Canadian Heritage   Patrimoine canadien

Study on Completion Guarantees and Financing Tools in the Audio-Visual Industry

Prepared by:

Nordicity Group Ltd.

April 27, 2005

The Department of Canadian Heritage, Trade Routes program, commissioned this Report. The opinions expressed are those of the author and do not necessarily reflect the view of the Department of Canadian Heritage.

Cat. No.: CH4-104/2005E-PDF

ISBN **0-662-41835-2**

Canada

About Nordicity Group Ltd.

Nordicity Group Ltd. (www.nordicity.com) is the pre-eminent, independent, Canadian consulting firm specializing in policy analysis, business strategy, and process improvement for clients in the communications and cultural sectors.

We are leaders in assessment, analysis, and evaluation of policy, programs, and regulation for government agencies. We also provide our deep understanding of policy and regulatory analysis to our private sector communications and media clients, and associations.

Nordicity helps organizations transform their business through sound strategic decisions, shrewd investments and resource commitments, and effective changes in processes. Nordicity also works with the public sector to assess the economic and business impacts of business conditions and policy or regulatory developments.

Since 1979, Nordicity has provided business and policy solutions for media and communications in Canada and around the world.

Nordicity Group works with public sector clients in Canada and elsewhere whenever economic analysis of the cultural and communications industries is required. Our consultants bring together a unique understanding of the business and policy issues in the cultural and communications sector, and rigorous economic analysis to client engagements.

Nordicity has offices in Ottawa and Toronto, with associates in other Canadian cities. We also offer global delivery of our expertise through affiliations with international professional services firms, notably PricewaterhouseCoopers and IBM Business Consulting Services.

Table of Contents Page

List of Tables Page

List of Figures Page

Executive Summary

1. Introduction

Between 1994 and 2004, the Canadian film and television production industry experienced tremendous growth. According to the latest statistics published by the Canadian Film and Television Production Association (CFTPA), total spending on film and television production in Canada increased by more than two-fold from $2.32 billion in 1994/95 to $4.92 billion in 2003/04 – an average annual rate of growth of 8.7%.[1]

The industry faces a number of challenges that reflect the heightened level of global competition for film and television production dollars. Several factors have come together to make the environment more competitive for Canadian producers and production crews. Western Europe's shift to intra-European production, the rising Canadian dollar, the introduction of film and television tax incentives in several American jurisdictions, the emergence of Eastern Europe as an economic location for production, and a shift, globally, for audiences and broadcasters to prefer domestic television content have all combined to create business conditions that threaten the Canadian film and television production industry.

More than ever, it is important that the Canadian industry has a highly efficient financing environment for production. It is crucial that Canadian producers have access to the most efficient financing tools possible, and certainly equivalent to those available to producers in other countries, and that these tools are available on competitive terms.

One such tool is the completion guarantee (also known as a completion bond). Banks and other financiers of a film or television production can require an independent producer to obtain a completion guarantee. In addition to completion guarantees, producers will typically obtain errors and omissions insurance, cast, and other forms of liability insurance. In some cases, this insurance can represent a significant cost in terms of the project budget.

For many Canadian producers, certain types of financing such as tax credits, Canadian Television Fund (CTF) funding, distributor minimum guarantees, and broadcaster licence fees are not completely available during shooting. The producer, nevertheless, faces financial obligations during shooting; crew salaries must be paid every two weeks, for example. Many Canadian producers, therefore, must obtain interim financing from financial institutions. Interim financing has become an important element in the film and television production financing process.

In light of the completion guarantee, insurance, and financing requirements facing Canadian film and television producers, the Department of Canadian Heritage (PCH) charged Nordicity Group Ltd. ("Nordicity Group") with the following overall mandate:

> *To determine if a viable business model exists for a Crown financial institution or newly formed public-private entity to provide completion guarantees or financial instruments to increase cash flow to the Canadian audio-visual industry.*

With this mandate in mind, the accompanying study offers a profile of the current financing environment in Canadian film and television production, and a review of the role of the Crown financial institutions, including Telefilm Canada ("Telefilm"), the Business Development Bank of Canada (BDC), Export Development Canada (EDC), and the Canadian Commercial Corporation (CCC).

The study also identifies service opportunities for the federal government and the Crown financial institutions. For the most promising or feasible of these opportunities, the study presents a high-level business case to demonstrate the economic viability of the service.

[1] CFTPA, *Profile 2005: An Economic Report on the Film and Television Production Industry,* p. 10.

2. Structure of the Canadian Film and Television Production Industry

The Canadian production industry can be divided into four major segments: (1) foreign location production, (2) CAVCO-certified production, (3) non-CAVCO production, and (4) broadcaster in-house production. In 2003/04, $4.92 billion was spent on film and television production in Canada – representing the dollar amount of production budgets in all four segments of the Canadian production industry. The largest single segment in the industry was foreign location production. In 2003/04, foreign location production totalled $1.9 billion.

The second largest segment of the Canadian industry was that of CAVCO-certified production, which refers to domestic production that is certified as Canadian content by CAVCO, and therefore is eligible for the Canadian Film or Video Production Tax Credit (CPTC). In 2003/04, production budgets in the CAVCO sector totalled $1.7 billion.

The non-CAVCO segment – which totalled $258 million in production in 2003/04 – includes Canadian television production that is certified by the Canadian Radio-television and Telecommunications Commission (CRTC).

The broadcaster in-house sector – at just over $1 billion in 2003/04 – represents the expenditures by Canadian broadcasters on the production of their station programming, particularly news and sports.

Production in Canada has always been tilted towards the creation of television programs and series, including made-for-television movies (often referred to as MOWs) and television mini-series. In 2003/04, approximately 70% of the $4.92 billion in production in Canada was created for television. The other 30% consisted of feature films and short films created for a first release in theatres or educational institutions.

While the spending on production budgets in Canada grew strongly between 1994/95 and 2003/04, Canadian production companies did not see their financial performance improve; indeed since 1999, it has deteriorated rapidly. Between 1998 and 2002 (the last year of available data) the EBT (Earnings Before Tax) margin of Canadian film and video production companies, making theatrical film and television programs[2], dropped from 6.0% to 1.6% of operating revenues. At 1.6%, the profitability of film and television producers was well below the 2002 average of 3.9% for all Canadian industries.

3. Financing Practices and Needs for Film and TV Production

The financing of film and television production in Canada varies depending on whether one is considering a television production or a film for theatrical release. In general, an examination of production financing data indicates that the financing of Canadian film and television production changed significantly during the 1999/00 to 2003/04 period.

In the television sector, Canadian broadcasters' share of television financing nearly doubled from 18% in 1999/00 to 35% in 2003/04. The share increase largely resulted because of the withdrawal of foreign financing from Canadian television production. Between 1999/00 and 2003/04, the share of Canadian television financing from foreign sources dropped from 28% to 11%. During this period, the international markets for foreign television programming weakened significantly, largely as European broadcasters turned to domestic or intra-European content for their television schedules.

The landscape for the financing of a Canadian theatrical production, namely theatrical feature films, was somewhat different. For this type of production, the largest financier group was the federal and provincial

[2] The financial performance data for film and television producers only includes data for theatrical movie producers and conventional and pay-television producers. It excludes data for producers of advertising, government and education productions, and industrial videos. It also excludes data for unspecialized producers.

governments. All told, federal and provincial governments provided approximately 61% of the financing in this segment in 2003/04. Note that the domestic theatrical production segment was about one-tenth the size of the domestic television segment in that year.

Canadian international treaty co-productions provide another approach to financing Canadian film and televisions productions. In an international treaty co-production, financing will come from each participating country; as well, the filming or other elements of the production will be shared among each country. International treaty co-production is an effective way for Canadian producers to gain experience on larger budget productions.

Canadian and foreign broadcasters still account for about 30% of the total project financing in television production. Tax credits play less of role, because they are only available for money spent in Canada; in the partner country(s), government support may take another form. Other private sources (e.g., private production assistance funds) and distributor financing appear to play a larger role in the financing structures.

In feature film production, private sources other than broadcasters and distributors play a larger in the project financing, when compared to Canadian domestic production. In 2003, 49% of project financing for Canadian treaty co-production feature films came from private sources other than broadcasters and distributors. What is more, approximately two-thirds of this other private money was brought to the production by the foreign producer.

4. Completion Guarantees, Other Insurance and Financial Instruments Used by Canadian Producers

Completion Guarantees

A completion guarantee essentially assures the financiers of a film or television production that the project will be completed and delivered within a specified time period. A completion guarantee also gives the project's investors the assurance that it will not cost them more than their specified investment to complete the production; and that should the production not be completed, that they will be reimbursed for their investment.

A producer will typically obtain a completion guarantee at the request of the project's investors. Completion guarantees are traditionally found in independent films that lack the access to the financial resources of one of the major Hollywood studios, in the event that some element of the production goes awry.

The completion bonder takes an active role in mitigating the risks that may prevent a production from being completed on-time and on-budget. What is more, when a production starts to fall off the rails, the completion bonder will step in to successfully complete the project rather than face a claim.

Before bonding a project, the completion bonder will conduct a through review of the script, budget, production schedule, and financing plan. During shooting, the completion bonder will monitor the progress of production often through the regular submission of progress and cost reports. After shooting, the completion bonder will monitor the post-production process. Once the film is delivered to the distributor, the completion bonder's assurance obligation ceases.

In Canada, there is currently only one Canadian firm providing completion guarantees to Canadian producers; it is Film Finances Canada (1998) Ltd. Some American completion guarantee companies, such as International Film Guarantors (IFG) and CineFinance – both based in Los Angeles – will from time to time execute completion guarantees for Canadian production; however, both of these American suppliers are likely to remain on the periphery of the Canadian market.

Historically, completion bond rates in Canada were as high as 6% of project budgets (this rate of 6% included a portion that was refunded to the producer upon project completion). During the late 1990s, with the numerous competitors in the Canadian market, rates were driven as low as 0.8%. This price competition and the diminishing number of re-insurers in Canada led to a market shake-up. In January 2003, Film Finances Canada acquired The Completion Guarantors; for a little over two years Canada has had a virtual domestic monopoly in provision of completion guarantees. Today rates are in the range of 2%.

<u>Interim Financing</u>

In Canada, much of the primary financing funds for a film or television program are not available to the producer until after the project is completed. The producer's financial obligations, including wages and other costs are due during the shooting. As such, the producer needs to obtain interim financing – sometimes referred to as cash flow financing – to meet current obligations in advance of future payments.

Before beginning a production, a producer will pre-sell her or his film or television program to broadcasters and distributors inside and outside of Canada. These pre-sale agreements often stipulate progress payments against milestones, including the delivery of the final film of television program. Government tax credits represent another form of financing, and are the last to be received. Producers submit their budget and financing details to federal and provincial government agencies, which then give the producer an advance ruling on the value of non-refundable tax credits they will receive. The producer does not receive the tax rebates until the federal and provincial assessments of the corporate tax filings. As such, most producers need to interim finance their expected tax credits, received well after the completion of the production.

Canadian banks will typically provide interim financing on the basis of an overall assessment of the project assuming there is a budget that is fully financed by creditworthy pre-sales and other funding programs such as tax credits, Telefilm investment, the Canadian Television Fund, etc.

Besides the CTF and Telefilm, Canadian banks have typically limited their interim financing to pre-sales to Canadian broadcasters and distributors, and "blue chip" foreign buyers (for example Disney, BBC, NBC). Canadian producers seeking interim financing of pre-sales to lesser-known foreign broadcasters and distributors require EDC receivables insurance; alternatively, the producer can approach the U.S.-based Comerica Entertainment Group for the interim financing of foreign receivables. Once the creditworthy receivables have been identified, the banks will often only loan up to 85% of the value of the receivable.

To obtain interim financing, Canadian producers must pay legal fees in the range of $14,000 to $20,000, in addition to the set-up fee and interest charges paid to bank. Interest rates for interim financing start at 100 basis points above prime rate.

<u>Foreign Receivables Insurance</u>

Foreign receivables insurance is a tool used by companies to enhance their access to credit based on commitments by foreign distributors and broadcasters to pay for the rights to the production once completed. In Canada, EDC provides foreign receivables insurance to Canadian exporters with sales outside of Canada. Other countries have similar organizations providing this financial service. EDC will insure up to 90% of the value of a Canadian exporter's foreign receivable. With such coverage from the EDC, a Canadian exporter can then approach their financial institution to access additional credit – in effect, monetizing the exporter's receivable.

EDC assumes the risk of non-payment by the foreign buyer. If the foreign buyer fails to pay due to default or insolvency, the Canadian exporter can make a claim. EDC will, in turn, direct the value of the insurance (up to 90% of the value of the receivable) to the exporter's financial institution. Canadian film and television producers have been using foreign receivables insurance for the last several years, ever since EDC started to accept film and television industry clients in 1999.

Gap Financing

Gap financing is the term used to describe financing obtained by producers to cover the difference between a project's budget and the total value of pre-sales and other financing sources. It may be the case that the total financing and value of pre-sales raised by the producer falls short of the project's budget. In effect, this gap is attributed to yet-to-be-sold exhibition or distribution rights.

Gap financing is a type of interim financing without the collateral of already-negotiated primary financing. Instead, to obtain gap financing, the producer will engage a sales agent to put together a plan to sell the project in unsold territories. The financial institution then provides a loan on the basis of this plan, namely the sales projection and capability of the sales agent.

Only one firm in Canada currently offers gap financing – that is La financière des entreprises culturelles du Québec (FIDEC), a Montreal-based limited partnership with $45 million in capital. In exchange for a gap fee equal to approximately 8% of the gap, FIDEC essentially provides a loan guarantee to the producer that then allows her or him to obtain credit from a financial institution. According to FIDEC this credit is provided at the prime rate. For the most part, up until now, Canadian producers outside of Quebec had to seek gap financing from financial institutions outside of Canada.

Insurance Services

In addition to completion guarantees and foreign receivables insurance, film and television producers will often obtain insurance for liability and to cover loss of property. There are four main types of insurance products used by film and television producers; they include:

1. **Entertainment Package:** This includes coverage for pre-production, cast, essential elements, negative, faulty stock, camera, processing, miscellaneous equipment, props, set and wardrobe, extra expense, property damage, office contents and physical damage to non-owned or hired automobiles.
2. **Comprehensive General Liability and Umbrella Liability:** This type of insurance is similar to standard liability insurance used by businesses and includes coverage for any stunts or special effects.
3. **Errors and Omissions:** This type of insurance protects film and television producers and broadcasters from lawsuits due to the violation of personal rights, libel or slander arising from the film or television program.
4. **Automobile Insurance:** In certain provinces, film and television producers will obtain auto insurance for leased vehicles used on a production.

In Canada, there are a handful of insurance brokers and wholesalers selling these types of services, including B.F Lorenzetti & Associates inc., Jones Brown Inc., Aon/Ruben-Winkler Entertainment Insurance Brokers, Multimedia Risk Consultants and Insurance Brokers, and Global Expert Risk Management Inc. The rates for film and television liability insurance can vary significantly depending on the type of production and the track record of the producer.

5. The Role of Crown Agencies in the Financing of Canadian Film and TV Production

Telefilm Canada

Telefilm is a Crown corporation formed in 1967 through the enactment of the *Canadian Film Development Corporation Act*. Telefilm's enabling legislation mandates it to "foster and promote the development of a feature film industry." Telefilm provides loans and equity investments to each of the audio-visual industries. It supports creators at the development, production, and post-production phases. Telefilm also administers several cultural industry support programs funded by the Department of Canadian Heritage. At times, Telefilm has also been involved in secondary financing, including interim financing loans and loan guarantees. During the 1990s, Telefilm operated a program that provided loan guarantees to film and television production companies. The fund was wound up, however, because its use was concentrated among small higher-risk companies.

Export Development Canada

EDC is a Crown corporation. It was formed in 1945 following the enactment of the *Export Development Act*. In its enacting legislation, EDC was given the mandate to “support and develop, directly and indirectly, Canada’s export trade and Canadian capacity to engage in that trade as well as respond to international business opportunities.” Today, EDC carries out its mandate by offering various insurance, financing, and bonding products to Canadian exporters.

Since late 1999, EDC has been providing accounts receivable insurance to Canadian film and television producers. For this service, EDC will insure up to 90% of the book value of receivables generated by Canadian producers’ pre-sales to foreign broadcasters and distributors. With EDC receivables insurance, the Canadian producer can access additional credit from her or his financial institution. The financial institution will increase the producer’s credit line by 90% of the receivable book value.

In 2004, EDC completed approximately 25 to 30 deals in which it insured approximately $25 million in foreign receivables for Canadian producers. Its volume of business has been higher in previous years. In its peak year for activity, two EDC underwriters completed about 50 deals worth $50 to $60 million in foreign receivables.

Throughout the five years that EDC has been underwriting foreign pre-sales, it has kept a very low profile within the Canadian film and television production community. It has not actively marketed its service offering; instead it has relied upon referrals or direct Exporter approach.

From a commercial perspective, EDC’s involvement in the insurance of film and television receivables has, thus far, not been profitable. The losses experienced by EDC have far exceeded the revenues generated by the business. Indeed, according to EDC, the magnitude of the losses has been such that the film and television underwriting operation is unlikely to recover fully the losses it has incurred to date. As a result of these past “hits”, EDC is currently reviewing its film and television underwriting operation.

Business Development Bank of Canada

BDC is a Crown Corporation formed in 1944 as the Industrial Development Bank. In 1995, Parliament adopted the *Business Development Bank Act*, giving BDC a “broadened and dynamic public interest mandate” under which it is to pay “special attention to exporting businesses and to businesses in the technology sector.” In April 2002, BDC's mandate was renewed for a period of ten years.

BDC provides loans, venture capital and subordinate financing, as well as financial consulting services to Canadian entrepreneurs. BDC pays special attention to the needs of small and medium-sized enterprises (SMEs) – companies with fewer than 500 employees.

BDC provides financing products to Canadian audio-visual industry companies, in so far as these companies meet its commercial eligibility and credit criteria. BDC has had some particular focus on the cultural industries through the Cultural Industries Development Fund (CIDF).

PCH established the CIDF in 1991, to offer loans to Canadian companies in the film and video, new media, book and periodical publishing, and sound recording industries. In 1999, PCH entered into a memorandum of understanding (MOU) with BDC, which transferred the CIDF to BDC. As part of this agreement, PCH transferred $28 million in capital to BDC. BDC agreed to use this capital to make loans in accordance with its commercial policies to the cultural industries. BDC also agreed to allocate 30% of the CIDF funds to Francophone firms, and to report annually to PCH. Under the CIDF, BDC provided financing that was in conjunction with conventional loans from outside lenders. CIDF loans ranged from $20,000 to $250,000 for working capital, expansion projects and various other initiatives geared to long-term growth and viability of the production industry and other cultural producers.

The MOU regarding the CIDF was for five years. According to BDC, the MOU was not renewed; the CIDF was wound up in late 2004. From BDC's perspective, the performance of the CIDF loans was poor. While BDC had a loan loss experience rate across all its clients of 3.3%[3], the loan loss experience in the CIDF was 10.9%. For CIDF loans to film and video production companies, the loan loss experience was 13.0%.

Throughout the tenure of the CIDF, BDC also provided financing to cultural firms through its own financial products at standard commercial interest rates. It continues to offer financing services to the cultural industries through its offices across the country. However, there is no longer any particular expertise within the BDC in the film and television production industry or any other cultural sector.

Canadian Commercial Corporation

The Canadian Commercial Corporation is a Crown corporation formed in 1946. Its mandate is defined by its enacting legislation, the *Canadian Commercial Corporation Act*. According to this legislation, the purpose of CCC is the "to assist in the development of trade between Canada and other nations; and to assist persons in Canada to dispose of goods and commodities that are available for export from Canada." While CCC's legislation does not specifically mention services or intangible exports, the latter are indeed under CCC's purview.

The CCC offers Canadian businesses several financial tools and services to facilitate export sales to foreign governments and private-sector buyers. The CCC also offers Canadian exporters a range of procurement and contract consulting services. Two products that may be relevant to the film and television production and production services industries are: (1) International Prime Contractor Solution, and (2) Progress Payment Program. The International Prime Contractor Solution is a mirror contract that gives buyers assurance of contract performance by the Canadian supplier. The Progress Payment Program gives Canadian exporters access to pre-shipment working capital loans from their financial institution.

According to the CCC, it has not had a Canadian film and television producer as client. Much of the CCC's service offerings are customized for the exporters of defence-industry products and services. What is more, its corporate plan indicates that it does focus on aerospace and defence; information, communications and technologies; environment and nuclear/biological/chemical (NBC) remediation; and engineering procurement and construction projects. However, the CCC appears to be open to expanding into new knowledge-based industries like film and television production services (e.g., special effects or new media).

6. Identification of Service Opportunities and Market Size

Completion Guarantee Market

Using data from CAVCO and information gathered through primary and secondary research, an estimate of the addressable market for completion guarantees in Canada was constructed – that is, the total dollar value of production budgets likely to have a completion guarantee. The addressable market for completion guarantees in Canada was estimated to have been $324.6 million in terms of budgets in 2003/04. To convert the estimate of total budgets to an estimate of completion guarantee fees, a rate of 2% of budgets was applied. While producers will often quote rates higher than this, these quoted rates are calculated net of project contingencies and certain budget items. On a total budget basis, the effective fee rate is closer to 2%. With premiums in the range of 2%, gross fees from completion guarantees were estimated to be in the neighbourhood of $6.5 million in 2003/04. Approximately one-half of the gross fee goes to the re-insurer. As such, the net fees earned from completion guarantees in Canada in 2003/04 were estimated at approximately $3.25 million.

[3] Interview with Charles Bernier and Sylvie Ratté of BDC.

The estimates of the addressable market for completion guarantees and fees demonstrate that the market has declined considerably in the last several years. The overall addressable market has nearly halved from an estimated $584 million in 1999/00 to $325 million in 2003/04. Total fees have dropped commensurately.

With respect to rates, most of the industry feels that completion guarantee rates were increased, once the competition was eliminated. A brief review of the international market confirms that rates in Canada are on the lower end of the spectrum and that terms are more reasonable. Film Finances Canada also points out the rates stayed the same for a year after its acquisition of its chief competitor, but inevitably moved higher to accommodate the current trend where more and more "lower risk" projects are produced without completion bonds.

A new entrant with a Canadian-based re-insurer might offer a different service level and act as another service provider in this business. However, it is a limited and declining market with an entrenched provider who has international ties. It is not clear that producers would be exposed to substantially different terms, although the prospect of an available alternative would always be viewed favourably.

If there were to be a new entrant, it would need to line up a re-insurance partner. If the partner were from the Canadian market, it would possibly provide "made-in-Canada" rates. However, the market seems to be trending toward completion bonds for international co-productions along with major feature films – and away from domestic television projects. Film Finances Canada would be prepared to explore the possibility of linking up with a different re-insurer for the television market – which is declining, anyway – but would find it impossible to re-insure through a company other than Lloyd's of London for feature films and international co-productions.

It is not clear who would promote a new entrant in the completion guarantee sector. A start-up could be financed in part by the BDC, but that organization has no mandate (or expertise) to find an entrepreneur or existing business to enter into competition with Film Finances Canada. From a public policy perspective it is not clear the benefits would be significant. Having a functioning completion guarantor operating in Canada is preferable to dealing with outposts of Los Angeles-based guarantors. Stimulating the interest of a re-insurer for domestic projects – possibly to work with Film Finances Canada – might be an initiative to explore.

Insurance Services

The Quebec production industry is increasingly concerned about the rise in costs of insurance, in particular, errors and omissions insurance and to a lesser extent, general liability and entertainment package insurance. Producers are not looking for alternatives so much as a return to the days when the premiums on errors and omissions insurance were quite nominal; or for broadcasters not to require this type of insurance. However, it is not clear that any new supplier of insurance services would greatly improve the business conditions for producers.

Using production budget data from CAVCO and the average rates of insurance reported in the L'Association des producteurs de films et de télévision du Québec (APFTQ) 2004 member survey, an estimate of the size of the film and television insurance services market in Canada in 2003/04 was constructed. Overall, Canadian producers paid an estimated $20 million in insurance premiums to insure $1.6 billion in production activity in 2003/04.

