YOUR FILMS ROI

(… so you don’t lose money!)

WRITTEN BY

JESSE IKEMAN

BUSINESS OF FILM

We've talked a lot on this site, and our Business of Film podcast, about what you need to do in order to affect a positive ROI on your film, but today, we're going to flip it.

Today, we're going to ask the question:

How do I NOT lose money on a film?

I think this is a critical question to ask, but sometimes it's about maximizing your returns, and other times, it's protecting your downside risk. In financial terms, it's called "hedging". So, we're going to steal this concept for our purposes here, and talk about how to hedge your feature film.

I just want to say, before, we jump in here, is that I love this concept. I love it, because we don't usually think like this when we are in a creative mindset. We're thinking about things like budget and financing, and how to finance a certain budget. But we don't usually think about "how to hedge a budget", or "how to hedge our financing".

1) What's at Risk?

If you are going to hedge anything, you have to understand first, what is actually at risk and what variables affect risk on a film. There are two kinds of risk in film, broadly speaking, there is the:

- financial risk, or risk that's associated with the financing of your film, and there's
- budgetary risk, or risk that's associated with the budget of your film.

Before you can start evaluating the risk proposition of your film, you need to identify clearly what both of those elements are.

Financial Risk

Examples of financial risk would be the equity that's at play. If your film is financed by a combination of pre-sales, broadcaster contracts, soft money, recoupable equity, and private equity, then you have to determine what buckets of money are most at risk. In most cases, we're talking about private lending. A private lender, or first tier lender, is usually the most at risk. But then there are tranches at risk that will come out above them, like bank debt, or gap loans.

In other words, there's a hierarchy of risk. For example, first there might a gap lender that gets their money back, then traditional bank financing, then private equity. Every deal is different.

Budgetary Risk

The second kind of risk is associated with the budget. An example of budgetary risk might be foreign exchange. If you are being financed in multiple currencies, or shooting in various locations around the world where you are handling multiple currencies, then you are exposing yourself to various levels of foreign exchange risk.

If the dollars you are working with are high enough, then thousands, if not hundreds of thousands of dollars can be at play.

About a year ago, while mid production on a fairly large budget production, the Canadian currency took a dive from a historical 0.9 level to the US, to close to 0.7. This was a massive hit to the budget. Luckily, there are things you can do to "hedge" against this problem.

Another kinds of budgetary risks is contingency. Do you have enough? Seems like a simple enough question, but there's a reason why a bond company wants to see roughly 10% of your budget in contingency. Because things happen. If you go over budget, and you don't have enough contingency, then you are most certainly putting yourself at risk.

There are other examples of budgetary risk, but for our purposes here, I think you get the picture.

2) You need to hedge both sides of the coin

Once you have identified what the various elements of risk are for your film, you need to think very clearly about how you are going to hedge against each eventual cause of that risk. Both on the financial and budgetary side. Remember, the two relate. If you protect your financing but go over budget, you are no better off. That's super important!

Producers can do a great job putting together their financing plan, only to be left exposed at the end of the day because of a budgetary hole that wasn't plugged.

So, here are a few examples of how to hedge your risk.

3) Hedging Your Financial Risk

Often times the financial risk comes down to sales. Ultimately, you will likely be exposed on a film to a certain degree and the only way to cover that exposure is by selling it.

If you have a million dollars invested, then you need to return a million dollars to your investor. But wait! That doesn't mean you need make a million dollars in sales, it means you need to make more... here's the formula.

First, take the exposed amount of money. For ease of example, lets just say it's a clean $1 million.

Second, (assuming you are making a deal with a sales company to rep your film); take that figure and divide by (1 - the sales fee). Lets assume it's 15%. You would take (1-0.15 = 085). So that's $1 million / 0.85 = $1,176,470.

That means, you have to reach $1, 176,470 in sales ($1,176,470 x 15% = $176,470) in order to get back to your million dollars (i.e. $1,176,470 - $176,470 = $1,000,000).