Foreign Receivables Insurance

As indicated earlier, the EDC provides receivables insurance for producers who have pre-sale agreements with foreign broadcasters or minimum guarantee commitments from foreign distributors. The first recourse of producers is for their interim financing lender (a bank) to finance these commitments as well.

EDC is already providing a valuable service to the production industry. However, EDC has experienced losses in the recent past and is re-evaluating its commitment to the business. Industry observers point out that some of the commercial practices of EDC put the agency into a more exposed condition, e.g.: contracting with the producer, rather than with the foreign distributor/broadcaster – which makes it more difficult to collect on the account; not being an inter-party signatory (which typically binds the producer, banker, and public agency); reliance on the due diligence and legal counsel of the banker, broadcaster, bonder, etc; and not investing in being a player in the industry (e.g., membership in the Independent Film & Television Alliance).

The service opportunity, then, is to seek to obtain a commitment by EDC to stay in the business and expand their marketing activities to elicit more interest among producers to consider the EDC. With more volume, it could justify further EDC investments in marketing and steps to lower its risk. The danger to the industry is that EDC proceeds in the opposite direction and withdraws from the foreign insurance service business. Loss of EDC insurance would eliminate a chunk of project financing that is provided through EDC – of some $25 million per year.

Estimates indicate that the Canadian film and television production industry generated foreign receivables in the range of $227.0 million in 2003/04. This amount excludes an estimate for the blue chip American broadcasters. With a 90/10 co-insurance rate, there was an estimated $204.3 million (90% of $227 million) in foreign receivables in the Canadian film and television production industry in 2003/04 from which interim financing could be obtained.

With an average duration of six months and an insurance premium of 2% (annualized), EDC revenues from the film and television production industry in 2003/04 could have been as high as $2.0 million in 2003/04 if they had tapped the full potential of the film and television production industry's foreign receivables.

Gap Financing

The major "hole" in putting together the financing for a production is the lack of gap financing. In the past, distributor advances on their minimum guarantees for the major territories were a significant part of the production's financial package. However, distribution guarantees and pre-sale commitments to acquire the product when completed are more difficult to obtain. Consequently, projects are often initiated with major "gaps" in territories pre-sold, which means that the proceeds from future sales to these regions need to be financed in other ways. The lack of pre-sale financing for major television projects and for feature films is a real handicap for the producer who is often scrambling to pull together all the elements of a production and complete the commitments for the financing.
Various Canadian producer and financial institutions have been in the gap financing business over the years when there was a strong foreign demand for Canadian product. However, most of these organizations have left the business after losses registered from markets and products that did not pan out. Clearly, it is a very risky business to rely on sales to territories not yet sold. For a commercially-based entry, the initiative would need to proceed on sound business principles and the rates charged would need to reflect the risks incurred – either through loans several points above prime, or by heavy discounting from earnings eventually realized.

Since 1999, FIDEC has operated in Quebec providing gap financing to Quebec-based producers of English-language productions. Over the last five years, it has built up its experience working with sales agents around world. FIDEC believes that many sales agents have begun to afford it more respect and more solid sales estimates. FIDEC focuses on what it considers the lowest-risk Canadian productions; this often means feature films with budgets in excess of $20 million and television movies with budgets of $1.5 million or higher.

In 2003/04, there was the potential for a total of $49.6 million in gap financing in the Canadian market. To convert the size of the gap market into revenues for gap financiers, an annual gap rate of 350 basis points above the prime rate was applied along with a gap loan duration of 24 months. Again, these assumptions reflect conditions in the Canadian market in recent years. Based on these assumptions, gap financing for

Canadian productions is estimated to have generated gap fees totalling $7.9 million in 2003/04. Of course, most of this revenue would have flowed to foreign gap financiers, as FIDEC only did about $15 million annually in gap financing volume in recent years.

With FIDEC's business volume in the range of $15 million and the overall market estimated to be closer to $50 million, there appears to be a genuine opportunity for another domestic service provider to enter this market in Canada, specifically outside of Quebec. It should be noted that FIDEC itself recognizes this untapped market and is planning to expand outside of Quebec in the near future.

Early Stage Interim Financing

The current financing environment is very cumbersome for producers. Completion of all the due diligence imposed by financial institutions, foreign distributors, broadcasters, completion bonders, and government agencies can push a producer against the wall financially and in terms of production scheduling.

In the television market, producers and broadcasters sign short form contracts (or the engagement letter) that trigger an application to the government agencies and nail down the basic terms. Then, the long form contract is negotiated with further details (like the commitments for promotion and sponsorship, what specialty channels are licensed to carry the programming). Multiple parties must approve these contracts, which means the process can drag on for, say, three months. In some cases the banks (and occasionally the broadcasters) advance some interim financing to enable the producer to address pre-production expenses. Once signed, the banks release the funds, while the broadcasters and government agencies then release progress payments for each stage of the production/post-production process (which are used to pay off the interim financing).

It is the "in-between" state that makes producers most vulnerable, i.e., between the short and long form contracts; and they can be pressed into concessions by different parties (e.g., committing to personal guarantees by the bank, or ceding more rights to the broadcaster). Thus, there is a potential opportunity in the marketplace for "early stage interim financing", or some form of insurance that would enable banks to release funds at an earlier stage.

Canadian producers required approximately $272.1 million in early stage interim financing in 2003/04. With average loan duration of three months, this suggests that interest charges in an early stage interim financing market in Canada could have totalled $4.4 million in 2003/04.

Other Financing Enhancements

One suggestion, gathered from interviews, was to establish a CCC-like service for audio-visual service suppliers who market to the U.S .and other international customers. The proposal is for, say, the CCC to offer to be the guarantor of delivery of specific services – similar to completion guarantees for production. If the CCC would guarantee delivery, this backing would increase the credibility of Canadian service providers. This kind of service is like a back-to-back contract, whereby the CCC enters into an agreement with the foreign buyer that the service would be supplied according to specifications in the contract, and the CCC would enter into a contract with the Canadian supplier to fulfil these specifications.[4]

Once well established with a specific customer or in a particular market, there would not be a need for such a service. One producer also sells certain facilities and infrastructure project design and management services. It would not need such a service for its established customer base, but might use it for new territories. Another producer who also does special effects for other projects believed this facility could be a major advantage in building credibility for the company.

Another suggestion was to hasten the turnaround for rebating tax credits. A production project can be 18 months completed before the final certification of the production's accounts results in a payment of tax

[4] The project team could not obtain market or industry level that could be used to estimate the market opportunity for production services performance guarantees.

credit monies. By advancing part of the tax credit claim and speeding up the payment of any balances, provincial and federal governments can reduce the interim financing charges incurred by producers.

Some progress has already been made in this area. Beginning in 2001, the Ontario Ministry of Finance, which administers the Government of Ontario's film and television tax credits, started to speed up the payment of tax credit monies to producers. Under the new system, the Ministry of Finance releases to producers up to 85% of their tax credit claim six weeks after submission of a corporate tax return. Producers still require certification from the OMDC, which they can obtain as early as the start of principal photography. Producers also reported that the Quebec government has shortened the process and waiting time for tax credit payments, as has the federal government to some extent. Despite this apparent progress, tax credit financing remains very common and generally represents the longest interval before payment. Therefore, any further improvements in this regard by the relevant authorities would be welcome.

7. Summary Business Case for an Alternative Supplier of New Financial Service

Financial models were prepared for the two most feasible of the identified services opportunities – gap financing and early stage interim financing. These five-year financial models were used to assess the business case for a some type of entity (public, private, public-private) to provide the service.

Each service opportunity was assessed on the basis of risk-adjusted rate of return to equity holders. That is, do the equity investors in the project earn a rate of return that compensates them for the risk of the investment? The equity investor can be a private investor, a government, or a Crown corporation.

The gap financing opportunity generated a rate of return to equity investors of 8.42%. The early stage interim financing opportunity generated a rate of return to equity investors of 7.18%.

Both results fell short of the historical equity returns observed on the stock market. Between 1926 and 2001, the Standard and Poor's 500 Index posted an annualized average return of 10.2%.[5] If one assumes that the stock market's future returns will be similar to its historical performance, then an equity investment in the either the gap financing operation or the early stage interim financing operation is uneconomic. The investment would only be economic if the investor could tolerate a lower return on equity. For example, BDC, in its 2003/04 annual report states that its target rate for return on common equity is 7.7%.[6] This rate is meant to be in line with the federal government's long run cost of borrowing.

Therefore, the business case analyses indicate that the return on equity is likely too low to attract private investors. However, it is likely high enough to attract a public sector investment such as one from BDC or Telefilm. As such, there may some requirement for direct public involvement in the form of loan guarantees to offset the increased risk and lower returns.

8. Conclusions and Recommendations

<u>Completion Guarantee Market</u>

Since January 2003, Canada has had only one domestic provider of completion guarantees – Film Finances Canada. While Film Finances Canada is the only Canadian supplier, two Los Angeles-based firms do, from time-to-time, provide completion guarantee services to Canadian producers. While this industry structure would suggest a quasi-monopoly in Canada, rates charged by Film Finances Canada are, in fact, in line with rates in other countries.

---

[5] Curt Morrison, "An Investment in the S&P 500 Is a Poor Choice Today," at http://news.morningstar.com/doc/document/print/1%2C3651%2C119823%2C00.html

[6] Business Development Bank of Canada, *2004 Annual Report. 2004,* p. 33.

Two major factors combine to make entry of a new competitor into the completion bond sector in Canada uneconomic. First, the market is a declining one. Trends in production activity in Canada and the growing track record of Canadian producers are such that the market for completion guarantees has been in decline. The analysis indicates that the total budgets suitable for completion guarantees in Canada has nearly halved since 1999/00. Without a strong reversal in trends in Canadian international treaty co-production, it is unlikely that volumes will rise considerably to warrant another supplier. The second factor is that re-insurance capacity is limited to one supplier, Lloyd’s of London.

A new entrant with a Canadian-based re-insurer might offer a different service level and act as another service provider in this business. However, it is a limited and declining market with an entrenched provider who has international ties. It is not clear that producers would be exposed to substantially different terms, although the prospect of an available alternative would always be viewed favourably.

Recommendation: To address the rates and completion guarantee terms offered to Canadian producers, PCH (or its agency, Telefilm) could consider exploring with Canadian insurance companies if any has an appetite to enter on a limited basis the completion guarantee business as a re-insurer. PCH may also want to consider FIDEC as a possible candidate to provide re-insurance – assuming that it has no intention of entering the market as a full-fledged competitor.

Foreign Receivables Insurance

In 2004, EDC completed approximately 25 to 30 deals in which it insured approximately $25 million in foreign receivables for Canadian producers. Its volume of business has been higher in previous years. In its peak year for activity, two EDC underwriters completed about 50 deals worth $50 to $60 million in foreign receivables. The EDC is a very valuable component of the project financing for film and television projects. However, because of some problem cases in the relatively near past, EDC is examining its commitment to this sector.

The research indicates that the Canadian film and television production industry generated foreign receivables that totalled as much as $227.0 million in 2003/04. This amount excludes an estimate for the receivables from blue chip American broadcasters.

With a 90/10 co-insurance rate, there was an estimated $204.3 million (90% of $227 million) in foreign receivables in the Canadian film and television production industry in 2003/04 from which interim financing could be obtained if EDC insurance was obtained. It appears that the size of the potential market in 2003/04 offers significant room for the EDC to expand.

With an average duration of six months and an insurance premium of 2% (annualized), EDC revenues from the film and television production industry in 2003/04 could have been as high as $2.0 million in 2003/04, if it had tapped the full potential of the film and television production industry's foreign receivables.

The service opportunity, then, is to seek to obtain a commitment by EDC to this sector, to make changes as appropriate that would reduce its risk, and expand its marketing activities to elicit more interest among producers to consider its insurance product. With more volume, it could justify further EDC investments in marketing and steps to lower its risk. The danger to the industry is that EDC proceeds in the opposite direction and withdraws from the foreign insurance service business. Loss of EDC insurance would eliminate a chunk of project financing that is provided through EDC – of some $25 million per year.

Recommendation: PCH could explore with EDC how the latter can strengthen its own performance in offering foreign receivables insurance to film and television producers and distributors in Canada, and as well, expand this line of business through more active marketing. PCH could facilitate improved linkages between EDC and the other financial stakeholders serving the sector, e.g. the banks, Film Finances Corporation, and FIDEC.

New Service Opportunities - Gap Financing

The research indicates that the lack of domestic gap financing in Canada represents a major hole in the market. The estimates indicate that there could be as much as $50 million annually in gap financing in the Canadian market. At present, the only domestic provider, FIDEC, only operates in Quebec, providing loan guarantees for the gap loans of Quebec-based producers of English-language productions. Producers outside of Quebec must use foreign financial institutions for gap financing.

FIDEC is planning to expand outside of Quebec in 2005; however, its focus will be on larger-budget productions that offer the lowest degree of risk. As such, there may be scope for another entity to provide gap loan guarantees to lower-budget, higher-risk productions.

A high-level business case analysis points to the gap financing operation as being uneconomic from a private-sector perspective. However, Crown financial institutions that can tolerate a lower return on equity may be potential investors in a newly formed gap financing entity. The analysis suggests that the return on equity offered by a gap financier may be somewhat below the required rate of return that investors would likely seek from such an entity. As such, there may some requirement for direct public involvement in the form of loan guarantees to offset the increased risk and lower returns.

Like other financial services firms in the film and television industry, success requires a highly experienced professional team that understands the global film and television industry and has worked with sales agents around the world. This kind of experience may be difficult to find and procure.

It is unclear how many of the Crown agencies fit into gap financing and a potential new entity. EDC already guarantees pre-sales, and its experience in this market may not give it the appetite to enter the even riskier arena of gap financing.

While BDC makes venture capital investments and offers subordinate equity, neither of these types of investments are necessarily suited to the equity investment required for a gap financier.

Telefilm does have industry knowledge which could be brought to a Canadian gap financing operation, and Telefilm already makes equity investments in Canadian film and television productions. A possible role for Telefilm is to back gap financing at the relatively higher risk level, e.g. for smaller projects with export promise but little pre-sales commitment. Of course, any loan losses would be taken from Telefilm's other programs, unless it obtained extra funding for that purpose.

Recommendation: PCH could explore with Telefilm how it can work with FIDEC or a newly formed organization to expand gap financing capacity for lower-budget, riskier projects seeking foreign sales. The first step in this exploration should be the preparation of a detailed business plan with input from Telefilm and FIDEC.

New Service Opportunities - Early Stage Interim Financing

Interim financing in Canada appears to be a relatively competitive marketplace. Several large Canadian banks, including Royal Bank and National Bank are active in this market. During the project research producers did not indicate any overwhelming difficulties in obtaining interim financing, however. As such, it would appear that there is very little opportunity for the government to take a role in this market.

On the other hand, the project research did point to early stage interim financing as one area where there could be room for increased loan capacity in Canada. Canadian producers will often begin pre-production on the basis of a short-form contract. The banks however will only offer interim financing against long-form contracts. Producers with strong track records and a better working capital position can often self-finance pre-production; smaller, lesser-established producers cannot.

The analysis indicates that there may be as much as $272 million eligible for early interim financing. Because this type financing would only be for up to three months, however, the fees for a service provider may only be in the neighbourhood of $4 million annually.

A high-level business case analysis points to the early stage interim financing operation as being uneconomic from a private-sector perspective. However, Crown financial institutions that can tolerate a lower return on equity may be potential investors in a newly formed early stage interim financing entity. The analysis suggests that the return on equity offered by an early stage interim financing operation may be somewhat below the required rate of return that investors would likely seek from such an entity. As such, there may some requirement for direct public involvement in the form of loan guarantees to offset the increased risk and lower returns.

Telefilm would seem to be the best equipped among the Crown agencies to participate in or shepherd the development of a new early interim financing vehicle. Telefilm has been involved in interim financing and loan guarantees in the past.

FIDEC is already involved to some degree in this market. It refers to this type of financing as “bridge-to-bridge” financing, so there may be scope for the federal government to expand this type of service by working through an organization such as FIDEC, or other financial institutions. The federal government would likely have to offer some type of loan guarantee to make entry economic for a private-sector entity, so that they can expand their loan portfolio into this riskier area.

Recommendation: PCH could explore with Telefilm and/or FIDEC how it can take a direct or indirect role in enhancing the private sector’s capacity for early stage interim financing for film and television producers. This exploration should begin with the preparation of a detailed plan with input from the potential partner organizations (Telefilm, FIDEC).

Other Financing Enhancements

Two other ways in which the federal government can perhaps intervene to improve the financing environment for Canadians in the audio-visual industry were identified. One area was in performance guarantees for Canadians who supply production services (inputs to the production process) to foreign buyers – namely foreign producers. This is different from completion guarantees in the sense that it does not involve the complete assurance of project completion to a production's financiers; but rather, fulfilment of a contract and delivery of an input to the project. The CCC already offers contract performance guarantees to foreign buyers of Canadian products and services; this is the International Prime Contractor Solution.

The CCC seems to be open to the idea of expanding into other knowledge-based industries. Before it begins offering service, it needs more audio-visual industry expertise, however. One option is for Telefilm to provide this expertise under contract or through the secondment of a Telefilm employee. In effect, PCH would make the investment to launch the service offering. The ideal candidate would have to have a deep understanding of the Canadian production services and new media industries, and at the same time have a financial services background that would allow them to operate in the CCC environment. If a qualified person could not be found within PCH or Telefilm, the CCC would have to create a position and hire someone. The CCC needs to generate over $200,000 in new fees annually to create a position. PCH could agree to subsidise any shortfall in fees during the launch phase of the service offering.

The second area for enhancing the financing environment for film and television producers is by speeding up the payment of the CPTC. The CPTC represents a large piece of a production's financing, yet it is one of the last elements to be paid to the producer. Producers must complete and submit a corporate tax return to claim the CPTC. The Province of Ontario has already embarked on an initiative to advance a share of the tax credit to producers. The industry is positive on this development in Ontario and would like to see the federal government follow suit.

Recommendations:

PCH (or Telefilm) could consider approaching the CCC to create and staff a position (on a pilot basis) within the CCC. The new position would focus on providing International Prime Contractor Solution and other CCC products to Canadian firms selling production services and new media products to foreign producers.

PCH could consider exploring with the Canada Revenue Agency and CAVCO in what ways larger portion of the CPTC can be advanced to producers, and thereby reduce the interim financing charges they face.

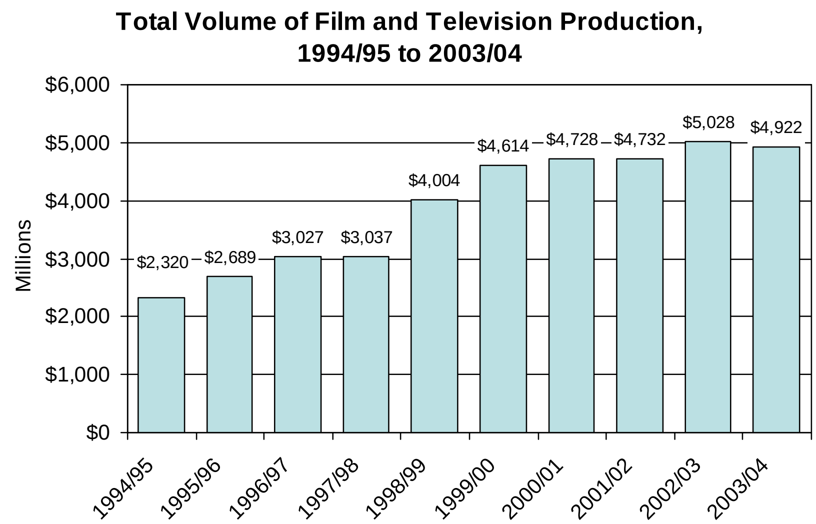
1 Introduction

1.1 Background and Mandate

Between 1994 and 2004, the Canadian film and television production industry experienced tremendous growth. According to the latest statistics published by the Canadian Film and Television Production Association (CFTPA), total spending on film and television production in Canada increased by more than two-fold from $2.32 billion in 1994/95 to $4.92 billion in 2003/04 – an average annual rate of growth of 8.7%.[7]

During 2003/04 (fiscal year ending March 31, 2004), the Canadian film and television production industry generated an estimated 51,800 direct jobs, and a further 82,900 jobs in other industries.[8] In that same year, the industry generated the equivalent of $2.3 billion in exports through foreign location production activity in Canada, and the pre-sale of Canadian television programs and films around the world.[9]

Figure 1 Total Volume of Film and Television Production, 1994/95 to 2003/04



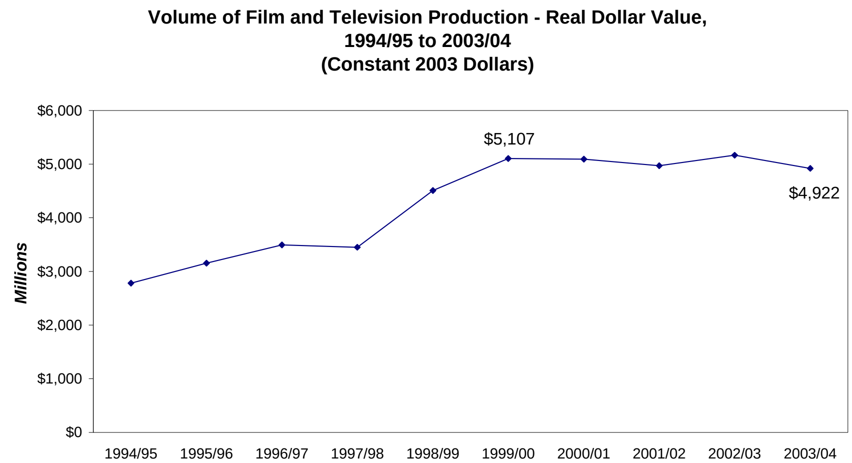
Source: Canadian Film and Television Production Association, *Profile 2005: An Economic Report on the Film and Television Production Industry,* Exhibit 1.

Between 1999/00 and 2003/04, however, film and television production spending slowed and even started to decrease. During that period, production spending on film and television grew by a total of only 6.7%. Indeed, in February 2005, the CFTPA reported that in 2003/04, total film and television production spending decreased by 2%.[10]

[7] CFTPA, *Profile 2005: An Economic Report on the Film and Television Production Industry,* p. 10.
[8] CFTPA, *Profile 2005: An Economic Report on the Film and Television Production Industry,* p. 12.
[9] CFTPA, *Profile 2005: An Economic Report on the Film and Television Production Industry,* p. 13.
[10] CFTPA, *Profile 2005: An Economic Report on the Film and Television Production Industry,* p. 10.

Figure 2 presents statistics for the total dollar volume of film and television production in Canada in real dollar terms – thus accounting for effect of inflation.

Figure 2 Volume of Film and Television Production - Real Dollar Value, 1994/95 to 2003/04 (Constant 2003 Dollars)



Source: Nordicity Group calculations based on data from: Canadian Film and Television Production Association, *Profile 2005: An Economic Report on the Film and Television Production Industry,* Exhibit 1, and Statistics Canada, Consumer Price Index, historical summary, CANSIM II, table 326-0002.

In real dollar[11] terms, film and television production spending in 2003/04 ($4,922 million) was 3.6% below the real-dollar peak of $5,107 million reached in 1999/00.

The industry faces a number of challenges that reflect the heightened level of global competition for film and television production dollars. Several factors have come together to make the environment more competitive for Canadian producers and production crews. Western Europe's shift to intra-European production, the rising Canadian dollar, the introduction of film and television tax incentives in several American jurisdictions, the emergence of Eastern Europe as an economic location for production, and a shift, globally, for audiences and broadcasters to prefer domestic television content have all combined to create business conditions that threaten the Canadian film and television production industry.

More than ever, it is important that the Canadian industry has a highly efficient financing environment for production. It is crucial that Canadian producers have access to the most efficient financing tools possible, and certainly equivalent to those available to producers in other countries, and that these tools are available on competitive terms.

One such tool is the completion guarantee (also known as a completion bond). Banks and other financiers of a film or television production can require an independent producer to obtain a completion guarantee. As described later, many television producers have been able to avoid the expense of obtaining a completion guarantee because of their track record. However, completion guarantees are still broadly required for feature films and certain drama programs for television.

The completion guarantee gives the financiers the assurance that the production will be completed and delivered to buyers on-time and on-budget, and that the deliverable to the buyer will meet all the contractual delivery terms of the buyer. The completion guarantor may at times be forced to step in and take charge to ensure that the project is completed, which may even require an investment on its part. In the unlikely event that the production cannot be finished and delivered at all, the completion guarantee gives the investors assurance that they will be reimbursed for their investment. Such an assurance is necessary because unlike most physical goods, an incomplete film and television production essentially has zero salvage value.

[11] Real dollars refer to dollar amounts that are adjusted to take into account the effect of inflation on the purchasing power of the Canadian currency.

In 2005 in Canada only one domestic firm, Film Finances Canada (1998) Ltd., provides completion guarantees to Canadian producers. Film Finances Canada is a subsidiary of the American parent company Film Finances, Inc., based in Los Angeles, California. Film Finances, Inc. originated in London, United Kingdom (U.K.) and maintains a strong base there.

In addition to completion guarantees, producers will typically obtain errors and omissions insurance, cast insurance, and other forms of liability insurance. In some cases, this insurance can represent a significant cost in terms of the project budget.

Beyond insurance products, producers will access a whole range of financing tools. If the producer faces a financing shortfall because she or he has been unable to pre-sell certain territories, the producer will often seek gap financing. Gap financing is relatively expensive, and again, there is only one firm in Canada, La financière des entreprises culturelles du Québec (FIDEC), that is currently offering it.

For many Canadian producers, certain types of financing such as tax credits, Canadian Television Fund (CTF) funding, distributor minimum guarantees, and broadcaster licence fees are not completely available during shooting. The producer, nevertheless, faces financial obligations during shooting; crew salaries must be paid every two weeks, for example. Many Canadian producers, therefore, must obtain interim financing from financial institutions. Interim financing has become an important element in the film and television production financing process.

Financial institutions will extend credit for most domestic receivables and certain kinds of foreign “paper”, for example, a minimum guarantee from an established broadcaster like the BBC, but not for lesser known buyers.

While one focus of this report concerns completion guarantees, the study also reviewed a wide variety of other financing tools. The Department of Canadian Heritage (PCH) charged Nordicity Group Ltd. (“Nordicity Group”) with the following overall mandate for the study:

> *To determine if a viable business model exists for a Crown financial institution or newly formed public-private entity to provide completion guarantees or financial instruments to increase cash flow to the Canadian audio-visual industry.*

With this mandate in mind, the study offers a profile of the current financing environment in Canadian film and television production, and a review of the role of the Crown financial institutions, including Telefilm Canada (“Telefilm”), the Business Development Bank of Canada (BDC), Export Development Canada (EDC), and the Canadian Commercial Corporation (CCC).

Based on this research the study identifies service opportunities for the federal government and the Crown financial institutions. For the most promising or feasible of these opportunities, a high-level business case was constructed to assess the economic viability of the service.

1.2 Methodology

This project was completed using a two-phase approach. The first phase entailed secondary and primary research. This research included the following activities:

- a document review;
- the collection and analysis of CAVCO Telefilm data; and,
- key informant interviews.

Various documents were reviewed during the preparation of the report; a list of them can be found in the References section at the end of the report.

The research and analysis for the study included the collection and tabulation of data from the Canadian Audio-Visual Certification Office (CAVCO). These data were used to estimate the total budgets of projects likely to require a completion guarantee, or other financing tools, and thereby the sizes of the various markets in Canada for certain financing tools. CAVCO also provided detailed production financing data; these data were used to estimate the levels of various types of primary financing.

Telefilm provided detailed tabulations of international treaty co-production budgets. These data were also used as input to the calculation of the size of the completion guarantee market in Canada.

For this project, 22 interviews were conducted with a total of 29 persons representing various stakeholder groups in the financial services and film and television production industries. A complete list of the interviewees, as well as copy of the interview guide, can be found in the appendices of this report. These interviews provided information about the financing tools currently available to film and television producers and the terms and rates charged to producers to access these tools. The interviews also provided information about the financing needs of Canadian producers in today's market. The interviews with the Crown financial institutions offered a look into the products and services that the Crown financial institutions currently provide to film and television producers, and the degree to which the institutions' mandates and business practices would allow them to expand their role in the industry. Research interviews were also conducted with television broadcasters in order to gain a better understanding of the financing terms that producers face in the marketplace.

Following this research, a set of service opportunities were identified that the federal government, Crown financial institutions, or a newly formed public-private entity could provision to film and television producers. From this set of service opportunities, two were selected which appeared to be most feasible. For both of these selected service opportunities, a simple business case analysis was constructed. The business case for each service was assessed in terms of the risk-adjusted rate of return that it provided to the equity investors in the service – whether those investors were a Crown corporation, private investors, or Canadian taxpayers.

Based on the research and business case analysis, several conclusions were formulated, as well as short-term and long-term recommendations for PCH. These recommendations put forth several of the actions that PCH can take to address the financing needs of Canadian film and television producers, and wherever possible leverage the resources of the Crown financial institutions and other financial services providers in Canada.

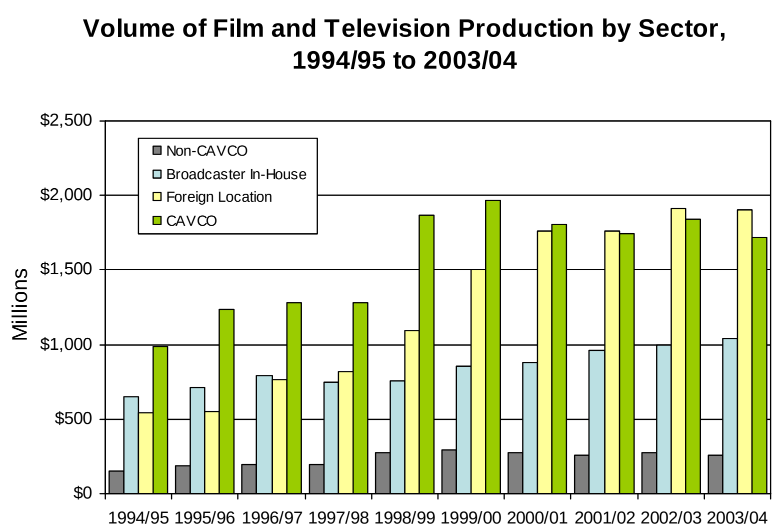
2 Structure of the Canadian Film and Television Production Industry

2.1 Sectors of Film and Television Production in Canada

In 2003/04, $4.92 billion was spent on film and television production in Canada, representing the dollar amount of production budgets in all segments of the Canadian production. The largest single segment in the industry was **foreign location production**. Foreign location production includes all films and television programs shot by non-Canadian producers in Canada. Often, American or other foreign producers will work with a Canadian service or line producer. The service producer is a Canadian resident who actually coordinates and executes the production of the film or television program. In 2003/04, just over $1.9 billion was spent in foreign location production in Canada.

Most indications are that the foreign location production segment in Canada experienced a significant contraction following March 31, 2004. The effect of the rising Canadian dollar and competition from other jurisdictions around the world made a significant dent in Canada's attractiveness as a foreign location spot for Hollywood studios.

Figure 3 Volume of Film and Television Production by Sector, 1994/95 to 2003/04



Source: Canadian Film and Television Production Association, *Profile 2005: An Economic Report on the Film and Television Production Industry,* Exhibit 3.

CAVCO production refers to domestic production that is certified as Canadian content by CAVCO, and therefore is eligible for the Canadian Film or Video Production Tax Credit (CPTC). CAVCO production includes both television programs and theatrical films. Many CAVCO television productions are also licensed to broadcasters in other countries; or distributors who re-sell to other broadcasters. In the case of feature films, distributors seek to release the films in theatres. In 2003/04, production budgets in the CAVCO sector totalled $1.7 billion.

The **Non-CAVCO** sector – which totalled $258 million in production in 2003/04 – includes Canadian television production that is certified by the Canadian Radio-television and Telecommunications Commission (CRTC).

The **Broadcaster In-House** sector – at just over $1 billion in 2003/04 – represents the expenditures by Canadian broadcasters on the production of their station programming, particularly news and sports.

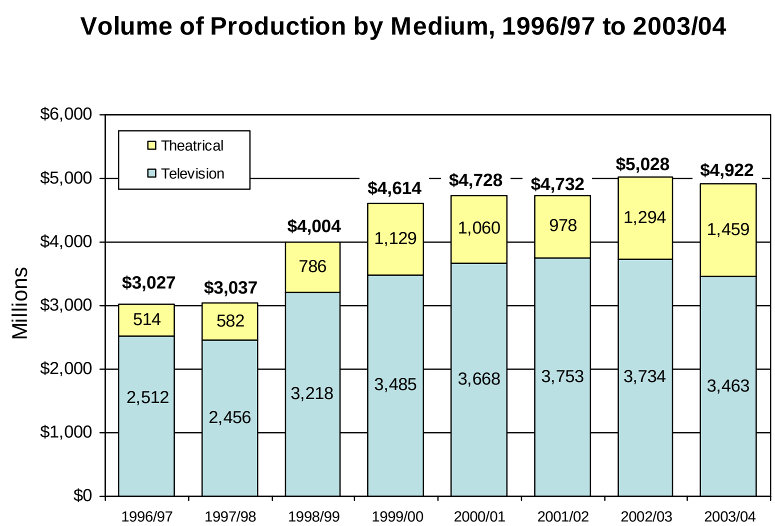
Between 1994/95 and 2003/04, each sector of the industry contributed to the overall rate of growth. During this period, total production spending in Canada more than doubled from $2.3 billion to $4.9 billion. The compound annual growth rate during this period was 8.7%. Between 1999/00 and 2003/04, the industry showed slower growth, with some of the larger segments actually showing decreases in production activity.

Initial indications suggest that total production in 2004/05 will be below the 2003/04 level, and well below the peak reached in 2002/03.

2.2 Types of Production

Production in Canada during the late 1990s and early 2000s was tilted towards the creation of television programs and series, including made-for-television movies (often referred to as MOWs) and television mini-series. Figure 4 provides a breakdown of the total volume of film and television production in terms of the two types of production – theatrical and television.

Figure 4 Volume of Production by Medium, 1996/97 to 2003/04



Source: Canadian Film and Television Production Association, *Profile 2005: An Economic Report on the Film and Television Production Industry,* Exhibit 8.

In 2003/04, approximately 70% of the $4.92 billion in production in Canada was created for television. The other 30% consisted of feature films and short films created for a first release in theatres or educational institutions.

Of the $3.46 billion in television production in 2003/04, approximately 80%, or $2.72 billion was Canadian content production. [12] The opposite was the case in the theatrical production segment. Of the $1.46 billion in theatrical-release production in Canada in 2003/04, about 80%, or $1.16 billion was in the foreign location sector.[13]

Canadian-financed feature films represent the type of production that is very relevant to the discussion of completion guarantees and financing. Television productions, particularly those produced by established Canadian producers, often go ahead without completion guarantees. Conversely, Canadian feature films for theatrical release often do require completion guarantees.

[12] CFTPA, *Profile 2005: An Economic Report on the Film and Television Production Industry,* p. 15.

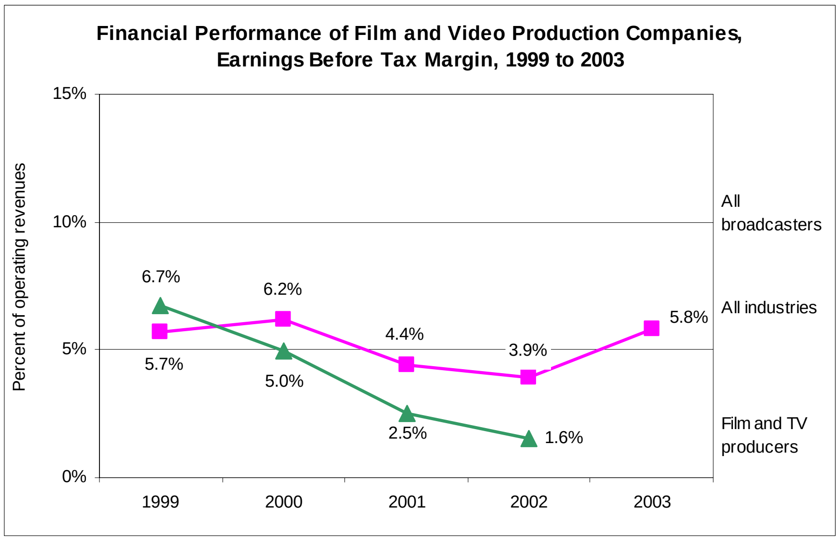
[13] CFTPA, *Profile 2005: An Economic Report on the Film and Television Production Industry,* p. 17.

The primary financing structures of television and theatrical production are also very different, and this difference has implications for the types of secondary financing required. As will be discussed in Section 3 of this report, television production is largely financed by Canadian broadcasters and the Canadian governments. Domestic theatrical production is largely financed by government sources and distributors to a lesser extent.

2.3 Financial Performance of Canadian Production Companies

While the spending on production budgets in Canada grew strongly between 1994/95 and 2003/04, Canadian production companies did not see their financial performance improve; indeed since 1999, it has deteriorated rapidly. Figure 5 compares the EBT (Earnings Before Tax) margin for all industries in Canada to that of Canadian film and video production companies, making theatrical film and television programs.[14]

Figure 5 Financial Performance of Film and Video Production Companies, Earnings Before Tax Margin, 1999 to 2003



Source: Data for all industries is from Statistics Canada, CANSIM Data Tables 187-0001. Data for film and television producers is from Statistics Canada, *Film, video and audio-visual production data tables, 2001/02*.
Note: Data for film and TV producers only includes theatrical movie producers and conventional and pay-television producers.

Between 1999 and 2002, the EBT of film and video production companies dropped from 6.7% to 1.6% of operating revenues. At 1.6%, the profitability of film and television producers was well below the 2002 average of 3.9% for all Canadian industries.

From a variety of indicators, the balance sheets of production companies have deteriorated even more since 2002. Producers have little room to increase their working capital or attract equity investment; there is a cap on producer fees in the domestically financed projects; there is little upside from the producer equity, partly in view of the recoupment positions taken by Telefilm as an equity investor; all tax credits are built into the financial structure of the production; and they are dependent on interim financing since payments are based on delivery points. Therefore, any improvement in working capital and lessening of financing costs would help production companies to acquire a little room to invest in their own projects.

[14] The financial performance data for film and television producers only includes data for theatrical movie producers and conventional and pay-television producers. It excludes data for producers of advertising, government and education productions, and industrial videos. It also excludes data for unspecialized producers.

3 Financing Practices and Needs for Film and TV Production in Canada

The financing of film and television production in Canada varies depending on whether one is considering a television production or a film for theatrical release. This section examines the financing components of both types of production. The analysis in this section is confined to the financing of CAVCO-certified Canadian production and considers both the major sources of financing and the various types of financing. This section also provides an overview of the ways in which production companies obtain cash flow financing, as much of their primary financing is only tendered upon completion of principal photography or other production or accounting deliverable. In general, the data indicate that the financing of Canadian film and television production has changed significantly during the 1999/00 to 2003/04 period.

3.1 Financing of Canadian Television Production

Table 1 details the various sources of financing for Canadian television production between 1999/00 and 2003/04. The most important element in the financing of a Canadian television production is the broadcaster. Without the interest and participation of a broadcaster, it is very difficult for a television production to proceed. When a broadcaster participates in a production, it is said to have licensed the production, or contributed a licence fee. In effect, the broadcaster contributes to the cost of the production in exchange for a licence to broadcast the program – usually on an exclusive basis for a certain period of time or number of plays. The licensing broadcaster may be Canadian or foreign. For most Canadian productions, the licensing broadcaster is Canadian. Television broadcasters may also make equity investments in television programs. This type of investment gives them an economic interest in the profits generated by television program through sales in other territories or syndication.

Table 1 Sources of Financing for CAVCO-Certified Television Production, 1999/00 to 2003/04

	1999/00	2000/01	2001/02	2002/03	2003/04
Private Broadcaster	12%	15%	17%	20%	22%
Public Broadcasters	6%	7%	8%	10%	13%
Federal Tax Credit	9%	9%	9%	9%	10%
Provincial Tax Credit	10%	10%	11%	12%	12%
Canadian Distributor	13%	15%	11%	8%	7%
Foreign	28%	22%	21%	16%	11%
Public*	7%	7%	8%	9%	9%
Other Private**	14%	15%	15%	18%	16%
Total	**100%**	**100%**	**100%**	**100%**	**100%**

Source: Nordicity Group estimates based on data obtained from CAVCO.
Note: Some totals may not add due to rounding.
* Public includes financing from the Canadian Television Fund (Equity Investment Program), provincial governments, Telefilm Canada and other government departments and agencies.
** Other Private includes financing from production companies, corporate production funds, the Canadian Television Fund (Licence Fee Program) and other private investors.

Broadcasters' share of television financing nearly doubled from 18% in 1999/00 to 35% in 2003/04. The share increase largely resulted because of the withdrawal of foreign financing from Canadian television production. Between 1999/00 and 2003/04, the share of Canadian television financing from foreign sources dropped from 28% to 11%. During this period, the international markets for foreign television programming weakened significantly, largely as European broadcasters turned to domestic or intra-European content for their television schedules.

Throughout the 1999/00 to 2003/04 period, federal and provincial governments were also significant sources of financing for Canadian television programs. All told, federal and provincial governments accounted for about 31% of the financing of Canadian television programs in 2003/04.

Public financing comes in various forms. Every Canadian production certified by CAVCO receives the CPTC. The CPTC rebates the producer for 25% of her or his expenditures on salaries and wages paid to Canadians. The CPTC's ceiling provisions are such that it can rebate as much as 15% of the production's total costs.

The federal government also finances Canadian television programs through the CTF. Through the CTF, the federal government and Telefilm Canada (a Crown corporation) inject approximately $140 million annually into distinctly Canadian television programs. This amount is roughly matched by the transfer of funds from direct-to-home (DTH) satellite service providers and cable companies, based on the total revenue generated by subscription fees (listed under "other private" – see below).

Provincial governments also finance production through their own tax credits and non-refundable rebates. The effective tax rates vary by province; however, on average, provincial tax credits accounted for roughly 12% of television production financing in 2003/04.

Canadian distributors, on average, contributed approximately 7% of television financing in 2003/04. Canadian distributors will often provide a minimum guarantee to a producer. When a television project is completed and delivered to the distributor, the distributor will provide a payment equal to the minimum guarantee. Distributors may also make financial advances to a producer. This is a payment made before delivery of the finished product. The distributor's contribution gives it certain rights to license the program outside of Canada, or after the licensing broadcasters' exclusive exhibition period in Canada has expired.

Between 1999/00 and 2003/04, the share of television financing from Canadian distributors nearly halved from 13% to 7%. Because distributors' sales are into foreign markets, the weakness in these markets during the 1999/00 to 2003/04 period contributed to a drop in the participation of Canadian distributors in Canadian television programs.

Other private sources accounted for about 16% of television program financing in Canada in 2003/04. The biggest single component of other private financing in Canada is actually contributions from cable-television companies and DTH satellite service providers. Companies in both of these markets must contribute 2% of their annual revenues to the CTF, which in turn distributes the money to Canadian television productions. In 2003/04, these contributions amounted to approximately $120 million in additional financing to Canadian television production.

Another significant source of other private financing is the production company itself. Production companies will often take equity in a project by deferring producer fees or other allocations for production-company overhead expenses.

Rounding out the other private sources of financing are the various private Canadian production funds formed other the years. These funds include the Bell Broadcast and New Media Fund, BravoFACT!, Canwest Western Independent Producers Fund, Cogeco Program Development Fund, Rogers Documentary Fund, and the Shaw Television Broadcast Fund, to name just a handful.

Types of financing

The financing of Canadian television production can also be viewed in terms of the types of financing. Table 2 details the financing of Canadian television programs in terms of the various types of financing.

Table 2 Types of Financing for CAVCO-Certified Television Production, 1999/00 to 2003/04

	1999/00	2000/01	2001/02	2002/03	2003/04
Canadian Broadcaster Licence	23%	27%	32%	39%	44%
Foreign Broadcaster Licence	10%	8%	6%	4%	2%
Tax Credits	19%	19%	20%	21%	22%
Canadian Distributor Pre-Sale	9%	8%	8%	4%	3%
Foreign Pre-Sale	22%	20%	18%	15%	13%
Equity	7%	7%	9%	10%	5%
Loans	2%	2%	1%	1%	1%
Public and Private Fund Assistance	1%	1%	1%	2%	6%
Production Company	6%	5%	4%	3%	2%
Other	2%	2%	2%	2%	1%
Total	**100%**	**100%**	**100%**	**100%**	**100%**

Source: Nordicity Group estimates based on data obtained from CAVCO.
Note: Some totals may not add due to rounding.

Licence fees from Canadian broadcasters were the largest type of television financing in Canada – accounting for 44% of total financing in 2003/04. This amount included not only broadcaster licence fees but also funding from the CTF's Licence Fee Program – the component of the CTF funded by the cable-television companies and DTH satellite service providers.

As discussed above, the increase in the share of financing in the form of licence fees, from 23% in 1999/00 to 44% in 2003/04, reflects the diminished participation of foreign buyers for Canadian television programs. Licence fees from foreign broadcasters dropped from 10% to 2%; while foreign pre-sales dropped from 22% to 13%. Pre-sales to Canadian distributors also dropped from 9% to 3%, reflecting the diminished international prospects for Canadian television programs.

Federal and provincial tax credits were another significant type of financing in 2003/04; they accounted for 22% of total television financing in that year. Assistance from public and private funds accounted for 6%. Equity investments – which include monies from the CTF's Equity Investment Program, and the equity investments of provincial funding agencies, broadcasters and producers – stood at 5% in 2003/04. No other single type of financing accounted for 5% or more total financing in 2003/04.

3.2 Financing of Canadian Theatrical Production

The landscape for the financing of a Canadian theatrical production, namely theatrical feature films, is somewhat different. For this type of production, the largest financier group is the federal and provincial governments. Table 3 details the sources of financing for Canadian theatrical feature films. All told, federal and provincial governments provided approximately 61% of the financing in this segment in 2003/04. Note that the domestic theatrical production segment was about one-tenth the size of the domestic television segment in that year. According to data from the CFTPA, Canadian theatrical production totalled $296 million in 2003/04, while Canadian television production totalled $2,723 million.[15]

The largest single source of theatrical financing in Canada in 2003/04 was the federal government's Canada Feature Film Fund, administered by Telefilm Canada. Since 2002/03, this fund has injected $100 million annually into various programs supporting Canadian theatrical production (about $85 million

[15] Please see CFTPA, *Profile 2005: An Economic Report on the Film and Television Production Industry,* Exhibits 9 and 11.

of which was allocated to the project development, production and marketing assistance program). In Table 3, these monies are included in the category of public financing, which accounted for 39% of total financing in 2003/04. The increase in public funding from 13% in 1999/00 to 39% in 2003/04 largely reflects the introduction of the Canada Feature Film Fund.

Table 3 Sources of Financing for CAVCO-Certified Theatrical Production, 1999/00 to 2003/04

	1999/00	2000/01	2001/02	2002/03	2003/04
Private Broadcaster	1%	2%	3%	4%	5%
Public Broadcasters	0%	0%	1%	0%	1%
Federal Tax Credit	8%	7%	6%	7%	5%
Provincial Tax Credit	10%	11%	12%	12%	17%
Canadian Distributor	9%	24%	18%	21%	10%
Foreign	29%	23%	20%	19%	10%
Public*	13%	15%	26%	25%	39%
Other Private**	30%	18%	14%	11%	12%
Total	**100%**	**100%**	**100%**	**100%**	**100%**

Source: Nordicity Group estimates based on data obtained from CAVCO.
Note: Some totals may not add due to rounding.
* Public includes financing from the Canadian Television Fund (Equity Investment Program), provincial governments, Telefilm Canada, Canada Feature Film Fund and other government departments and agencies.
** Other Private includes financing from production companies, corporate production funds, the Canadian Television Fund (Licence Fee Program) and other private investors.

Provincial and federal tax credits contributed 23% of theatrical production financing in 2003/04. Financing from Canadian distributors and foreign sources fluctuated from year to year during the 1999/00 to 2003/04 period. In the latest year for available data, 2003/04, Canadian distributors and foreign sources each contributed 10% to the production of Canadian theatrical works.