Now, subtract marketing costs. This can be expressed as a percentage of the deal or a fixed amount. Lets just say it's a fixed amount of $50,000. So, you'll have to add that to the pile (and note here, that sometimes sales fees can be charged on top of the marketing fee, so the sales rep could be taking a fee on that $50,000 turning a recoupable position of $50,000 into $58,823 (i.e. $50,000 / 0.85).

Here's the thing, these computations can get tricky. Contracts and definitions can get murky. Consult a lawyer. Make sure you understand how you get back to the number you need in order to return your films investors funds.

Then, **STRESS TEST** it. Here's a simple rule of thumb, most banks in the business of gap lending will need at least 3;1 coverage. That means, if a bank is to lend you say $2 million dollars as gap loan against foreign sales, they will need at least $6 million in world wide sales estimates.

Now, these numbers may seem big. But they apply equally, if not more so, to the smaller films. If you have a budget of $500,000 and you need to return say $250,000 to your investors, if you don't have at least $750,000 in gross sales estimates, you may find yourself in tough position later on.

The above is just an example, but you need to figure in a certain buffer that you are comfortable with. The kind of film you are making, the sales company you are working with, your budget, your cast, the level of equity, it all comes into play. There is not right answer here. It's all important. You have to factor it all in.

After you crunch your numbers, hopefully you will get to a place that you feel comfortable about your financial plan and your films ability to return its investment. But if you don't get to that place, then you'll have some choices. Maybe that means reducing the budget, or trying to find a way to bring in less equity or bank gap. It's all variable.

4) Hedge Your Budgetary Risk

We talked above about certain kinds of budgetary risk, but what do you do about it? What do you do if you find that your contingency isn't high enough? Or, if you find yourself exposed to certain foreign exchange issues.

Some things are easier handled than other. But for example, foreign exchange risk is fairly straight forward, and I can give you two ways to mitigate that kind of risk.

The first way is to try to spend money in the currency that you are receiving it in. That's not always possible, mind you, but that's always the goal. You want to try to not have to convert financing to another currency if you don't have to. If you are hiring a U.S. star - and they get paid in US currency - then, if part of your financing is coming in from US sources you will want to pay them in US dollars.

That sounds simple enough, but that's not always the case. Consider this:

You are filming out of country. The first money that arrives in your bank account is the US currency, but you need that money to pay for your pre-production in a country that's not in the US, lets say Australia. So, you have to convert your US dollars because you need money now in a currency that isn't USD.

So, it's not always that straight forward. Here's what you do.

You go to the bank (note: that's a much bigger discussion)... but lets just say you are doing a bank deal, and you get the bank to lend you money in the currency that you are spending it in, so that you don't have to convert the funds. This may mean, though, that you start to pay interim financing costs on a loan from the bank, but it also means that you have a "natural hedge" against foreign currency movements. See what I mean? This stuff can get very very complicated, especially in international co-productions where you may be dealing with three or sometimes more currencies.

Hire a good accountant. That's the best advice I can give you. The more complicated your currency situation is, you'll be sure to want to hire the best accountant you can afford. Trust me.

Other kinds of budgetary risks that you can plan on dealing with, such as contingency or overtime, that comes down to really good planning. Having a first AD that you can really rely upon. **The number one piece of advice I every received on budgetary risk is: don't us magical thinking.**

If you think, in your gut, that there might be a problem, odds are there will be a problem. It's easy to think there won't be a problem, but that's the magical part. Plan for the worst, and hope for the best. In that regard, you'll be hedging against the downside of going over budget and thereby protecting yourself and your investors.

5) Iterate, Iterate, Iterate

The process of figuring our your level of risk is all about iterating. That means, going back and forth between your budget and your financing plan. Constantly changing the model until you have a financing plan with a level of risk that you are comfortable with, and a budget that you are comfortable with to produce your film.

This process is a constant battle. At our production house, we label our budgets "v1, v2, v3" etc. And to steal some advice from [Bob Monroe], we never, never, never say final. There is no such thing as a final. Just keep iterating until you find the perfect balance for you and your film.

in Conclusion:

If you apply these concepts to your next film, then you will be all that more likely to protect your investors money and at the same time, create a budgetary and financial model that can return an investment to you, the filmmaker.