In comparison to television production, Canadian broadcasters play a much smaller role in the financing of theatrical production. Nevertheless, Canadian broadcasters will finance documentaries or feature films that will have some theatrical distribution before going to television. As such, broadcasters will provide licence fees or even take an equity position in the project.

Types of Financing

When viewed on the basis of the types of financing, the data indicate that there is a far higher level of equity investment in theatrical production than is found in television production. This equity largely represents the financing provided by Telefilm Canada; it includes only small amounts of private-sector equity investments. By the same token, public and private fund assistance is largely comprised of monies from Telefilm Canada. Table 4 details the types of financing that went to Canadian theatrical production between 1999/00 and 2003/04.

Table 4 Types of Financing for CAVCO-Certified Theatrical Production, 1999/00 to 2003/03

	1999/00	2000/01	2001/02	2002/03	2003/04
Canadian Broadcaster Licence	3%	4%	5%	5%	7%
Foreign Broadcaster Licence	1%	1%	3%	0%	1%
Tax Credits	18%	18%	18%	19%	22%
Canadian Distributor Pre-Sale	8%	9%	7%	10%	8%
Foreign Pre-Sale	28%	31%	25%	23%	13%
Equity	12%	15%	28%	24%	22%
Loans	18%	12%	2%	10%	4%
Public and Private Fund Assistance	1%	1%	1%	4%	18%
Production Company	9%	7%	8%	4%	4%
Other	1%	1%	4%	1%	2%
Total	**100%**	**100%**	**100%**	**100%**	**100%**

Source: Nordicity Group estimates based on data obtained from CAVCO.
Note: Some totals may not add due to rounding.

Federal and provincial tax credits as well as equity investments held the largest shares in 2003/04; each accounted for 22%. Public and private assistance also held a large share at 18% in 2003/04. The increases in both equity investments and public and private assistance largely reflect the introduction of the Canada Feature Film Fund.

3.3 Financing of International Treaty Co-Production

Canada currently has international co-production treaties with 53 countries (Canada does not have a treaty agreement with the U.S.). Under the terms of these co-production treaties, a Canadian producer can work jointly with a producer in one or more other treaty countries to make a film or television program, which will receive national treatment in each of the participating countries. In an international treaty co-production, financing will come from each participating country; as well, the filming or other elements of the production will be shared among each country. International treaty co-production is an effective way for Canadian producers to gain experience on larger budget productions. In 2003, Telefilm Canada gave advanced rulings to 107 treaty co-productions involving Canadian producers. In total, these 107 projects had total budgets of $728 million.

The data tables in this section detail the aggregate sources of financing for Canadian treaty co-productions with partners in the U.K., France, Germany, and Australia. During the last several years, these countries have accounted for a large share of Canadian treaty co-production. While the data supplied by Telefilm is not directly comparable to that from CAVCO, it does offer some indication of the different financing sources. In comparison to conventional domestic production, treaty co-production, by its very nature, obtains about one-half of its financing from outside Canada. Table 5 details the financing of Canadian television programs made under international co-production treaties.

Table 5 Sources of Financing of Canadian Treaty Co-Production with Selected Partner Countries†, Television Production, 2000 to 2003

		2000	2001	2002	2003
Canadian Financing	Broadcaster	8%	8%	12%	12%
	Tax Credit	12%	9%	11%	10%
	Distributor	22%	17%	15%	16%
	Other Public	2%	1%	2%	1%
	Other Private	17%	10%	14%	11%
	Subtotal	**61%**	**45%**	**54%**	**49%**
Foreign Financing	Broadcaster	7%	16%	14%	18%
	Tax Credit	0%	3%	0%	1%
	Distributor	8%	11%	6%	12%
	Other Public	2%	4%	3%	4%
	Other Private	22%	22%	22%	16%
	Subtotal	**39%**	**55%**	**46%**	**51%**
Total		**100%**	**100%**	**100%**	**100%**

Source: Nordicity Group tabulations based on data obtained from Telefilm Canada.
† Data only includes productions with the U.K., France, Australia, Germany.
Note: Some totals may not add due to rounding.

Canadian and foreign broadcasters still account for about 30% of the total project financing in television production. Tax credits play less of role, because they are only available for money spent in Canada; in the partner country(s), government support may take another form. Other private sources (e.g., private production assistance funds) and distributor financing appear to play a larger role in the financing structures.

In feature film production, private sources other than broadcasters and distributors play a larger in the project financing, when compared to Canadian domestic production. Table 6 details the financing of Canadian feature films made under international co-production treaties.

Table 6 Sources of Financing of Canadian Treaty Co-Production with Selected Partner Countries†, Feature Film Production, 2000 to 2003

		2000	2001	2002	2003
Canadian Financing	Broadcaster	2%	6%	3%	3%
	Tax Credit	6%	8%	9%	8%
	Distributor	21%	21%	15%	11%
	Other Public	3%	7%	8%	11%
	Other Private	11%	10%	12%	16%
	Subtotal	**43%**	**50%**	**46%**	**49%**
Foreign Financing	Broadcaster	5%	1%	10%	1%
	Tax Credit	0%	0%	0%	0%
	Distributor	19%	17%	5%	9%
	Other Public	4%	6%	5%	8%
	Other Private	28%	26%	34%	33%
	Subtotal	**57%**	**50%**	**54%**	**51%**
Total		**100%**	**100%**	**100%**	**100%**

Source: Nordicity Group tabulations based on data obtained from Telefilm Canada.
† Data only includes productions with the U.K., France, Australia, and Germany.
Note: Some totals may not add due to rounding.

In 2003, 49% of project financing for Canadian treaty co-production feature films came from private sources other than broadcasters and distributors. What is more, approximately two-thirds of this other private money was brought to the production by the foreign producer.

3.4 Financing Needs of Canadian Producers

The data in Sections 3.1 and 3.2 indicate the sources and types of financing utilized by Canadian producers. In television, the licensing broadcasters and governments are the largest primary financiers. In theatrical production, governments provide the majority of the primary financing for production. By definition, primary financing is most critical to the film and television production. The overall size and growth of the industry is very closely correlated with it. If primary financing shrinks then production spending will have to drop. Indeed, over the past five years, the domestic production side of the industry contracted by about 11% as primary financing from foreign sources has diminished.

Foreign Financing and Sales

The data and research suggest that improved access to foreign financing is one of the needs of Canadian producers. Of course, to sell Canadian television programs and films outside of Canada, it is necessary that the product has audience appeal outside of Canada. However, this by itself is not a sufficient condition. Canadian producers must also have the tools and environment for completing international financing deals. Canada is a small media market; producers need all the tools required to market and sell their products outside of Canada.

One such tool is gap financing. Gap financing is essentially a loan to the producer, which is based on the prospects for selling the production in territories that it has not yet been sold in. In Section 4, the study looks at gap financing in more detail.

Interim Financing

Primary financing, whether it be a broadcaster licence fee, government tax credits, or a distribution guarantee, is not often available until after shooting and post-production is completed. In the interim, the producer must meet regular financial obligations, including the payment of salaries and wages, and other services acquired during production. This timing mismatch between the payment obligations and income generates the need for secondary sources of financing or financial solutions, namely interim financing.

The research indicates that the interim financing market in Canada is competitive. According to the Royal Bank (which holds a significant share of the film and television interim financing market outside of Quebec), film and television producers are charged rates of prime plus 1%. Such rates are on par with those charged to established small businesses with solid balance sheets.

Interim financing becomes costly for Canadian producers because they often have to maintain outstanding balances for as long as 18 months, as they wait to collect post-delivery financing. Indeed, government tax credits are often the last to come in; and they can comprise 20 to 25% of total financing.

As such, a need definitely exists to speed-up the receipt of certain types of financing.

The remainder of the report examines some of the tools currently available to Canadian producers for these purposes, and considers other potential opportunities to assist producers in this area.

4 Completion Guarantees and Other Insurance, and Financial Instruments Used by Canadian Producers

4.1 Completion Guarantees

A completion guarantee essentially assures the financiers of a film or television production that the project will be completed and delivered within a specified time period. A completion guarantee also gives the project's investors the assurance that it will not cost them more than their specified investment to complete the production; and that should the production not be completed, that they will be reimbursed for their investment. A producer will typically obtain a completion guarantee at the request of the project's investors. Completion guarantees are traditionally found in independent films that lack the access to the financial resources of one of the major Hollywood studios, in the event that some element of the production goes awry. However, recently, with the increasing number of co-productions between the major studios and independent producers, completion bonding has found its way into major studio productions as well.[16]

Unlike most traditional insurance, completion bonding is a very hands-on business. The completion bonder takes an active role in mitigating the risks that may prevent a production from being completed on-time and on-budget. What is more, when a production starts to fall off the rails, the completion bonder will step in to successfully complete the project rather than face a claim.

Before bonding a project, the completion bonder will conduct a through review of the script, budget, production schedule, and financing plan. The completion bonder will also meet with the key creative personnel to go over the project. Completion bonders must consider the background, experiences and personalities of the creative team, as it can have a bearing on the delivery.

During shooting, the completion bonder will monitor the progress of production often through the regular submission of progress and cost reports. The completion bonder may also visit a set or location. After shooting, the completion bonder will monitor the post-production process, again by requiring the submission of regular written updates of progress and incurred costs.

Once the film is delivered to the distributor, the completion bonder's assurance obligation ceases. The completion bonder ensures that the producer has complied with all the delivery requirements in the contract, so that the distributor agrees that the production has been completed. Distributors sometimes seek to release themselves from the obligation to accept the completed production because their priorities have changed or because they are over-committed. It should be noted that the completion guarantor is not responsible for obtaining payment from the distributor. That remains the obligation of the producer, unless the production company has purchased receivables insurance (see Section 4.3 below).

In Canada, there is currently only one Canadian firm providing completion guarantees to Canadian producers; it is Film Finances Canada (1998) Ltd. Some American completion guarantee companies, such as International Film Guarantors (IFG) and CineFinance – both based in Los Angeles – will from time to time execute completion guarantees for Canadian production; however, both of these American suppliers are likely to remain on the periphery of the Canadian market. At the same time, Film Finances Canada will receive some business from its foreign affiliates in Los Angeles (for example), so that part of its bonding sales would not be available to a non-affiliated competitor.

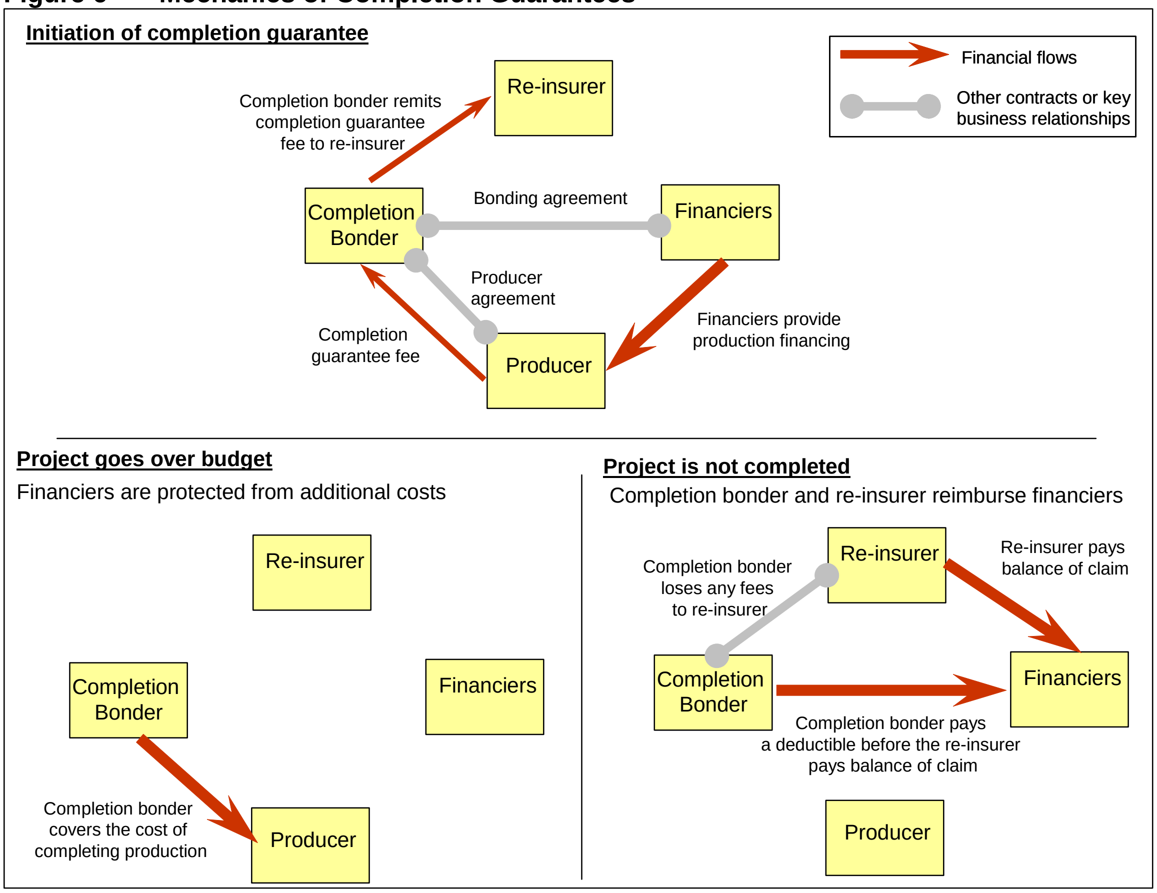
At times there has been more than one domestically-based completion bonder operating in Canada. As recently as 2002, there were three such firms offering completion bond services in Canada. Along with Film Finances, there was The Completion Guarantors, the Motion Picture Bond Company – now both

[16] Charles E. Boyle, "Hollywood and the Insurance Industry." *Insurance Journal West*, September 11, 2001. Wells Publishing, Inc., 2001.

disappeared after a fiercely competitive struggle. At the time, the subsidiaries of California-based companies, Cinema Completions International and WorldWide Film Completion were also active in Canada.

Figure 6 depicts the financial flows and contractual relationships inherent in completion guarantees.

Figure 6 Mechanics of Completion Guarantees



Source: Prepared by Nordicity Group based on interview with Film Finances Canada.

Historically, completion bond rates were as high as 6% of project budgets (this rate of 6% included a portion that was refunded to the producer upon project completion). During the late 1990s, with the numerous competitors in the Canadian market, rates were driven as low as 0.8%. This price competition and the diminishing number of re-insurers in Canada led to a market shake-up. In January 2003, Film Finances Canada acquired The Completion Guarantors. For a little over two years Canada has had a virtual domestic monopoly in provision of completion guarantees.

In 2004, L'Association des producteurs de films et de télévision du Québec (APFTQ) conducted a survey of its members. The results indicated that among Francophone producers, completion guarantees were used very little outside of feature films. Table 7 presents the survey results with respect the use of and average rates paid for completion guarantees by producers.

Table 7 Completion Guarantee Use and Rates among APFTQ Members

	Documentary Series	Documentary (Single-Episode)	Drama	Feature Films	Magazine	Variety
Number of respondents that were required to use completion guarantees	None out of 10 survey respondents	None out of 31 survey respondents	1 out 11 survey respondents	6 out 16 survey respondents	2 out of 16 survey respondents	None out of 20 survey respondents
Fee rates for completion guarantees	n/a	n/a	n/a	Average: 1.8% Range: 0.7% to 2.0%	n/a	n/a

Source: APFTQ, Survey of APFTQ members, 2004.
n/a – data not available or data not applicable.

The results indicated that out of responding producers there were only 9 out of 104 projects for which completion guarantees were obtained. Six of the nine cases were for feature film projects; only one out of 11 television drama projects required a completion guarantees. The other two cases were in the magazine genre.

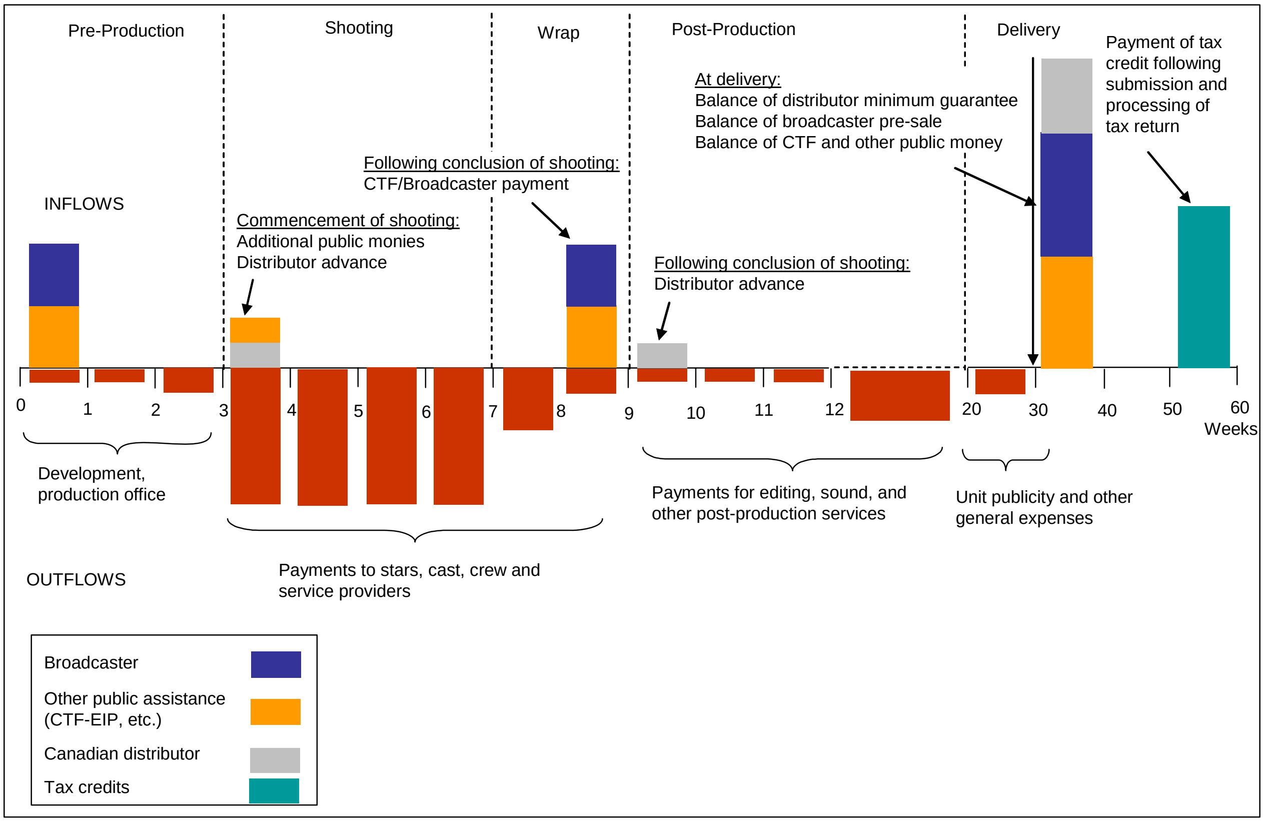
4.2 Interim Financing

In Canada, much of the primary financing funds for a feature film or television program are not available to the producer until after the project is completed. The producer's financial obligations, including wages and other costs are due during the shooting. As such, the producer needs to obtain interim financing – sometimes referred to as cash flow financing – to meet current obligations in advance of future payments.

Before beginning a production, a producer will pre-sell her or his film or television program to broadcasters and distributors inside and outside of Canada. These pre-sale agreements often stipulate progress payments against milestones, including the delivery of the final film of television program. Government tax credits represent another form of financing, and are the last to be received. Producers submit their budget and financing details to federal and provincial government agencies, which then give the producer an advance ruling on the value of non-refundable tax credits they will receive. The producer does not receive the tax rebates until the federal and provincial assessments of the corporate tax filings. As such, most producers need to interim finance their expected tax credits, received well after the completion of the production.

Figure 7 delineates the timing and relative magnitudes of the cash inflows and outflows for a typical Canadian television project. The producer will receive some monies from the licensing broadcaster and other public assistance at the outset of the project. This will give the producer the funds needed to launch the pre-production phase of the project. This phase will last about three weeks. The start of shooting at week four will often trigger additional funds, but these funds will not be sufficient to meet the large weekly obligations incurred during this phase. Shooting can last about four weeks and will generate a high rate of outflows as the producer pays performers, crews and service providers. It is during this phase that the producer most needs interim financing.

Figure 7 Production Cash Flows



Source: Adapted by Nordicity Group from Kathy Avrich Johnson, *Canadian Production Finance: A Producers Handbook,* 2001, p. 73.

At the end of shooting, the producer will often receive monies from the broadcaster and the CTF. These payments will cover only a portion of the shooting costs. As such, the producer will continue to pay the financing charges on the interim financing that she or he required to finance expenditures during the shooting phase.

The post-production phase can last several months, as the television program is readied to be delivered as a final product. During this phase, the producer will have to pay for editing, sound and other post-production services, but will not necessarily trigger any additional milestone payments from buyers or funders.

Approximately 30 weeks after the project was initiated, the producer will deliver the final tape to the broadcaster and distributor. The delivery will trigger significant payments from buyers, as well as the CTF and other sources of public funding. The sum of these payments will still leave the producer with a gap of about 25% that still requires interim financing, as the producer must wait for the tax credit payments.

The payment of the tax credits occurs after the production company completes and files its corporate tax return. The payment of tax credit in most provinces and at the federal level is further delayed until the tax return is processed and the filing company is audited.

Beginning in 2001, the Ontario Ministry of Finance, which administers the Government of Ontario's film and television tax credits, started to speed up the payment of tax credit monies to producers. Under the new system, the Ministry of Finance releases to producers up to 85% of their tax credit claim six weeks after submission of a corporate tax return. Producers still require certification from the Ontario Media Development Corporation (OMDC), which they can obtain as early as the start of principal photography. Under the old system, a producer would have to wait until after they were audited – following submission of their tax return – before they received tax credit monies. The timing of the audit was outside the producer's control, and could take place several months after they submitted their corporate tax return.

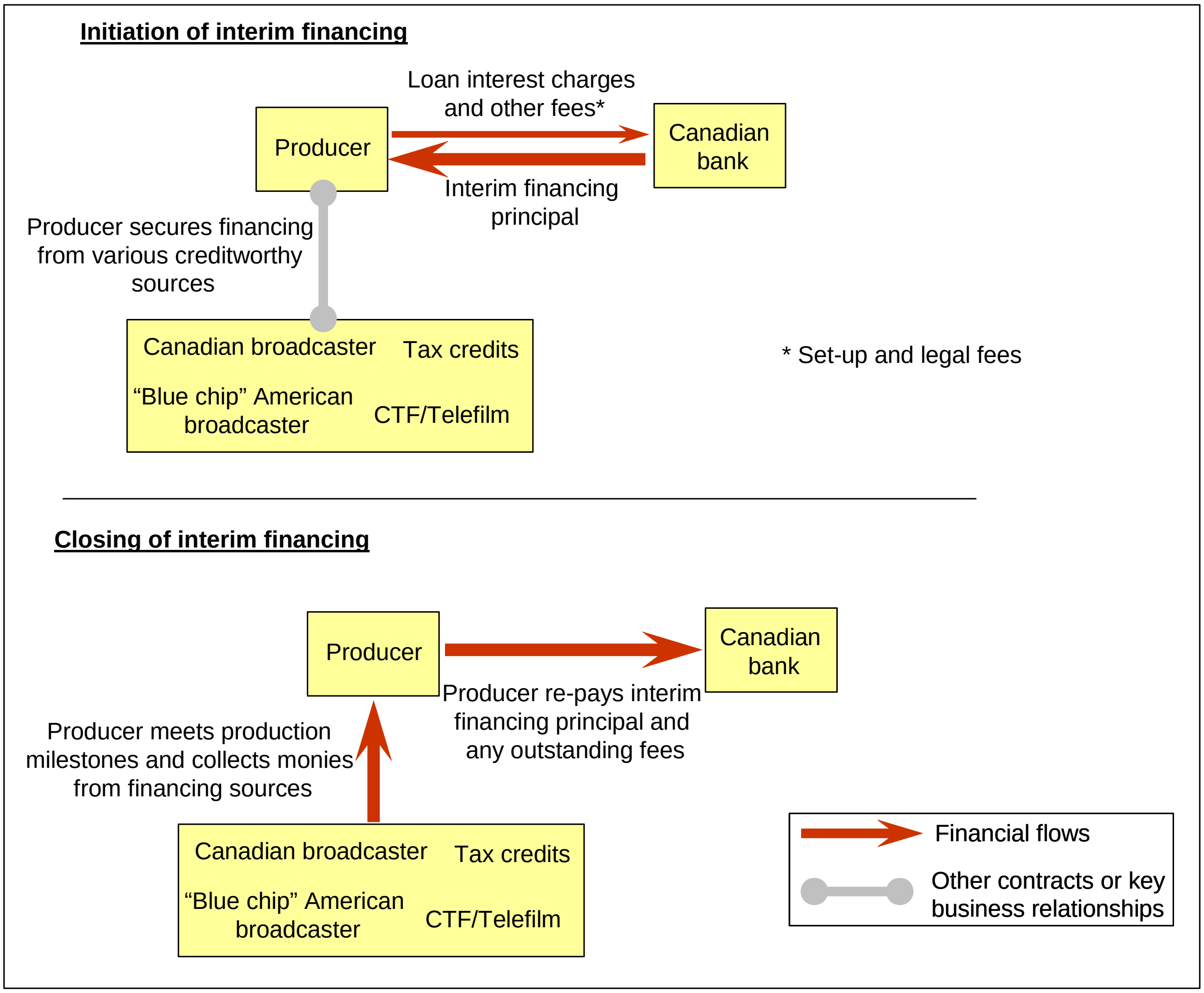
Canadian banks will typically provide interim financing on the basis of an overall assessment of the project assuming there is a budget that is fully financed by creditworthy pre-sales and other funding programs such as tax credits, Telefilm investment, CTF, etc.

Security for loans of this nature would typically include a General Security Agreement, copyright mortgage, all-risks, and errors and omissions insurance, completion guarantee where warranted, lab access letters, and specific assignments of the producers rights and benefits under the various financing agreements. In many cases, these assignments are acknowledged by the financing sources who agree to make their payments directly to the bank.

The banks try to provide a high level of service to all their clients. The financing model described above is becoming increasingly difficult to execute as producers are turning to more complex funding sources to complete the financing for projects. This includes international co-productions and tax-driven incentives in other countries. There is a threshold in terms of loan size where this production financing model and its related transaction costs may be prohibitive for smaller productions. The bank approaches each such situation on a case-by-case basis.

Of course, banks assess and establish the credit-worthiness of producers before extending credit. A producer with a good track record and high volume of business will merit better loan terms from banks; while producers with smaller credit needs and less established credibility often need more collateral, like personal guarantees. Indeed, many small producers with small interim financing needs cannot obtain interim financing. The fixed ancillary costs can be prohibitive; what is more, the dollar amounts of the deal may be too small for the banks to consider.

Figure 8 Mechanics of Interim Financing



Source: Prepared by Nordicity Group based on interview with RBC Royal Bank, Commercial Markets.

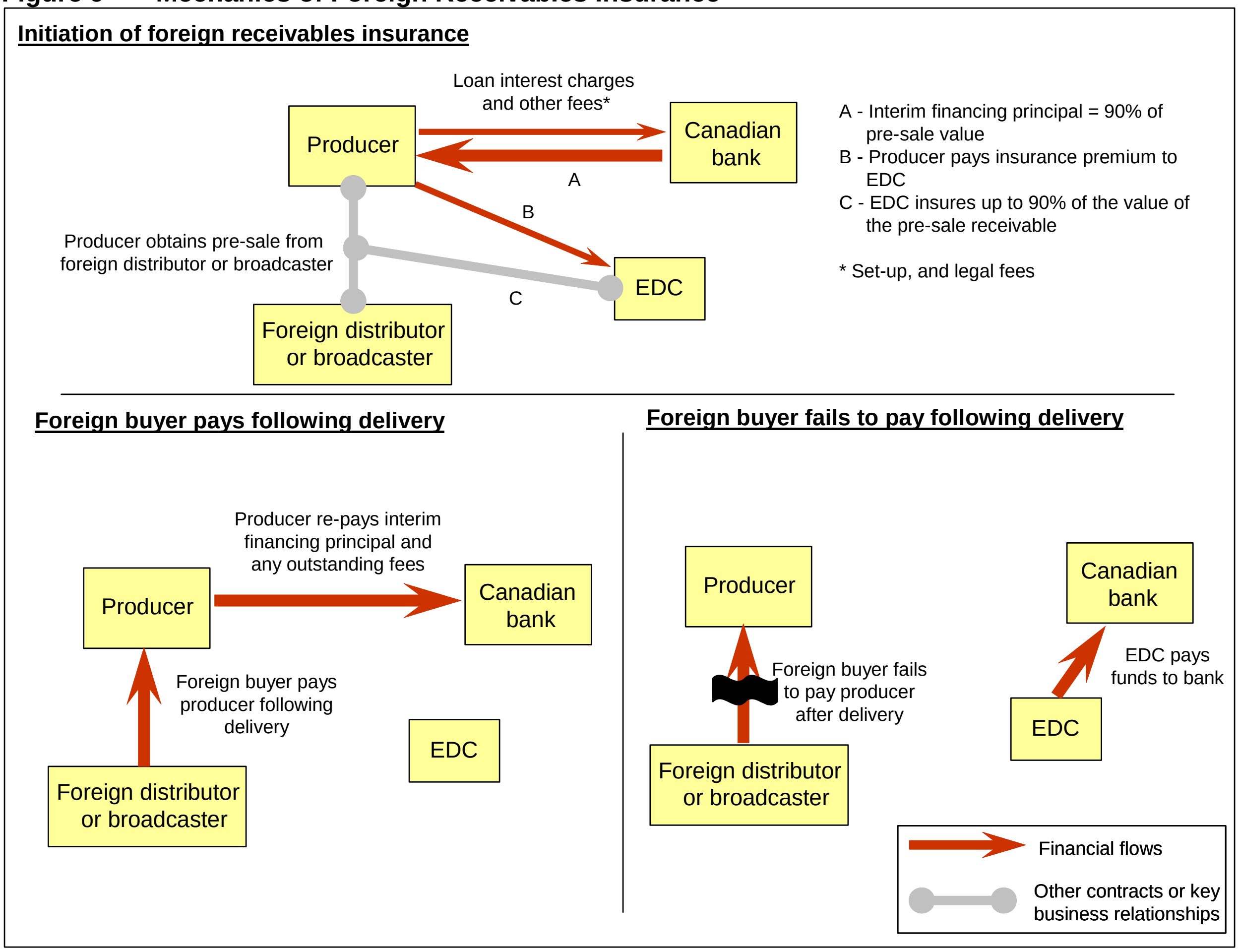
Besides the CTF and Telefilm, Canadian banks have typically limited their interim financing to pre-sales to Canadian broadcasters and distributors, and "blue chip" foreign buyers. Canadian producers seeking interim financing of pre-sales to lesser-known foreign broadcasters and distributors require EDC receivables insurance (see Section 4.3); alternatively, the producer can approach the U.S.-based Comerica Entertainment Group for the interim financing of foreign receivables. In comparison to Canadian banks and the EDC, Comerica maintains an international network of film and television banking specialists who can effectively assess the credit-worthiness of buyers around the world. Interim financing from Comerica is, of course, more expensive than Canadian sources of interim financing.

Because pre-sales require that the project be completed and delivered to the buyer, a completion guarantee is often an integral part of an interim financing package. Canadian banks, however, may waive the requirement for a completion guarantee for certain established producers and production companies. As shown earlier, in Quebec most production aside from feature films do not trigger the need for completion guarantees. For the rest of Canada, MOWs and mini-series drama production typically necessitate the use of completion guarantees, but not all drama television series do so.

4.3 Foreign Receivables Insurance

Foreign receivables insurance is a tool used by companies to enhance their access to credit based on commitments by foreign distributors and broadcasters to pay for the rights to the production once completed. In Canada, EDC provides foreign receivables insurance to Canadian exporters with sales outside of Canada (See discussion of EDC in Section 5.2). Other countries have similar organizations providing this financial service. EDC will insure up to 90% of the value of a Canadian exporter's foreign receivable. With such coverage from the EDC, a Canadian exporter can then approach their financial institution to access additional credit – in effect, monetizing the exporter's receivable.

Figure 9 Mechanics of Foreign Receivables Insurance



Source: Prepared by Nordicity Group based on interview with EDC.

EDC assumes the risk of non-payment by the foreign buyer. If the foreign buyer fails to pay due to default or insolvency, the Canadian exporter can make a claim. EDC will, in turn, direct the value of the insurance (up to 90% of the value of the receivable) to the exporter's financial institution.

Canadian film and television producers have been using foreign receivables insurance for the last several years, ever since EDC started to accept film and television industry clients in 1999. Section 5.2 of the report discusses EDC's role in film and television industry in more detail. Canadian producers will essentially seek EDC insurance for receivables generated by pre-sales to foreign broadcasters and distributors for which Canadian banks are not able to establish the creditworthiness.
Another valuable feature with respect to EDC is the willingness to extend favourable terms to creditworthy buyers. So, a foreign distributor can delay paying for the project after delivery for 90 days or 180 days. This kind of term enables Canadian producers to attract foreign distributors to commit to a project, but obviously extends the risk of EDC of not being paid.

4.4 Gap Financing

Gap financing is the term used to describe financing obtained by producers to cover the difference between a project's budget and the total value of pre-sales and other financing sources. It may be the case that the total financing and value of pre-sales raised by the producer falls short of the project's budget. In effect, this gap is attributed to yet-to-be-sold exhibition or distribution rights.

Gap financing is a type of interim financing without the collateral of already-negotiated primary financing. Instead, to obtain gap financing, the producer will engage a sales agent to put together a plan to sell the project in unsold territories. The financial institution then provides a loan on the basis of this plan, namely the sales projection and capability of the sales agent.

Gap financing allows the producer to complete the financing of a project without diluting the producer's equity.[17] Traditionally, the gap financier holds the first recoupment on any revenues earned by a production. The view of gap financiers is that the budget must be paid before the equity investors begin to make profits.[18] Of course, this financial positioning creates a conflict with the recoupment policies that come along with equity investments from Telefilm Canada (see Section 5).[19]

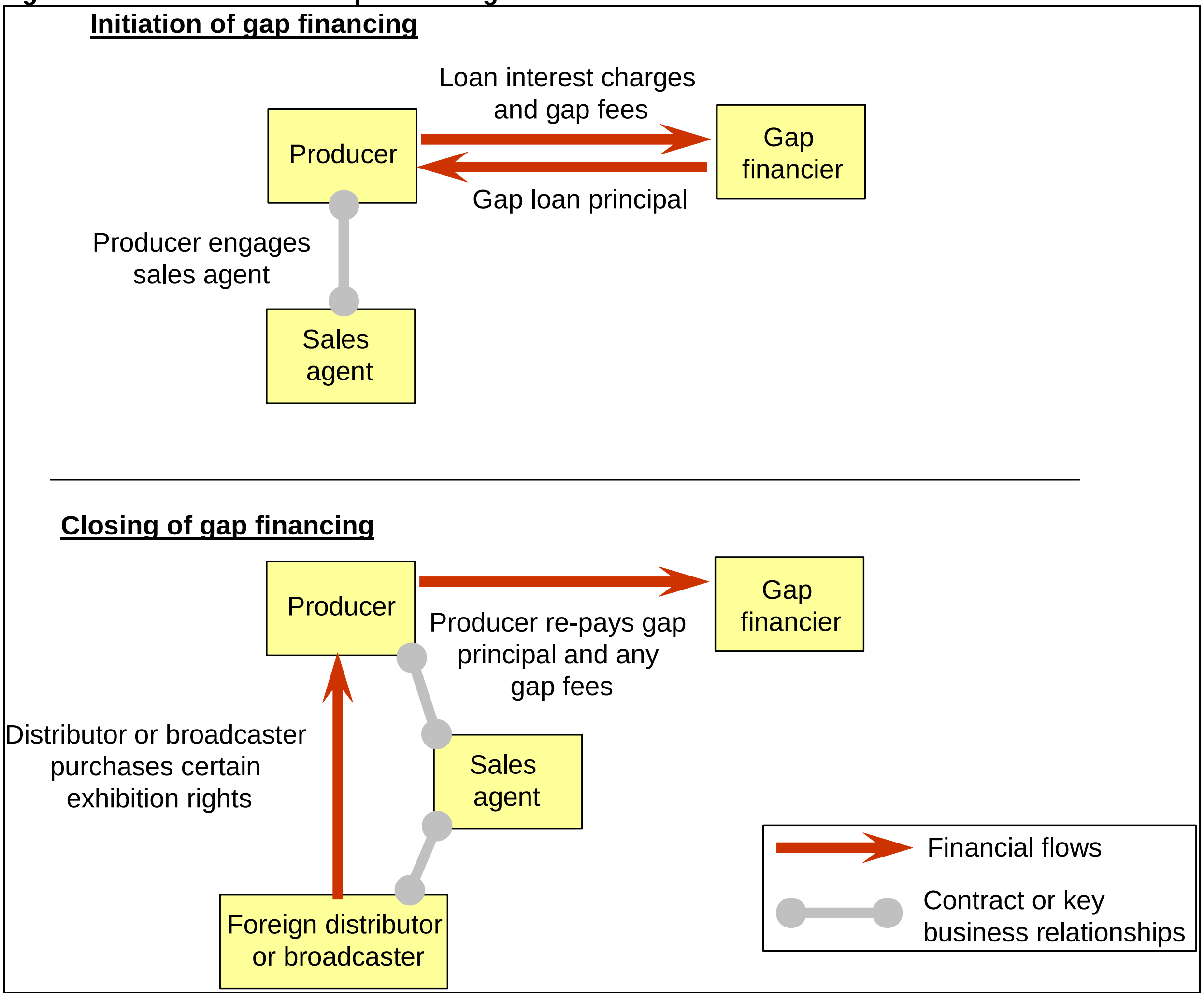
Only one firm in Canada currently offers gap financing – that is FIDEC, a Montreal-based limited partnership with $45 million in capital. FIDEC's partners include Société de developpement des entreprises culturelles (SODEC), Fonds de solidarité des travailleurs du Québec (FTQ), National Bank of Canada, Groupe TVA, L'Equipe Spectra, Daniel Langlois Investments, DKD!Spectacle, FranceFilm, and Mr. Rosaire Archambault. FIDEC originally only operated in Quebec; in short order, it plans to begin operating in the rest of Canada.

In exchange for a gap fee, FIDEC essentially provides a loan guarantee to the producer that then allows her or him to obtain credit from a financial institution. According to FIDEC, this credit is provided at the bank prime rate.

For the most part, up until now, Canadian producers outside of Quebec had to seek gap financing from financial institutions outside of Canada. Some of the major sources of gap financing include Comercia Entertainment Group (which operates in Canada through Independent Film Financing), Lew Horwitz Organization, and Union Bank in the United States; and Royal Bank of Scotland, and Bank of Ireland in the United Kingdom.

[17] Leo Rice-Barker, "Financing more of a public/private mix," *Playback Magazine*, February 17, 2003, p. 23.
[18] *Ibid*
[19] *Ibid*

Figure 10 Mechanics of Gap Financing



Source: Prepared by Nordicity Group based on interview with FIDEC.

Before a Canadian producer can obtain gap financing, the production must typically be at least 80% covered by pre-sales and soft money.[20] This 80% must include sales to at least two other major foreign territories; the latter stipulation provides a gauge of the foreign marketability of the project.[21]

The sales agent's sales plan is typically discounted by 50% (sometimes more) to determine the amount of gap financing to be made available.[22] The sales plan must also include sales to at least two or three of the primary territories (North America, the U.K., France, Spain, Italy, Germany, Benelux, Scandinavia, Japan, Australia, South Africa [usually], pan-Asian satellite TV [sometimes], Latin American pay-TV [sometimes]).[23]

[20] Leo Rice-Barker, "Financing more of a public/private mix," *Playback Magazine*, February 17, 2003, p. 23.
[21] *Ibid*
[22] *Ibid*
[23] *Ibid*

Because gap financing carries a higher risk than interim financing, it comes at a higher price. Gap financing can cost in the neighbourhood of 18% to 20% in terms of an interest rate equivalency. The cost of gap financing will include

- the interest cost (typically prime plus 2%);
- a setup fee (1.25% to 2.50% of the loan amount, depending on the complexity of the deal);
- a gap fee (equivalent to 7% to 8% of the amount of the gap); and,
- legal fees.[24]

4.5 Insurance Services

In addition to completion guarantees and foreign receivables insurance, film and television producers will often obtain insurance for liability and to cover loss of property. There are four main types of insurance products used by film and television producers; they include:

1. **Entertainment Package:** This includes coverage for pre-production, cast, essential elements, negative, faulty stock, camera, processing, miscellaneous equipment, props, set and wardrobe, extra expense, property damage, office contents and physical damage to non-owned or hired automobiles.
2. **Comprehensive General Liability and Umbrella Liability:** This type of insurance is similar to standard liability insurance used by businesses and includes coverage for any stunts or special effects.
3. **Errors and Omissions:** This type of insurance protects film and television producers and broadcasters from lawsuits due to the violation of personal rights, libel or slander arising from the film or television program.
4. **Automobile Insurance:** In certain provinces, film and television producers will obtain auto insurance for leased vehicles used on a production.

In Canada, there are a handful of insurance brokers and wholesalers selling these types of services, including B.F Lorenzetti & Associates inc., Jones Brown Inc., Aon/Ruben-Winkler Entertainment Insurance Brokers, Multimedia Risk Consultants and Insurance Brokers, and Global Expert Risk Management Inc. These Canadian insurance brokers market policies underwritten by one of the following global insurance companies, Fireman's Fund, Chubb Insurance Company of Canada, and Lloyd's of London (two syndicates).[25]

The rates for film and television liability insurance can vary significantly depending on the type of production and the track record of the producer. Table 8 details the utilization rates and fees paid by APTFQ members for various types of liability insurance. The data were collected through a survey of APFTQ members, and show that rates can vary widely, depending partly on the genre of production.

[24] *Ibid*

[25] This is not an exhaustive list. It was constructed from information gathered through our interviews, CFTPA, Guide 2005, and a review of the Insurance-Canada.ca web site.

Table 8 Utilization and Fee Rates for Liability Insurance, APFTQ Members

Insurance Product	Documentary Series	Documentary (Single-Episode)	Drama	Feature Films	Magazine	Variety
Errors and omission insurance	Average: 1.1% Range: 0.3% to 5.0%	Average: 2.8% Range: 0.2% to 11.6%	Average: 0.2% Range: very small	Average: 0.3% Range: very small	Average: 1.2% Range: 0.2% to 3.2%	Average: 3.4% Range: 0.2% to 10.8% (used very little)
Project insurance	Average: 0.5% Range: very small	Average: 0.9% Range: 0.2% to 3.2%	Average: 0.3% Range: very small	Average: 0.8% Range: very small	Average: 0.5% Range: very small	Average: 0.6% Range: 0.04% to 5.00% (used very little)
Liability insurance	Average: 0.2% Range: very small	Average: 0.4% Range: 0.1% to 1.4%	Average: 0.1% Range: very small	Average: 0.1% Range: 0.06% to 0.54%	Average: 0.2% Range: 0.04% to 0.90%	Average: 0.13% Range: very small
Other insurance	Little use	Little use	None	Little use	Little use	Used frequently
Total cost of insurance†	Average: 1.6% Range: 0.6% to 1.6%	Average: 3.4% Range: 0.3% to 16.3%	Average: 0.7%	Average: 1.8%	Average: 1.8%	Average: 1.9% Range: 0.5% to 13.0%

Source : APFTQ, Survey of APFTQ members, 2004.
† Results for the feature film segment include cost of completion guarantee fees

For point-of-view documentaries, the range for errors and omissions insurance is between 0.24% and 11.63% (averaging 2.82%) of the total budget; for cast insurance in TV dramas there is little variation for an average of 0.29%. This high rate for documentaries can be attributed to the high rates for errors and omissions insurance. Documentary makers are often vulnerable to defamation or liable suits because of the nature of their projects. The results of the APFTQ's survey indicate that other genres face liability insurance costs in the range 0.3% to 1.8% of the total budget.

5 The Role of Crown Agencies in the Financing of Canadian Film and TV Production

Over the last several decades the federal government has established numerous Crown corporations to provide financial services to Canadian companies. The formation and operation of Crown corporations have often been based on an underlying policy goal of the federal government. Increasingly, however, Crown corporations operate with commercial business principles akin to private-sector organizations.

This section examines the role that four of Canada's Crown corporations play in the financing of the film and television industry. This section identifies and describes the financing tools offered by Telefilm Canada ("Telefilm"), Export Development Canada (EDC), the Business Development Bank of Canada (BDC), and the Canadian Commercial Corporation (CCC).

5.1 Telefilm Canada

Telefilm is a Crown corporation formed in 1967 through the enactment of the *Canadian Film Development Corporation Act*. Telefilm's enabling legislation mandates it to "foster and promote the development of a feature film industry." Over the last 25 years, through a series of memorandums of understanding, the federal government has expanded the capacity and responsibilities of Telefilm.[26] Today, Telefilm provides financial and other support to Canada's audio-visual industries, including the film and television production, new media, and music.

Telefilm provides loans and equity investments to each of the audio-visual industries. It supports creators at the development, production, and post-production phases. Telefilm also administers several cultural industry support programs funded by the Department of Canadian Heritage.

Table 9 lists five of Telefilm's programs which provide primary financing to the development and production of Canadian films and television programs.

Table 9 Telefilm Canada Financing and Funding Programs for the Film and Television Industry

Program	**Description**
Canadian Television Fund	Directly provides approximately $50 million in equity financing to the production of high-quality 10/10 Canadian television productions. Also administers approximately $50 million in equity financing on behalf of the Department of Canadian Heritage to the production of high-quality 10/10 Canadian television productions.
Canada Feature Film Fund – Development, Production and Marketing	Provides total annual financing of $85 million to the development, production and marketing of Canadian feature films.
Screenwriting Assistance Program	Provides total annual funding of $2.3 million to the creation of feature film screenplays for Canadian-content productions (eligible for CAVCO certification).
Low Budget Independent Feature Film Assistance Program	Provides total annual funding of $1.8 million to the production and post-production/completion of high quality, original and culturally relevant director-driven low budget feature films from both emerging and established filmmakers.
Versioning Assistance Fund	Provides assistance for the versioning (addition of dubbing, subtitles) to Canadian feature films and CTF-financed television productions.

Source: http://www.telefilm.gc.ca

At times Telefilm has also been involved in secondary financing, including interim financing loans and loan guarantees. During the 1990s, Telefilm operated a program that provided loan guarantees to film

[26] The government recently concluded a legislative review of the *Canadian Film Development Corporation Act*. This review is intended to result in certain amendments to the legislation.

and television production companies. The fund was wound up, however, because its use was concentrated among small higher-risk companies.

5.2 Export Development Canada

EDC is a Crown corporation. It was formed in 1945 following the enactment of the *Export Development Act*. In its enacting legislation, EDC was given the mandate to "support and develop, directly and indirectly, Canada's export trade and Canadian capacity to engage in that trade as well as respond to international business opportunities."

Today, EDC carries out its mandate by offering various insurance, financing, and bonding products to Canadian exporters. The table below lists some of the products offered by EDC.

Table 10 EDC Lines of Business and Products

Line of Business	Product
Insurance	Accounts Receivable Insurance Documentary Credits Insurance Specific Transactions Insurance Political Risk Insurance
Financing	Line of Credit Loans Project Finance Guarantee Equity (and other investments)
Bonding	Performance Security Guarantee Performance Security Insurance Surety Risk Insurance Surety Fronting Insurance
Online Products and Tools	*Export Protect* (online product) *Export Check* *Export Able* *Export Market Insight*

Source: Export Development Canada, *2004-2008 Corporate Plan Summary*, pp. 10-12.

Since late 1999, EDC has been providing accounts receivable insurance to Canadian film and television producers. For this service, EDC will insure up to 90% of the book value of receivables generated by Canadian producers' pre-sales to foreign broadcasters and distributors. With EDC receivables insurance, the Canadian producer can access additional credit from her or his financial institution. The financial institutional will increase the producer's credit line by 90% of the receivable book value.

EDC's insurance is distinct from a completion guarantee in that it only protects the producer and lender against non-payment by the buyer due to non-payment or default. While the producer's pre-sale may have taken place before production started, the receivable is not created until such time as the film or series is delivered and completed. EDC assumes the risk of non-payment between the time of delivery and final payment by the foreign buyer. As such, accounts receivable insurance is complementary to a completion guarantee; the completion guarantor assumes the project risk up until delivery. EDC does not require completion guarantees in all cases, and such determination is essentially established on a case-by-case basis.

To begin providing accounts receivables insurance to film and television producers, EDC had to customize its transaction documentation. It also had to leverage the knowledge and expertise of the Canadian film and television production community. Its initial focus was on Quebec-based producers selling television programs outside of Canada. Since then, it has broadened the composition of its portfolio.

In 2004, EDC completed approximately 25 to 30 deals in which it insured approximately $25 million in foreign receivables for Canadian producers. Its volume of business has been higher in previous years. In its peak year for activity, two EDC underwriters completed about 50 deals worth $50 to $60 million in foreign receivables. This represented a minute share of the $37.2 billion in short-term insurance volume for EDC in 2003.[27]

Throughout the five years that EDC has been underwriting foreign pre-sales, it has kept a very low profile within the Canadian film and television production community. It has not actively marketed its service offering; instead it has relied upon referrals or direct Exporter approach. The research interviews with the production community corroborated this. Producers did not report a widespread awareness of the fact that they could approach EDC in order to enhance their access to interim financing. At the same time, however, the producers who had used EDC's products found them to be very beneficial to their project financing.

From a commercial perspective, EDC's involvement in the insurance of film and television receivables has, thus far, not been profitable. The losses experienced by EDC have far exceeded the revenues generated by the business. Indeed, according to EDC, the magnitude of the losses has been such that the film and television underwriting operation is unlikely to recover fully the losses it has incurred to date. As a result of these past "hits", EDC is currently reviewing its film and television underwriting operation. Many options are currently being explored, one would be for EDC to exit the business altogether and cease issuing insurance for film and television receivables; another option might involve EDC placing more stringent underwriting criteria on any film and television industry deals that it enters into.

According to EDC, the film and television production community does not use any of the Crown corporation's other insurance, financing, or bonding products. EDC confirmed that no other EDC product lines are currently or are anticipated to be offered to the film and television production industry.

5.3 Business Development Bank of Canada

BDC is a Crown Corporation formed in 1944 as the Industrial Development Bank. In 1995, Parliament adopted the *Business Development Bank Act*, giving BDC a "broadened and dynamic public interest mandate" under which it is to pay "special attention to exporting businesses and to businesses in the technology sector." In April 2002, BDC's mandate was renewed for a period of ten years.

BDC provides loans, venture capital and subordinate financing, as well as financial consulting services to Canadian entrepreneurs. BDC pays special attention to the needs of small and medium-sized enterprises (SMEs) – companies with fewer than 500 employees. The table below lists and describes the various financing products offered by BDC.

[27] Export Development Canada, *Annual Report 2003,* p. 3.

Table 11 Business Development Bank of Canada, Financing Products

Program	Description
Loans	**Terms Loans** offer a larger percentage of asset financing extended over a longer-term, often under-secured. **Co-Vision Loans** provide financing for start-ups in manufacturing, wholesale, transport and service industries. These loans are aimed at supporting entrepreneurs who need equipment or working capital (up to $100,000) to start their businesses. **Productivity Plus Loans** provide financing for new or used equipment and machinery that are geared to improve the productivity of the business. In addition to financing the hard assets, PPLs provide up to an additional 25% of the total (maximum $500,000) for costs associated to acquire the equipment (e.g., costs related to installing and assembling the equipment and training the employees who use it). The PPL solution is a particularly good example of how the Bank supplements other sources of financing. **Innovation Loans** offer a single approach for working capital needs to support the development and implementation of an innovation strategy such as the development of new products, staff training and development, adoption of industry standards, research and development costs, and the purchase, development or transfer of new technology (up to $250,000).
Venture Capital	BDC provides venture capital financing to Canadian technology companies with the goal of supporting them from the seed stage to a public equity offering.
Subordinate Financing	Subordinate financing is a hybrid type of investment incorporating elements of both debt and equity.

Source: BDC, *Summary of Corporate Plan: Fiscal 2005-2009.*

Cultural Industries Development Fund

BDC provides financing products to Canadian audio-visual industry companies, in so far as these companies meet its commercial eligibility and credit criteria. BDC has had some particular focus on the cultural industries through the Cultural Industries Development Fund (CIDF).

PCH established the CIDF in 1991, to offer loans to Canadian companies in the film and video, new media, book and periodical publishing, and sound recording industries. In 1999, PCH entered into a memorandum of understanding (MOU) with BDC, which transferred the CIDF to BDC. As part of this agreement, PCH transferred $28 million in capital to BDC. BDC agreed to use this capital to make loans in accordance with its commercial policies to the cultural industries. BDC also agreed to allocate 30% of the CIDF funds to Francophone firms, and to report annually to PCH

Under the CIDF, BDC provided financing that was in conjunction with conventional loans from outside lenders. CIDF loans ranged from $20,000 to $250,000 for working capital, expansion projects and various other initiatives geared to long-term growth and viability of the production industry and other cultural producers.

CIDF loans were available to Canadian-owned companies that had been in business for at least two years – or operated by persons with prior pertinent industry experience. Firms must also have had adequate financial resources to ensure payment of all debts and loans assumed by the company. Financing was provided on a term loan basis and the interest rate was fixed at prime plus 3% in the latter half of the fund's operation.
Under the CIDF, a film or television production company – if it met BDC commercial criteria – could obtain loans for among other things the acquisition of equipment or to finance the production of a project. What is more, a distributor could obtain a working capital loan to acquire the rights for a television program.

The MOU regarding the CIDF was for five years. According to BDC, the MOU expired in August 2004; as of March 2005, no decision had been made with regards to renewal. From BDC's perspective, the performance of the CIDF loans was poor. Table 12 details the loan loss performance of the BDC's CIDF loans.

Table 12 Loan Loss Experience in the Cultural Industries Development Fund

Industry	Net Loan Authorizations, Fiscal Year 2000 to Fiscal Year 2004 ($ 000s)	Cumulative Loan Loss Experience Fiscal Year 2000 to Fiscal Year 2004 ($ 000s)	Cumulative Loan Loss as a Percentage of Net Loan Authorizations
Film / Video Production	72,325	9,374	13.0%
Film / Video Distribution	8,738	1,445	16.5%
Total Film /Video Production and Distribution	81,063	10,819	13.3%
TV / Radio Broadcasting & Sound Recording	7,664	573	7.5%
Book Publishing	12,039	933	7.7%
Periodical Publishing	10,863	713	6.6%
Commercial Arts & Galleries	5,076	0	0%
Theatrical & Staged Entertainment	5,746	335	5.8%
Total	**122,451**	**13,373**	**10.9%**

Source: Business Development Bank of Canada, *BDC and the Cultural Sector*, 2000/04, p. 32.

While BDC had a loan loss experience rate across all its clients of 3.3%[28], the loan loss experience in the CIDF was 10.9%. For CIDF loans to film and video production companies, the loan loss experience was 13.0%. The loan loss rate for film and video distribution companies was 16.5%. Overall the film and video industry posted a loan loss rate of 13.3%.

Throughout the tenure of the CIDF, BDC also provided financing to cultural firms through its own financial products at standard commercial interest rates. It continues to offer financing services to the cultural industries through its offices across the country. However, there is no longer any particular expertise within the BDC in the film and television production industry or any other cultural sector.

5.4 Canadian Commercial Corporation

The Canadian Commercial Corporation is a Crown corporation formed in 1946. Its mandate is defined by its enacting legislation, the *Canadian Commercial Corporation Act*. According to this legislation, the purpose of CCC is the "to assist in the development of trade between Canada and other nations; and to assist persons in Canada to dispose of goods and commodities that are available for export from Canada." While CCC's legislation does not specifically mention services or intangible exports, the latter are indeed under CCC's purview.

The CCC offers Canadian businesses several financial tools and services to facilitate export sales to foreign governments and private-sector buyers. The CCC also offers Canadian exporters a range of procurement and contract consulting services. Table 13 (below) lists two specific, which may be of most relevance to the audio-visual industry.

Table 13 Canadian Commercial Corporation Products

[28] Interview with Charles Bernier and Sylvie Ratté of BDC.

Product	Description
International Prime Contractor Solution	Primary among CCC's service offerings is its International Prime Contractor Service. Essentially the CCC acts as the prime contractor for an export transaction; it enters into a mirror contract or back-to-back contract – one that in effect supplants the contract between the exporter and the buyer. In its role as prime contractor, the CCC, with the backing of the Government of Canada, can give buyers the assurance of contract performance.
Progress Payment Program	The CCC also offers Canadian exporters, particularly SMEs, a service called the Progress Payment Program (PPP). With the PPP, the CCC assists exporters in obtaining pre-shipment working capital from their financial institution. An exporter using the PPP service can access credit at its financial institution equal to as much as 90% of the value of a future payment expected at shipment delivery.

Source: Canadian Commercial Corporation, *CCC Corporate Plan Summary, 2004-2005 to 2008-2009*.

In many respects the international prime contractor solution is analogous to a completion guarantee. The key difference is that CCC does not assume any indemnify. If, for example, an exporter does not make a delivery on time, and the CCC has to pay a penalty to the foreign buyer, CCC will seek compensation from the exporter. A completion guarantor on the other hand assumes the costs of completion, and does not seek compensation from the producer.

According to the CCC, it has not had a Canadian film and television producer as client. Much of the CCC's service offering are customized for the exporters of defence-industry products and services. What is more, its corporate plan indicates that it does focus on aerospace and defence; information, communications and technologies; environment and nuclear/biological/chemical (NBC) remediation; and engineering procurement and construction projects.

It should be noted that CCC does not provide insurance; the supplier indemnifies it in all respects. If the terms of a contract are not met, the CCC will seek full remediation from the supplier. It is really in cases where the supplier goes bankrupt or supplier remediation is unlikely that the CCC has to take a loss on a transaction.

6 Identification of Service Opportunities and Market Size

To identify new service opportunities in the area of interim financing, completion guarantees, and insurance products, a review was conducted of the factors affecting demand and supply in the sector including:

- the current <u>needs</u> of the film and television production industry in interim financing, completion guarantees and insurance services; and,
- the current <u>offerings</u>, the competitive situation with respect to current service providers, the level of industry satisfaction in the production industry for the services provided, and the favourable and unfavourable factors affecting the suppliers of these services.

The services identified for discussion included:

- completion guarantees (including re-insurance);
- insurance services (especially errors and omissions insurance);
- foreign receivables insurance;
- gap financing/international distribution;
- early stage interim financing; and,
- other financing enhancements such as production services performance guarantees and faster payment of tax credits.

The research and analysis did not conclude that there was a market opportunity in all these areas.

This section also discusses the potential actions by existing providers and identifies opportunities for new entrants. In general terms, for the Canadian film and television production industry to succeed in generating quality product and building capacity, it needs a variety of complementary instruments, competition among suppliers, good service, and reasonable terms for small as well as larger firms. The needs change in the Canadian production sector over time, but at this time services should be assessed in recognition of the following conditions:

- A complex financing environment involving multiple parties, which creates additional barriers to close financing because of the multiple approvals required. The complexity adds to the cost, drags the timeframe that plays havoc with producer deadlines, and places more emphasis on deal-making/closing than the production process.
- A weak international market for presales, distribution advances, and minimum guarantees; the disappearance of Canadian-based distributors with access to foreign markets.
- The deterioration of working capital and corporate financial resources for producers to invest in development, growth, equity in their own productions, or in financing the early stages of production.

Accordingly, this opportunity section is driven by both the consideration of needs of producers as well as business opportunities for the Crown corporations involved in financing the private sector. Where relevant, the analysis is accompanied by estimates of market size.

6.1 Completion Guarantee Market

As noted earlier, in the late 1990s the domestic completion guarantee market consolidated into a single supplier. Price competition had forced two other suppliers into bankruptcy and sale to the market "winner", Film Finances Canada, and its re-insurance partner, Lloyd's of London.

From a peak of some $600 million of bonded production in the late 1990s, the bonding market has declined as more and more Canadian producers build a solid track record and manage to convince their financiers that completion guarantees are no longer necessary. This situation is true particularly in Quebec, but also in television in general (except drama series/mini-series and some series).

While Film Finances Canada is the only domestic supplier, it is a private company, and so information on its annual revenues and volume of business are confidential. To develop an estimate of total fees in the completion guarantee market in Canada, data from CAVCO and Telefilm Canada was used to estimate the size of the addressable market for completion guarantees – that is, the total dollar value of budgets that are most likely to require a completion guarantee. The analysis started with the overall total volume of production, and then removed certain types of production that are unlikely to require a completion guarantee. Table 14 presents the estimates for the addressable market for completion guarantees among domestic productions. The assumptions underlying this estimate are detailed in the box following Table 14.

Table 14 Addressable Market for Completion Guarantees, Domestic Production, 1996/97 to 2003/04

($ millions)	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Feature film budgets	177.7	198.3	147.6	229.1	155.0	164.6	168.0	139.1
Television budgets	90.6	105.0	153.4	128.3	128.0	130.6	154.1	104.8
Total domestic budgets	268.2	303.3	301.0	357.5	283.0	295.2	322.1	243.9

Source: Nordicity Group estimates based on data from CAVCO.
Note: Some totals may not add due to rounding.

Assumptions:

- Estimate of television projects only includes budgets for productions in the genres of drama and children's programming; it excludes budgets for documentary, educational/instructional, magazine, VAPA, and other.
- Estimate of television projects excludes all projects with a total budget of less than $750,000.
- The category of feature film budgets includes feature film projects for theatrical, television, home and other non-theatrical release.
- The category of television budgets includes television mini-series, movies of the week, pilots, and television movies; it excludes the budgets of television series.

In terms of domestic Canadian production (CAVCO-certified production, excluding treaty co-production), the total addressable market is estimated to have amounted to $243.9 million in budgets in 2003/04.

The assumptions reflect the information gathered through the project research. It is noteworthy that budgets for domestic television series have been excluded. CBC does not typically require completion guarantees. CTV does require them, but only for its major Canadian fiction series.

With one exception, the same set of assumptions was used to estimate the size of the addressable market in Canadian treaty co-production. The one exception: The total volumes of television series with total budgets of greater than $10 million were included. Information gathered through the research interviews indicated that treaty co-production introduces a heightened degree of risk to projects – including television projects – and therefore more often warrant a completion guarantee.

For the estimate of the completion guarantee market in Canadian international treaty co-production, only the total budgets of treaty co-production in which Canada was a majority participant were considered; this would be a natural market for a Canadian completion guarantor. However, Film Finances Canada did disclose during an interview that it bonds minority Canadian projects from time to time, if a Canadian producer is playing a prominent role in project. Table 15 presents the estimates for the size of the addressable market for completion guarantees among Canadian majority treaty co-productions. The addressable market in the treaty co-production segment is estimated to have totalled $188.9 million in 2003/04.

Table 15 Addressable Market for Completion Guarantees, Canadian Majority Treaty Co-Production, 1996/97 to 2003/04

($ millions)	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Feature film budgets	36.6	113.8	81.4	117.8	97.4	121.1	139.8	177.6
Television series budgets (total budgets > $10 million)	28.3	25.8	100.6	109.3	111.3	129.8	109.2	0.0
Other television budgets	21.3	5.3	4.8	0.0	18.4	12.6	16.0	11.2
Total treaty co-production budgets	**86.2**	**144.9**	**186.9**	**227.2**	**227.1**	**263.5**	**264.9**	**188.9**

Source: Nordicity Group estimates based on data from CAVCO.
Note: Some totals may not add due to rounding.

Together, the addressable markets in domestic production and treaty co-production totalled $432.8 million in terms of budgets in 2003/04. To arrive at an estimate of the overall addressable market, an adjustment factor was applied to this total. Information from the interview research indicated that in recent years, many Canadian producers who have built a solid track record have convinced Canadian banks and government agencies that a completion guarantee is unnecessary. While it is unclear exactly what share of the industry these producers comprise, a sliding scale adjustment factor was applied which started at 10% in 2000/01 and increased to 25% in 2003/04. In effect, the estimation process incorporated the assumption that 25% of the production in the addressable market was made by *established* producers. In 2003/04 the adjusted total for the addressable market was $324.6 million. The adjusted totals are presented in Table 16.

Table 16 Estimate of Total Fees in the Completion Guarantee Market in Canada, 1996/97 to 2003/04

($ millions)	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Domestic budgets	268.2	303.3	301.0	357.5	283.0	295.2	322.1	243.9
Treaty co-production budgets	86.2	144.9	186.9	227.2	227.1	263.5	264.9	188.9
Total budgets	354.4	448.2	487.9	584.6	510.1	558.7	587.1	432.8
Adjustment factor	0%	0%	0%	0%	10%	15%	20%	25%
Adjusted total	354.4	448.2	487.9	584.6	459.1	474.9	469.7	324.6
Gross fees (2% of total budget)	7.09	8.96	9.76	11.69	9.18	9.50	9.39	6.49
Net fees (1% of total budgets)	**3.54**	**4.48**	**4.88**	**5.85**	**4.59**	**4.75**	**4.70**	**3.25**

Source: Nordicity Group estimates based on data from CAVCO.
Note: some totals may not add due to rounding.

To convert total budgets to an estimate of completion guarantee fees, a rate of 2% of budgets was applied. While producers will often quote rates higher than this for completion guarantees, these quoted rates are calculated net of project contingencies and certain budget items. On a total budget basis, the effective fee rate is closer to 2%.

Film Finances Canada confirmed the estimates of market size and total annual fees as being reasonable. With premiums in the range of 2%, estimated gross fees were in the neighbourhood of $6.5 million in 2003/04. Approximately one-half of the gross fee goes to the re-insurer. As such, the net fees earned from completion guarantees in Canada in 2003/04 were estimated to have been approximately $3.25 million. The estimates of the addressable market for completion guarantees and fees demonstrate that the market has declined considerably in the last several years. The overall addressable market has nearly halved from an estimated $584 million in 1999/00 to $325 million in 2003/04. Total fees have dropped commensurately.

The APFTQ's research (discussed in Section 4.1) further illustrates how the need for completion guarantees has declined. Only 6 out 16 responding feature film producers reported use of completion guarantees. Producers in other categories had even lower rates of use.

As mentioned in Section 4.1, there are in fact competitors to Film Finances Canada, in the sense that foreign-based CineFinance and IFG occasionally take Canadian projects on an opportunistic basis. If Film Finances Canada were to disappear, Canadian producers would need to avail themselves of bonding services located in Los Angeles and possibly London. It is maintained in the industry that set-up fees and rates would be more onerous than presently offered by Canadian-based Film Finances.

A Montreal-based company did attempt to enter the completion guarantee market in Canada as recently as 2004. In April 2004, Globex Media – with Lloyd's of London as its re-insurer – started operations.[29] It appears that Globex Media has ceased operating in the market.

Producers, bankers, and others have commented on some aspects of Film Finances Canada that might indicate there would be room for a competitor with a different re-insurance partner:

- Lloyd's of London, Film Finances Canada's re-insurance partner, is alleged to base its terms and conditions on U.S. market conditions. Because the Canadian market is much more "regulated" by government funding agencies, it is much more disciplined than the U.S. market where the risks are greater.
- That the imposition of these conditions (e.g., requiring a 10% budget contingency) holds up closure of completion guarantees until late in the production process. One broadcaster in fact said that in the last two production seasons the completion guarantor seems to be late in signing on every project where a guarantee is required.

As a rejoinder, however, Film Finances Canada contends that the company has been pushed by the market to be more flexible on terms and rates (e.g., accepting a 5% contingency instead of requiring 10%). They contend that Film Finances Canada is in fact insisting on completing steps in the documentation process that the producer should have done in the first place – thus exercising a diligence discipline that should benefit all parties.

With respect to rates, most of the industry feels that completion guarantee rates were increased, once the competition was eliminated. A brief review of the international market confirms that rates in Canada are on the lower end of the spectrum and that terms are more reasonable. Film Finances Canada also points out the rates stayed the same for a year after its acquisition of its chief competitor, but inevitably moved higher to accommodate the current trend where more and more "lower risk" projects are produced without completion bonds. As the lower risk projects are removed from the Film Finances Canada portfolio, it will leave only the higher risk projects – which inevitably push up rates because of the higher risk. Insurance philosophy seems to indicate that risk should be spread, which would mean that lower risk projects should be covered by completion bonds. However, this philosophy clashes with the reality of the Canadian industry where financing is tight, and stakeholders are willing to take what they perceive as low risks.

Table 17 lists the average fee and contingency rates for completion guarantees in Canada and selected other regions where Film Finances Inc. operates. The fee rates are expressed as a percentage of the total project budget. Completion guarantee terms also require the producer to include a contingency reserve in the production budget. The contingency rates are also expressed as a percentage of the total project budget. The data were supplied by Film Finances Canada.

[29] Leo Rice-Barker, "Globex Media enters completion bond sector", *Playback Magazine,* April 28, 2003, p. 2.

Table 17 Film Finances International Worldwide Summary of Completion Bond Fees

Region	Year	Average Fee	Average Contingency
Australia	2003/2004	2.39%	6.65%
Canada	2003/2004	2.19%	7.83%
France & Italy	2003/2004	2.68%	8.90%
Scandinavia	2003/2004	2.77%	9.34%
United Kingdom	2003/2004	2.76%	9.68%
United States	2003/2004	2.40%	9.80%

Source: Film Finances Canada
Note: The data exclude television production. Because television production is a significant component of the Canadian market, the actual average rate in Canada is somewhat lower than 2.19%, as rates for television are, in general, lower than for feature film.

The data indicate that among the six regions listed, Canada has the lowest average fee rate for completion guarantees. According to Film Finances Canada, the fee rates quoted in the table are only for feature film projects. The average fees for television projects are typically lower. As such, the overall effective rate faced by Canadian producers would have actually been lower than 2.19%. With respect to contingency rates, Film Finances Canada required Canadian feature film producers to set aside, on average, 7.83% of the project budget. This rate was lower than all other regions except Australia.

A new entrant with a Canadian-based re-insurer might offer a different service level and act as another service provider in this business. However, it is a limited and declining market with an entrenched provider who has international ties. It is not clear that producers would be exposed to substantially different terms, although the prospect of an available alternative would always be viewed favourably.

If there were to be a new entrant, it would need to line up a re-insurance partner. If the partner were from the Canadian market, it would possibly provide "made-in-Canada" rates. However, the market seems to be trending toward completion bonds for international co-productions along with major feature films – and away from domestic television projects. Film Finances Canada would be prepared to explore the possibility of linking up with a different re-insurer for the television market – which is declining, anyway – but would find it impossible to re-insure through a company other than Lloyd's of London for feature films and international co-productions.

It is not clear who would promote a new entrant in the completion guarantee sector. A start-up could be financed in part by the BDC, but that organization has no mandate (or expertise) to find an entrepreneur or existing business to enter into competition with Film Finances Canada. From a public policy perspective it is not clear the benefits would be significant. Having a functioning completion guarantor operating in Canada is preferable to dealing with outposts of Los Angeles-based guarantors. Stimulating the interest of a re-insurer for domestic projects – possibly to work with Film Finances Canada – might be an initiative to explore.

6.2 Insurance Services

The Quebec production industry is increasingly concerned about the rise in costs of insurance, in particular, errors and omissions insurance, and to a lesser extent, general liability and entertainment package insurance. Table 8 (in Section 4.5) presents the results of the APFTQ's recent survey research on this topic.

The main insurance suppliers in Quebec have apparently been marketing their products to banks, broadcasters, and agencies – for the latter to require insurance as a condition of extending credit and making progress payments. According to some producers, broadcasters are now inserting errors and omissions insurance into their contracts for documentary programming. In fact, broadcasters have confirmed their intent in this regard. Whereas in the past, they waived errors and omissions insurance, they are no longer doing so. The terms of some broadcasters are more onerous than others (e.g., some accept a shorter period in which the insurance provides protection), but broadcasters believe it is prudent and smaller producers would not be able to finance a legal defence if they did not have such insurance. It is mainly the broadcasters who are exposed in terms of copyright and other infringements, since the claims would be made against the broadcasters as well as the producers. These claims would be made well after the interim financing has been completed, so it is not an issue to the banks because the interim financing would have been paid off.

As indicated, producers are not looking for alternatives so much as a return to the days when the premiums on errors and omissions insurance were quite nominal; or for broadcasters, etc., not to require this type of insurance. However, it is not clear that any new supplier of insurance services would greatly improve the business conditions for producers.

Using production budget data from CAVCO and the average rates of insurance reported in the APFTQ's member survey, an estimate was constructed of the size of the film and television insurance services market in Canada in 2003/04. The estimate is detailed in Table 18.

Table 18 Estimate of Size of Film and Television Insurance Market in Canada, 2003/04

	Average insurance premium rate (premium as percent of project budget)	Total volume of production, 2003/04 (dollars)	Estimate of total insurance fees, 2003/04 (dollars)
Documentary series	1.6%	169,581,311	2,713,301
Documentary single episode	3.4%	72,320,624	2,458,901
Fiction television	0.7%	885,068,069	6,195,476
Feature film	1.8%	276,622,531	4,979,206
Magazine	1.8%	87,730,680	1,579,152
Variety	1.9%	107,582,595	2,044,069
Total	**--**	1,598,905,810	19,970,106

Source: Nordicity Group calculations based on data from CAVCO and APFTQ.

Overall, Canadian producers paid an estimated $20 million in insurance premiums to insure $1.6 billion in production activity in 2003/04. The highest insurance rates were found in single-episode documentaries, where errors and omissions insurance has become more and more of a necessity. In the other genres the insurance rates are lower.

6.3 Foreign Receivables Insurance

As indicated earlier, the EDC provides receivables insurance for producers who have pre-sale agreements with foreign broadcasters or minimum guarantee commitments from foreign distributors. The first recourse of producers is for their interim financing lender (a bank) to finance these commitments as well. Banks will do so for foreign purchasers who are "blue chip"[30] or otherwise low risk to the bankers. For example, Disney or NBC may be considered a blue chip buyer. EDC will insure that the foreign distributor will pay upon satisfactory delivery of the product.

For Canadian producers this foreign receivables insurance is quite valuable. First, producers might otherwise not be able to tap into this interim financing at all. Second, EDC's rates are very low – about 2% (annualized basis) of the value of the receivable. Third, EDC is able to offer very favourable terms to the foreign buyer, such as 90 and 180-day payments – which enables the foreign buyer to start collecting revenues on the Canadian product before their own payment is due.

There are alternative vehicles in the U.S., but the terms for the foreign party and for the Canadian producer are much less advantageous and might not be available at all. Foreign providers like Comerica Entertainment Group are likely to offer the service on something like the following terms: discount the receivable by 25%, require an up-front payment from the foreign buyer, and charge the Canadian producer 5%.

As this brief description portrays, EDC is already providing a valuable service to the production industry. However, EDC has experienced losses in the recent past and is re-evaluating its commitment to the business. Industry observers point out that some of the commercial practices of EDC put the agency into a more exposed condition, for example: contracting with the producer, rather than with the foreign distributor/broadcaster – which makes it more difficult to collect on the account; not being an inter-party signatory (which typically binds the producer, banker, and public agency); reliance on the due diligence and legal counsel of the banker, broadcaster, bonder, etc; and, not investing in being a player in the industry (e.g., membership in the Independent Film & Television Alliance).

The service opportunity, then, is to seek to obtain a commitment by EDC to stay in the business and expand its marketing activities to elicit more interest among producers to consider its insurance product. With more volume, it could justify further EDC investments in marketing and steps to lower its risk. The danger to the industry is that EDC proceeds in the opposite direction and withdraws from the foreign insurance service business. Loss of EDC insurance would eliminate a chunk of project financing that is provided through EDC – of some $25 million per year.

Market Size

To further assess the market opportunity for foreign receivables insurance tabulations were prepared based on CAVCO data, in order to estimate the level of foreign financing in Canadian film and television production including treaty co-production. The logic involved in building the potential market size was as follows:

- The annual value of licence fees and pre-sales from four different sources were summed: American distributors, American broadcasters, offshore distributors, offshore broadcasters, and Canadian distributors. Because many American broadcasters are considered "blue chip" by Canadian banks, the total financing amount by was discounted by 75%. In effect, the analysis assumed that only 25% of the financing from American broadcasters was from non-blue-chip buyers, and therefore, the producer would require receivables insurance to obtain interim financing against the receivable.

[30] "Blue chip" refers to companies that have a low degree of credit risk. This includes large publicly traded companies that demonstrate superior financial performance and are known to pay their obligations on time and quickly. Private companies can also be "blue chip" if they have a track record of paying their obligations on time and quickly.

- Offshore broadcasters are less likely to be considered “blue chip” and therefore the financing amount was not subjected to the same adjustment in the calculations. For both American and offshore broadcasters, however, the total financing amount was further reduced by 60%, in recognition that the broadcaster will often provide some progress payments at the early stages of production.
- 100% of the foreign pre-sales of Canadian distributors were included. While these financing amounts do not represent a foreign receivable of the producer, they are a foreign receivable of the Canadian distributor, and therefore could come under the purview of EDC.

Table 19 presents the estimates of the foreign receivables of Canadian film and television producers during the 1996/97 to 2003/04 period. Based on the assumptions described above, the estimates indicate that the Canadian film and television production industry generated foreign receivables that totalled as much as $227.0 million in 2003/04. This amount already excludes an estimate for the blue chip American broadcasters.

Table 19 Estimate for Market Size of Foreign Receivables in the Canadian Film and Television Production Industry, 1996/97 to 2003/04

($ millions)	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
American Distributor	80.9	117.4	126.5	204.3	118.1	89.5	122.5	88.9
American Broadcaster*	11.3	10.7	13.6	12.3	11.6	7.7	4.6	2.8
Offshore Distributor	154.5	127.3	222.2	166.4	142.0	166.8	97.4	66.0
Offshore Broadcasters	12.9	4.7	16.7	19.8	2.7	5.1	4.6	2.6
Canadian Distributors	41.2	20.0	46.9	75.2	136.0	67.5	79.0	66.7
Total	**300.8**	**280.0**	**426.0**	**478.1**	**410.3**	**336.5**	**308.0**	**227.0**
90% of total	**270.7**	**252.0**	**383.4**	**430.3**	**369.3**	**302.9**	**277.2**	**204.3**

Source: Nordicity Group calculations based on data from CAVCO.
* Amount already includes an adjustment to remove non-blue-chip buyers.

With a 90/10 co-insurance rate, there was an estimated $204.3 million (90% of $227 million) in foreign receivables in the Canadian film and television production industry in 2003/04 from which interim financing could be obtained if EDC insurance was obtained. It should be noted that this amount, $204.3 million, is well below the level of $430.3 million reached in 1999/00. The significant drop in foreign receivables reflects the weakness in international markets described earlier. Still, the size of the potential market in 2003/04 does offer significant room for the EDC to expand.

Table 20 converts the annual level of foreign receivables into an estimate of the insurance premiums for EDC.

Table 20 Estimate of Potential EDC Insurance Premiums for Film and Television Production Industry Foreign Receivables, 1996/97 to 2003/04

($ millions unless specified otherwise)	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Foreign receivables	270.7	252.0	383.4	430.3	369.3	302.9	277.2	204.3
Annualized insurance premium rate	2%	2%	2%	2%	2%	2%	2%	2%
Duration of receivable	180 days	180 days	180 days	180 days	180 days	180 days	180 days	180 days
Estimate of EDC insurance premiums	2.67	2.49	3.78	4.24	3.64	2.99	2.73	2.02

Source: Nordicity Group calculations based on data from EDC and CAVCO.

With an average duration of six months and an insurance premium of 2% (annualized), EDC revenues from the film and television production industry in 2003/04 could have been as high as $2.0 million in 2003/04, if it had tapped the full potential of the film and television production industry's foreign receivables.

6.4 Gap Financing

The major "hole" in putting together the financing for a production is the lack of gap financing. In the past, distributor advances on their minimum guarantees for the major territories were a significant part of the production's financial package. However, distribution guarantees and pre-sale commitments to acquire the product when completed are more difficult to obtain. Consequently, projects are often initiated with major "gaps" in territories pre-sold, which means that the proceeds from future sales to these regions need to be financed in other ways. The lack of pre-sale financing for major television projects and for feature films is a real handicap for the producer who is often scrambling to pull together all the elements of a production and complete the commitments for the financing.

There is very little Canadian based foreign distributor activity, which is a handicap to the operation of a "gapper". To extend credit based on unsold territories is a major risk; and can only be mitigated if there is strong sales-agent backing – in essence a strong foreign distributor. There is an apparent lack of operating expertise in Canada in estimating and selling product in foreign markets, and thus, there is a lack of financing for these territories in Canada.

Various Canadian producer and financial institutions have been in the gap financing business over the years when there was a strong foreign demand for Canadian product. However, most of these organizations have left the business after losses registered from markets and products that did not pan out. Clearly, it is a very risky business to rely on sales to territories not yet sold. For a commercially-based entry, the initiative would need to proceed on sound business principles and the rates charged would need to reflect the risks incurred – either through loans several points above prime, or by heavy discounting from earnings eventually realized.

Since 1999, FIDEC has operated in Quebec providing gap financing to Quebec-based producers of English-language productions. Over the last five years, it has built up its experience working with sales agents around world. FIDEC believes that many sales agents have begun to afford it more respect and more solid sales estimates. FIDEC focuses on what it considers the lowest-risk Canadian productions; this often means feature films with budgets in excess of $20 million and television movies with budgets of $1.5 million or higher.

Gap financing is offered by foreign entities, like Comerica Entertainment Group, for their largely studio clientele. The advantage of Comerica lies in its ability to muscle its way into foreign deals by leveraging the Hollywood product that foreign customers need or want for television or for their distribution catalogue. Any Canadian initiative faces the handicap that there is no such product power.
Yet, the opportunity arises, then, for the creation of a gap financing vehicle outside of Quebec, possibly based on public-private partnership to help deal with the high risk nature of gap financing. The service could start small, establish networks and credibility, and gain experience as a precaution against going too far too fast and running into problems. Like FIDEC, it could have a mix of investors from the banking community, government agencies, and those already in foreign distribution in some respect.

Discussions with FIDEC and its board members indicated that the organization is expecting to expand into English Canada. Although FIDEC is a Quebec company, almost all of its gap financing is for English-language productions. If offices were established in Toronto and Vancouver, FIDEC could service those two markets as well. Nevertheless, FIDEC only serves part of the gap market, i.e., the larger budget projects. The need is for gap financing for the medium level feature films and television productions as well.

Role of Federal Financing Agencies

EDC is geared up to work with new interim financing vehicles and could possibly leverage some of its foreign engagements. However, it is not clear if EDC has the authority to become a gap financing company itself. As well, EDC has limited expertise in international production financing, and might feel more comfortable to stick to its role of insuring receivables when the producer has lined up a foreign distributor.

BDC has even less expertise in gap financing, and thus would not be a logical vehicle to provide this service on its own. However, BDC could be a possible term lender for a start-up entity that would be established along the lines of FIDEC; it could also play a role in FIDEC's expansion outside Quebec.

Entities with international distribution expertise should be part of the equation, whether it is through FIDEC's connections or other distributors. One suggestion made by a broadcaster is that the NFB's distribution arm might be a suitable foreign sales agent for international documentary programming sales.

Market Size

To estimate the size of the gap financing market in Canada, the analysis focussed on the production activity in two genres – fiction and documentary. Projects that obtain gap financing typically have already sold some foreign territory. As such, the analysis only considered Canadian productions that had some foreign pre-sale.

Fiction:

As per the practice of FIDEC, gap financing has been for projects above $10 million where the production values are high enough to generate international sales. Indeed, FIDEC tends to focus on feature films with budgets in the range of $20 million, and MOWs in the range of $1.5 million to $2.0 million. For feature films, the analysis was restricted to projects with budgets of over $10 million; for television series, the same threshold of $10 million was used; for television MOWs and mini-series, a threshold of $2.5 million was used.

Documentary:

For the documentary genre, where production costs tend to be lower, the analysis was restricted to feature films and television projects with budgets higher than $2.5 million.

Total potential fiction and documentary

Table 21 presents the estimates of the total budgets of Canadian productions that may have benefited from some type of gap financing during the 1996/97 to 2003/04 period.

Table 21 Estimate of Addressable Market for Gap Financing, Total Budgets, 1996/97 to 2003/04

($ millions)	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Total budget	455.1	450.1	725.5	730.8	593.8	579.5	387.8	278.0

Source: Nordicity Group tabulations based on data from CAVCO.

Productions that represent potential for gap financing in these categories accounted for an estimated $278 million worth of budgets in 2003/04. This was down from as much as $731 million in 1999/00.

There are some projects in the next tier of budget levels that could mean potential for gap financing, although they have not been identified in the market size. There are projects which do not make the budget thresholds as set above, but which have foreign sales potential. If some of the territories are pre-sold and thus establish a foreign market value, then they would merit attention for gap financing. These projects would tend to be more risky. The extra risk involved could be covered by an agency such as Telefilm, which has been involved in the past in interim financing (e.g., loan guarantees).

Table 22 presents estimates for the annual level of gap financing in Canada. To arrive at these estimates, the levels of foreign pre-sales for the productions included in the addressable market for gap financing were tabulated. These amounts were then discounted by 50%. In effect, the analysis assumed that the value of unsold territories was one-half that of the pre-sold territories.

Table 22 Estimate of Total Potential Market for Gap Financing, 1996/97 to 2003/04

($ millions)	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Feature film: total foreign pre-sales	13.9	14.4	21.6	11.6	22.6	26.6	9.7	6.7
Television: total foreign pre-sales	229.7	134.2	238.5	237.5	205.0	157.1	93.1	92.4
Feature film: potential gap	6.9	7.2	10.8	5.8	11.3	13.3	4.9	3.4
Television: potential gap	114.8	67.1	119.2	118.7	102.5	78.5	46.6	46.2
Total potential gap	**121.8**	**74.3**	**130.1**	**124.5**	**113.8**	**91.8**	**51.4**	**49.6**

Source: Nordicity Group tabulations and estimates based on data from CAVCO.
Note: Some totals may not add due to rounding.

Based on this approach, it was estimated that in 2003/04 there was the potential for a total of $49.6 million in gap financing in the Canadian market. This estimate for the size of the Canadian market is consistent with FIDEC's view of the Canadian market. According to FIDEC, it executes approximately $15 million annually in gap financing with Canadian producers based in Quebec, and broadly estimates the potential for $40 million to $50 million in gap financing for the Canadian market as a whole.

To convert the size of the gap market into revenues for gap financiers, an annual gap fee rate of 8% was used and a gap loan duration of 24 months. The fee and duration assumptions were drawn from the research. The calculation of the gap fee market is presented in Table 23.

Table 23 Estimate of Total Gap Fees, 1996/97 to 2003/04

($ millions unless indicated otherwise)	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Total potential gap	121.8	74.3	130.1	124.5	113.8	91.8	51.4	49.6
Annual gap fee rate	8%	8%	8%	8%	8%	8%	8%	8%
Average duration of gap loan (months)	24	24	24	24	24	24	24	24
Total estimated gap charges	19.5	11.9	20.8	19.9	18.2	14.7	8.2	7.9

Source: Nordicity Group estimates based on data from CAVCO.
Note: Some totals may not add due to rounding.

Again these assumptions reflect conditions in the Canadian market in recent years. Based on these assumptions, it was estimated that gap financing for Canadian productions generated gap fees totalling $7.9 million in 2003/04. Of course, most of this revenue would have flowed to foreign gap financiers, as FIDEC only did about $15 million annually in gap financing volume in recent years.

6.5 Early Stage Interim Financing

As indicated above, the current financing environment is very cumbersome for producers. Completion of all the due diligence imposed by financial institutions, foreign distributors, broadcasters, completion bonders, and government agencies can push a producer against the wall financially and in terms of production scheduling. The legal cost increases for all parties, and some of it (e.g., the banks' legal fees, which one producer said was between $14,000 and $20,000 per project for very straight-forward deals) is passed on to the producer.

Interim financing in Canada appears to be a relatively competitive marketplace. Several large Canadian banks, including RBC and National Bank are active in this market. During the project research producers did not indicate any overwhelming difficulties in obtaining interim financing. As such, it would appear that there is very little scope for the government to take a direct role in this market.

On the other hand, the project research did point to early stage interim financing as one area where there could be room for increased loan capacity in Canada. Canadian producers will often begin pre-production on the basis of a short form contract. The banks however will only offer interim financing against long form contracts. Producers with strong track records and a better working capital position can often self-finance pre-production; smaller, less-established producers cannot.

In the television market, producers and broadcasters sign short form contracts (or the engagement letter) that trigger an application to the government agencies and nail down the basic terms. Then, the long form contract is negotiated with further details (like the commitments for promotion and sponsorship, what specialty channels are licensed to carry the programming). Multiple parties must approve these contracts, which means the process can drag on for, say, three months. In some cases the banks (and occasionally the broadcasters) advance some interim financing to enable the producer to address pre-production expenses. Once signed, the banks release the funds, while the broadcasters and government agencies then release progress payments for each stage of the production/post-production process (which are used to pay off the interim financing).

It is the "in-between" state that makes producers most vulnerable, i.e., between the short and long form contracts; and they can be pressed into concessions by different parties (e.g., committing to personal guarantees by the bank, or ceding more rights to the broadcaster). The better financed producers with a strong track record and a relatively large volume of annual production have less of a problem than smaller or less experienced producers. The better financed producers can commit to bulk deals with banks, or even finance the early stages themselves. With multiple projects on the go, producers have some flexibility to leverage a quicker cash flow from one project to finance another. In passing, the larger producers commented that they do not know how smaller producers are able to cope with the rigours and constraints of production financing.

Thus, there is a potential opportunity in the marketplace for “early interim financing”, or some form of insurance that would enable banks to release funds at an earlier stage. One interviewee suggested that ACTRA’s pension fund could help to establish an interim financing fund with more rapid decisions, less paperwork, and lower costs. Presumably, that means higher risk than banks are able to tolerate, which raises the question whether such a fund could afford the higher exposure to losses.

Another role for the early interim financing entity would be to help close the business for the producer. Since only the larger producers can afford business affairs and in-house legal counsel, the small producer typically has to use outside legal counsel for each project. It has been suggested that some party should take charge and “ride herd” on the process to shorten the time to complete the negotiations of the long form contract. Sometimes, there can be a dozen participants on a conference call because of the number of parties to an agreement. Therefore, a role for the new interim financing party could be to help manage that process, since it is clearly in its interest to succeed as soon as possible. Therefore, one extra benefit is that it might improve the bargaining power of the producer.

Role of federal financing agencies

As with the proposal regarding gap financing, it is not apparent that EDC or CCC can play any direct role as an early interim financing vehicle. Telefilm would seem to be more equipped to participate from an expertise perspective. As well, Telefilm has been involved in the past in interim financing and in backing loan guarantees. If a public-private financing vehicle were put into place, the BDC could possibly help out via corporate lending or venture capital financing. FIDEC is already providing a form of early stage interim financing. The research did not point to any other domestic entities – public or private – providing this type of financing in Canada.

Another option is for the CTF to provide early interim financing. Each year, the CTF receives its contribution from PCH and then ends up holding it for several months before distributing it to recipients. Instead of keeping the funds in short term financial instruments, the CTF could use it to operate an early stage interim financing fund open to producers unable to access such financing from other sources.

Market sizing

To estimate the size of the market for early stage interim financing, an estimate of the overall interim financing market in Canada was prepared first. To estimate the level of total interim financing, the total financing to Canadian productions from presales to Canadian and American broadcasters, distributor minimum guarantees and advances, the CTF, private film funds, and other public money were summed. These sources represent pre-sales and direct public funding. In the case of the financing from American broadcasters, 75% of the total was used, since Canadian banks will only provide interim financing for blue chip buyers in the U.S. Eighty-five percent of the value of tax credits was used for the calculation of the interim financing market. The Canadian banks do not typically provide interim financing for 100% of the value of the tax credits. The data incorporated into this estimate are detailed in Table 24.

Table 24 Estimate of Interim Financing Market, 1996/97 to 2003/04

($ millions unless indicated otherwise)	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Pre-sales and direct public funding								
American Broadcaster	21.4	20.1	25.5	23.1	21.7	14.5	8.5	5.3
Canadian Broadcaster - Private	30.9	30.0	50.5	51.1	60.9	63.7	77.4	81.8
Canadian Broadcaster - Public	23.0	18.0	25.1	26.4	27.7	31.3	37.0	48.1
CTF	18.5	20.8	28.3	24.6	26.3	32.4	41.4	41.0
Film Fund	2.0	1.8	3.4	3.4	5.0	7.3	9.0	7.7
Public money	9.2	3.9	4.3	5.1	4.8	7.7	8.8	8.1
Total	105.1	94.6	137.0	133.8	146.5	157.0	182.2	192.0
Average loan duration	4	4	4	4	4	4	4	4
Tax credits								
Tax credit *	171.6	193.3	301.3	318.7	295.7	290.7	318.0	320.4
Average loan duration	16	16	16	16	16	16	16	16
Prime rate	4.8%	6.0%	6.8%	6.5%	7.5%	4.0%	4.5%	4.5%
Prime + 1	5.8%	7.0%	7.8%	7.5%	8.5%	5.0%	5.5%	5.5%
Total bank revenues from interest payments	**15.1**	**20.1**	**34.5**	**35.1**	**37.5**	**21.9**	**26.5**	**26.9**
Total interim financing market	276.7	287.9	438.3	452.5	442.2	447.7	500.2	512.4
Total project budgets	1,278	1,284	1,868	1,963	1,810	1,748	1,842	1,719

Source: Nordicity Group estimates based on data from CAVCO.
Notes:
Total financing from American broadcasters discounted by 25% to account for non-blue-chip sources.
For financing from pre-sales and direct public funding sources, 25% of the total amount has been used to represent the monies in the producer's cash flow shortfall requiring interim financing.
* The total amount of tax credits has been reduced by 15% since Canadian banks do not typically provide interim financing for the full value of the tax credits.
Some totals may not add due to rounding.

In total, the analysis found that Canadian producers required approximately $512.4 million in interim financing in 2003/04. This was equal in value to approximately 30% of total budgets in that year. With a loan rate of prime plus 1%, interim financing generated interest charges of approximately $26.9 million for Canadian banks in 2003/04.

To estimate the size of the potential market for early stage interim financing, a similar approach was used but with a higher interest rate (prime plus 2%) and a loan duration of only three months for pre-sales, direct public finding, and tax credits. For the tax credits, a rate of 85% of 25% of the total value of tax credits was used to represent the portion of the tax credits consumed during pre-production. These estimates for the early stage interim financing market are detailed in Table 25.

Table 25 Estimate of Early Stage Interim Financing Market, 1996/97 to 2003/04

($ millions unless indicated otherwise)	**1996/97**	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**2003/04**
Pre-sales and direct public funding								
American Broadcaster	21.4	20.1	25.5	23.1	21.7	14.5	8.5	5.3
Canadian Broadcaster - Private	30.9	30.0	50.5	51.1	60.9	63.7	77.4	81.8
Canadian Broadcaster – Public	23.0	18.0	25.1	26.4	27.7	31.3	37.0	48.1
CTF	18.5	20.8	28.3	24.6	26.3	32.4	41.4	41.0
Film Fund	2.0	1.8	3.4	3.4	5.0	7.3	9.0	7.7
Public money	9.2	3.9	4.3	5.1	4.8	7.7	8.8	8.1
Total	105.1	94.6	137.0	133.8	146.5	157.0	182.2	192.0
Average loan duration	3	3	3	3	3	3	3	3
Tax credits								
Tax credit*	42.9	48.3	75.3	79.7	73.9	72.7	79.5	80.1
Average loan duration	3	3	3	3	3	3	3	3
Prime rate	4.8%	6.0%	6.8%	6.5%	7.5%	4.0%	4.5%	4.5%
Prime + 2	6.8%	8.0%	8.8%	8.5%	9.5%	6.0%	6.5%	6.5%
Total bank revenues from interest payments	2.5	2.9	4.6	4.5	5.2	3.4	4.3	4.4
Total interim financing market	148.0	143.0	212.3	213.5	220.4	229.6	261.7	272.1
Total project budgets	1,278	1,284	1,868	1,963	1,810	1,748	1,842	1,719

Source: Nordicity Group estimates based on data from CAVCO.
Notes:
Total financing from American broadcasters discounted by 25% to account for non-blue-chip sources.
For financing from pre-sales and direct public funding sources, 25% of the total amount has been used to represent the monies in the producer's cash flow shortfall requiring interim financing.
*The total amount of tax credits has been reduced by 15% since Canadian banks do not typically provide interim financing for the full value of the tax credits.
Some totals may not add due to rounding.

The early stage interim financing market was estimated at approximately $272.1 million in 2003/04. With average loan duration of three months, this put potential interest charges in the early stage interim financing market at about $4.4 million in 2003/04.

6.6 Other Financing Enhancements

During the research interviews with industry stakeholders, other suggestions were put forward in the context of new opportunities for improving the interim financing structure for the production industry. Some interviewees suggested to that the two particular financing enhancements – production services performance guarantees and faster payment of tax credits – would be very useful to them and their industries. These two enhancements were selected for further review because there was a revealed demand, as well as a potential supplier or organization in Canada that could address the demand.

Production Services Performance Guarantees

One suggestion was to establish a CCC-like service for service suppliers who market to the U.S .and other international customers. The proposal is for, say, the CCC to offer to be the guarantor of delivery of specific services – similar to completion guarantees for production. If the CCC would guarantee delivery, this backing would increase the credibility of Canadian service providers. This kind of service is like a back-to-back contract, whereby the CCC enters into an agreement with the foreign buyer that the service would be supplied according to specifications in the contract, and the CCC would enter into a contract with the Canadian supplier to fulfil these specifications.

Once well established with a specific customer or in a particular market, there would not be a need for such a service. One producer also sells certain facilities and infrastructure project design and management services. It would not need such a service for its established customer base, but might use it for new territories. Another producer who also does special effects for other projects believed this facility could be a major advantage in building credibility for the company.

Market or industry level data that could be used to estimate the market opportunity for production services performance guarantees were not available for the study, so a market sizing could not be prepared.

Faster Payment of Tax Credits

Another suggestion was to hasten the turnaround for rebating tax credits. A production project can be 18 months completed before the final certification of the production’s accounts results in a payment of tax credit monies. By advancing part of the tax credit claim and speeding up the payment of any balances, provincial and federal governments can reduce the interim financing charges incurred by producers.

Some progress has already been made in this area. Beginning in 2001, the Ontario Ministry of Finance, which administers the Government of Ontario’s film and television tax credits, started to speed up the payment of tax credit monies to producers. Under the new system, the Ministry of Finance releases to producers up to 85% of their tax credit claim six weeks after submission of a corporate tax return. Producers still require certification from the OMDC, which they can obtain as early as the start of principal photography. Producers also reported that the Quebec government has shortened the process and waiting time for tax credit payments, as has the federal government to some extent. Despite this apparent progress, tax credit financing remains very common and generally represents the longest interval before payment. Therefore, any further improvements in this regard by the relevant authorities would be welcome.

7 Summary Business Case for an Alternative Supplier of New Financial Service

In this section, financial models are presented for two of the service opportunities – gap financing and early interim financing – identified in Section 6. Each service opportunity is assessed on the basis of risk-adjusted rate of return to equity holders. That is, do the equity investors in the project earn a rate of return that compensates them for the risk of the investment? The equity investor can be a private investor, a government, or a Crown corporation.

For each of the two business cases, a summary of the cash flows to equity, and the net present value of the investment are presented. Instead of using a model in which cash flows are perpetual, each financial model uses a scenario in which equity investors recover any remaining equity capital at the end of the fifth year of operation. In each business case, equity investors provide equity capital to the firm as it requires it in order to expand its financial capacity to provide loan guarantees (gap financing) or interim financing loans.

Because the status of the proposed organization – Crown corporation, public, private, public-private ownership – was undefined, the analysis ignored corporate income taxes (Crown corporations are exempt from corporate income taxes). If the status of the proposed organization is not tax exempt, then equity cash flows would be lower, thus reducing the net present value and business case for the proposed operation.

Section 6 reviewed the service opportunities that exist in four other markets – (1) completion guarantees, (2) insurance services, (3) foreign receivables insurance, and (4) other financing enhancements. For a variety reasons, business case analyses were not prepared for these other four opportunities. In the case of the completion guarantee market, the analysis in Section 6 found that there was little economic basis for market entry without domestic re-insurance alternatives. In the cases of the insurance services market, it is already served by several brokers in Canada. EDC is already active in foreign receivables insurance. Very little market data was available to allow for the formulation of business case analyses for the other financing enhancements. As such, this section focuses on only two of the identified opportunities – gap financing and early interim financing.

Each business case is based on a forecast of future business performance. These forecasts are built on numerous assumptions. Many of the assumptions are based directly on information gathered through the research interviews or document review. Some assumptions have been formulated in order to build a plausible scenario. For example, the business case analysis for the gap financier is based on the assumption that it will capture 10% of the market in Year 1 and 40% in Year 5. None of the research points to these market share estimates as being definite outcomes. Instead, these market share estimates should be viewed by the reader as indicators of the business performance required to achieve a certain level of profitability and return on investment.

Interest rates play a significant role in both of the business cases. Both business cases assume that the Bank of Canada will continue to tighten monetary policy during the five-year period of the analysis.

It should be emphasized that these are “high level” or “simple” business cases intended to offer some guidance as to the economic viability of the opportunities in the Canadian market.

7.1 Gap financing

The first opportunity under analysis is gap financing. As discussed in Section 6.4, the total volume of gap financing in Canada is estimated to be $50 million annually. Table 26 summarizes the cash flow to equity that a gap financier operation in Canada could earn. Cash flow to equity is essentially the operating income, as the gap financier is assumed to have no debt capital on its balance sheet. Cash flow to equity is examined first because it is the main driver of the business case analysis.

Table 26 Estimate of Gap Financing Opportunity, Summary of Cash Flows to Equity

(all amounts in dollars unless indicated otherwise)	Year 1	Year 2	Year 3	Year 4	Year 5
Income from gap fees	360,000	1,168,750	2,081,250	2,958,750	3,420,000
Interest earned on deposits	135,000	481,250	925,000	1,315,000	1,520,000
Total revenue	495,000	1,650,000	3,006,250	4,273,750	4,940,000
Provision for impaired loans	500,000	750,000	1,125,000	1,000,000	1,000,000
Income before operating expense	(5,000)	900,000	1,881,250	3,273,750	3,940,000
Salaries and wages	293,753	403,118	606,483	618,613	630,985
Other administrative expenses	186,700	187,600	207,640	209,925	212,255
Total operating expenses	480,453	590,718	814,123	828,538	843,240
Operating income	(485,453)	309,282	1,067,127	2,445,212	3,096,760
Taxes	0	0	0	0	0
Cash flow to equity	(485,453)	309,282	1,067,127	2,445,212	3,096,760

Source: Nordicity Group estimates

In the first year of operation, the gap financier earns $360,000 from gap fees charged to producers. The gap financier is assumed to hold equity capital equal to 100% of the gap loans that it guarantees.[31] As such, the investors in the gap financing operation must provide the necessary capital. This capital is held in short-term, interest-bearing securities. This capital, set aside in one-year treasury bills, for example, yields additional interest on deposits of $135,000 in Year 1. The yield on the treasury bills is assumed to be 3.0% in Year 1, or 150 basis points less than the prime rate.[32] In total, the gap financier generates $495,000 in revenue in the first year of operation.

The gap financier must make a provision for the gap loans that will become impaired, and thereby require it to release funds to the financial institution that made the gap loan to the producer. For the first year of operation, the provision for impaired loans is assumed to be $500,000. Throughout the business case analysis, the value of impaired loans is assumed to equal the impaired loan provision in the year of the provision. Because the provision of $500,000 actually exceeds the total revenue of $495,000, the gap financier posts a loss of $5,000 in Year 1, before paying any administrative expenses.

In Year 1, the provision for impaired loans is equal to 10% of gap loans. In Years 2 and 3, this rate drops to 7.5% as the gap financier gains more experience. In Years 4 and 5, the loss ratio is assumed to decrease to 5.0%.

For the first year of operation, total operating expenses are $480,453. This amount includes $293,753 for salaries and wages, and $186,700 for other administrative expenses. Table 29 (later in this section) provides more detail on salaries and wages and administrative expenses incorporated in the business case analysis. At the end of Section 7, a description of the assumptions underlying the expense

[31] This is an assumption. FIDEC did not disclose to us that they hold 100% of equity capital for each loan guarantee. In this business case, we have used the most conservative scenario.

[32] As of March 22, 2005, the yield on a one-year Canada treasury bill was 3.04%; the prime rate was 4.25%. In our model, we have used a slightly higher prime rate to account for rate increases forecast for the near future.

estimates is provided. Once operating expenses are deducted, the operating income in the first year of operation is negative $485,453. Equity investors face a cash loss and are required to inject this amount back into the business in order to maintain operations.

The financial performance of the gap financier improves steadily during the five years of operation, as it grows its market share from 10% to 40% and reduces its rate of impaired loans. By Year 5 of the model, the gap financier is earning total revenues of $4,940,000, and generating cash flow to equity holders of $3,096,760.

To assess the business case for the gap financier, the various outflows from and inflows to equity holders were identified and then discounted to Year 1 – the point at which the investment decision is made. An iterative process was used to solve for the discount rate or cost of equity capital that allowed the present value of the equity inflows to equal the present value of the outflows. If the discount rate or cost of equity capital is high enough to compensate investors for the risk of the business venture, then a net present value of zero or higher indicates that the business case is economic for investors – that is, they will earn a return exceeding the opportunity cost of their capital. Table 27 summarizes the calculation of the net present value for the gap financier business case.

Table 27 Estimate of Gap Financing Opportunity, Net Present Value

	(all amounts in dollars unless indicated otherwise)	Year 1	Year 2	Year 3	Year 4	Year 5	Total
A	Cash flow earnings to equity	(485,453)	309,282	1,067,127	2,445,212	3,096,760	
B	Present value of cash flow to equity	(485,453)	285,255	907,765	1,918,458	2,240,897	4,866,921
C	New injections of equity capital	(4,500,000)	(9,250,000)	(9,375,000)	(9,750,000)	(5,125,000)	
D	Present value of equity capital injections	(4,500,000)	(8,531,400)	(7,974,959)	(7,649,629)	(3,708,585)	(32,364,572)
E	Terminal value of shareholders' equity	n.a.	n.a.	n.a.	n.a.	38,000,000	
F	Present value of terminal value of shareholders' equity						27,497,798
G	**Net present value (B+D+F)**						**147**
	Cost of equity capital (required rate of return)						**8.42%**

Source: Nordicity Group estimates
n.a. - not applicable

Essentially, the data in the table indicate that equity outflows and inflows will be approximately equal with a cost of equity capital of 8.42%. In other words the gap financier operation, as modelled, yields an annualized return of 8.42% for equity investors. To assess the business case for the gap financier, this rate of return must be compared to other investments with similar risk profiles. If 8.42% is lower than the return demanded by investors in projects with similar risk, then the investment is not economic and there is no business case. If 8.42% is higher than the required rate of return then there is a business case for equity investors to participate in the venture.

One benchmark for comparison is the equity return on the stock market – a suitable alternative investment for equity investors. Between 1926 and 2001, the Standard and Poor's 500 Index posted an annualized average return of 10.2%.[33] If one assumes that the stock market's future returns will be similar to its historical performance, then an equity investment in the gap financing operation is uneconomic. The investment would only be economic if the investor could tolerate a lower return on

[33] Curt Morrison, "An Investment in the S&P 500 Is a Poor Choice Today," at http://news.morningstar.com/doc/document/print/1%2C3651%2C119823%2C00.html

equity. For example, BDC, in its 2003/04 annual report states that its target rate for return on common equity is 7.7%.[34] This rate is meant to be in line with the federal government's long run cost of borrowing.

Therefore, the business case analysis for the gap financing operation indicates that the return on equity is likely too low to attract private investors. However, it is likely high enough to attract a public sector investment such as one from BDC or Telefilm.

Line A in Table 27 represents the annual inflows to equity holders. In Year 1, the inflow is negative because the gap financier records a loss on operating income. In subsequent years, the annual inflows turn positive. Line B is the present value of the amounts in Line A. Line C represents the new equity capital that the investors must inject into the gap financing operation in order to provide capital for collateral for the loans that it guarantees. In Year 1, investors provide $4.5 million in equity capital. In Year 2, investors provide an additional $9.75 million. When combined with the equity injection of Year 1, this gives the gap financier the capacity to guarantee $15.25 million in gap loans in Year 2.

Line D is the present value of the annual equity injections. By the end of the five-year period, the present value of all equity injections is $32,364,572. Line E represents the cumulative value of the equity injections during the five-year period – that is the sum of the amounts in Line C. By the end of the five-year period, investors have provided a total $38 million in collateral for gap loans. At the end of the five-year period, the gap financier is closed and all of the capital is returned to equity investors. The present value of the returned capital is Line F, $27,497,798.

The net present value of the gap financier business opportunity is arrived at by summing the *Total* column for Lines B, D and F. With a discount rate of 8.42%, the net present value is $147, or approximately zero.

[34] Business Development Bank of Canada, *2004 Annual Report. 2004,* p. 33.

Table 28 details the how the total revenues for the gap financier are derived. The total size of the gap financing market is held constant at $50 million annually. In Year 1, the gap financier captures 10% market share, and guarantees $5 million in gap loans. By Year 5, the gap financier increases its market share to 40% and guarantees $20 million in gap loans.

Table 28 Estimate of Gap Financing Opportunity, Revenue Statement

(all amounts in dollars unless indicated otherwise)	Year 1	Year 2	Year 3	Year 4	Year 5
Total Canadian gap financing market	50,000,000	50,000,000	50,000,000	50,000,000	50,000,000
Market share	10%	20%	30%	40%	40%
New gap loans	5,000,000	10,000,000	15,000,000	20,000,000	20,000,000
Book value outstanding loans	5,000,000	15,000,000	25,000,000	35,000,000	40,000,000
Outstanding gap loans	4,500,000	13,750,000	23,500,000	33,250,000	38,000,000
Prime rate	4.5%	5.0%	5.5%	5.5%	5.5%
Annual gap fee rate	8.0%	8.5%	9.0%	9.0%	9.0%
Gap fees	360,000	1,168,750	2,081,250	2,958,750	3,420,000
Interest income	135,000	481,250	925,000	1,315,000	1,520,000
Total revenue	495,000	1,650,000	3,006,250	4,273,750	4,940,000
Provision for Impaired loans	500,000	750,000	1,125,000	1,000,000	1,000,000
Income before administrative expenses	(5,000)	900,000	1,881,250	3,273,750	3,940,000

Source: Nordicity Group estimates

Gap loans are assumed to be outstanding for an average of 24 months. This loan duration reflects the time that elapses between the completion of a project's financing, and the collection of monies on any foreign sales in secondary territories. Because of the 24 month loan duration, at the end of Year 2, the gap financier's outstanding loans have a book value of $15 million ($5 million in Year 1 plus $10 million of new loans in Year 2). After deducting for the value of impaired loans, the total value of income-generating loans was $13.75 million.

The annual gap fee charged on outstanding gap loans is assumed to be 350 basis points above the prevailing prime rate. As discussed in Section 4.4, gap fees are typically 7% to 8% of the gap (FIDEC confirmed this rate), which puts the rate about 300 to 400 basis points above the prime rate. In Year 1, the prime rate is assumed to be 4.5%. By Year 5, it is assumed to have increased to 5.5%. The corresponding annual gap fee rate is 8.0% in Year 1 and increases to 9.0% in Year 5. As the market share and gap fee rate increases, total annual gap fees also increase. Gap fees increase from $360,000 in Year 1 to $3.42 million in Year 5.

The gap financier also earns interest on the equity capital held as collateral for the loans it guarantees. Interest income increases as the capitalization of the gap financier grows and the interest rate on short-term securities rises with increases in the prime rate. The interest rate on short-term securities is assumed to increase from 3.0% in Year 1 to 3.5% in Year 2 and 4.0% in Year 3. The capitalization of the gap financier is outlined in Table 30 later in this section.

Table 29 details the operating expenses of the gap financier. In addition to salaries and other personnel costs (payroll taxes and benefits), the gap financier incurs expenses for office rent, consulting services, travel and hospitality, computer hardware and software, marketing and promotion, telecommunications services, and miscellaneous office expenses. The assumptions behind each of these expense line items are described at the end of the section. The operating expenses grow during the five-year modelling period, as wages and certain other expenses grow with inflation.

Table 29 Estimate of Gap Financing Opportunity, Statement of Operating Expenses

(all amounts in dollars unless indicated otherwise)	Year 1	Year 2	Year 3	Year 4	Year 5
Salaries and wages					
CEO (number)	1	1	1	1	1
Average salary	146,000	148,920	151,898	154,936	158,035
Total professional compensation	146,000	148,920	151,898	154,936	158,035
Financial analysts (number)	1	1	2	2	2
Average salary	75,666	77,179	78,723	80,297	81,903
Total professional compensation	75,666	77,179	157,446	160,595	163,807
Account managers (number)	0	1	2	2	2
Average salary	89,000	90,780	92,596	94,448	96,336
Total professional compensation	0	90,780	185,191	188,895	192,673
Administration (number)	1	1	1	1	1
Average salary	36,012	36,733	37,467	38,217	38,981
Total administrative compensation	36,012	36,733	37,467	38,217	38,981
Grand total compensation - all personnel	257,678	353,612	532,003	542,643	553,496
Payroll taxes and benefits	36,075	49,506	74,480	75,970	77,489
Total employee costs	293,753	403,118	606,483	618,613	630,985
Office rent	30,000	30,000	30,000	30,000	30,000
Legal and consulting services	100,000	102,000	104,040	106,121	108,243
Travel and hospitality	10,000	15,000	25,000	25,000	25,000
Hardware & software	9,500	11,000	14,000	14,000	14,000
Marketing and promotion	20,000	10,000	10,200	10,404	10,612
Telecommunications	7,200	9,600	14,400	14,400	14,400
Miscellaneous expenses	10,000	10,000	10,000	10,000	10,000
Total other administration expenses	186,700	187,600	207,640	209,925	212,255
Total operating expenses	480,453	590,718	814,123	828,538	843,240

Source: Nordicity Group estimates

The gap financier is assumed to have a single CEO, financial analysts, account managers, and an administrative assistant. In Year 1, the gap financier is comprised of a CEO, a financial analyst and an administrative assistant. In Year 2, the gap financier adds an account manager to assist in growing the firm's market share. In subsequent years, the gap financier adds additional account managers and financial analysts, who can initiate, review, and complete deals. In the financial model, by Year 5, the gap financier is operating with a CEO, two financial analysts, two account managers, and an administrative assistant. This structure is very similar to that of FIDEC.

Table 30 details the balance sheet data for the gap financier. The assets of the gap financier are equal to loans guaranteed by the firm. This collateral for the gap loans are held in short-term securities that earn interest for the investors. Total assets are equal to the gross book value of outstanding loans less the value of impaired loans.

Table 30 Estimate of Gap Financing Opportunity, Balance Sheet Data and Summary of Equity Capital Injections

(all amounts in dollars unless indicated otherwise)	Year 1	Year 2	Year 3	Year 4	Year 5
Assets					
Book value of loans	5,000,000	15,000,000	25,000,000	35,000,000	40,000,000
Less: impaired loans	500,000	1,250,000	1,875,000	2,125,000	2,000,000
Net book value	4,500,000	13,750,000	23,125,000	32,875,000	38,000,000
Total assets	4,500,000	13,750,000	23,125,000	32,875,000	38,000,000
Liabilities					
Debt	0	0	0	0	0
Shareholders' equity					
Initial capital	4,500,000	4,500,000	4,500,000	4,500,000	4,500,000
Book value of capital injection	0	9,250,000	18,625,000	28,375,000	33,500,000
Retained earnings	0	0	0	0	0
Total shareholders' equity	4,500,000	13,750,000	23,125,000	32,875,000	38,000,000
Total shareholders' equity and liabilities	4,500,000	13,750,000	23,125,000	32,875,000	38,000,000
Cash flows					
Injections of equity capital	4,500,000	9,250,000	9,375,000	9,750,000	5,125,000

Source: Nordicity Group estimates

The gap financier is assumed to hold no debt; all of the loans it guarantees are backed by highly liquid short-term investments. As the gap financier's portfolio of loan guarantees grow, so do its assets and equity.

7.2 Early Stage Interim Financing

The second opportunity under analysis is early stage interim financing. As discussed in Section 6.5, the total volume of early stage interim financing in Canada is estimated to be $227 million annually and is estimated to generate interest charges in the neighbourhood of $4.4 million.

Table 31 summarizes the cash flow to equity holders in an early interim financing operation. The cash flow to equity is essentially the operating income. In the first year of operation, the financial institution earns $1,020,000 in interest charges. The financial institution is assumed to hold capital equal to 10% of the gap loans that it guarantees; it borrows the other 90%. As such, the financing operation faces its own interest expenses. In this financial model, the financial institution is assumed to be borrowing at 100 basis points below the prime rate. In Year 1, interest expenses total $419,832.

Table 31 Estimate of Early Interim Financing Opportunity, Summary of Cash Flows to Equity

(all amounts in dollars unless indicated otherwise)	Year 1	Year 2	Year 3	Year 4	Year 5
Income from interest charges and set-up fees	1,020,000	1,360,000	1,734,000	2,312,000	2,312,000
Interest expenses	419,832	599,760	809,676	1,079,568	1,079,568
Net revenue	600,168	760,240	924,324	1,232,432	1,232,432
Provision for impaired loans	272,000	340,000	408,000	544,000	544,000
Income before operating expenses	328,168	420,240	516,324	688,432	688,432
Salaries and wages	228,773	233,349	388,447	441,985	450,825
Other administrative expenses	61,700	61,800	75,252	79,806	79,912
Total operating expenses	290,473	295,149	463,699	521,791	530,737
Operating income	37,695	125,091	52,625	166,641	157,695
Taxes	0	0	0	0	0
Cash flow to equity	37,695	125,091	52,625	166,641	157,695

Source: Nordicity Group estimates

The financial institution must make a provision for the interim loans that will become impaired. For the first year of operation, the provision for impaired loans is assumed to be $272,000, or one dollar for every $200 in interim loans or 0.5%. This loan loss rate was selected after reviewing the annual report of Royal Bank of Canada; it recorded a ratio of specific provisions for credits to average loans of 0.27% in 2004, with a medium-term target of 0.4 to 0.5%.[35] Throughout the business case analysis, the value of impaired loans is assumed to equal the impaired loan provision in the year of the provision.

For the first year of operation, total operating expenses are $290,473. This amount includes $228,773 for salaries and wages, and $61,700 for other administrative expenses. A detailed breakdown of salaries and wages, and administrative expenses can be found in Table 34 (later in the section). The operating income in the first year of operation is $37,695.

The financial performance of the financial institution improves steadily during the five years of operation, as it grows its market share. By Year 5 of the model, the financial institution is earning total revenues of $1,232,432, and generating cash flow to equity holders of $157,695.

[35] Royal Bank of Canada, *Annual Report 2004*, p. 7

To assess the business case for the early interim financing operation, the various outflows from and inflows to equity holders were identified and then discounted to Year 1 – the point at which the investment decision is made. An iterative process was used to solve for the discount rate or cost of equity capital that allowed the present value of the equity inflows to equal the present value of the outflows. If the discount rate or cost of equity capital is high enough to compensate investors for the risk of the business venture, then the business case is indeed economic for investors – that is, they will earn a return exceeding the opportunity cost of their investment.

Table 32 summarizes the calculation of the net present value for the early stage interim financing business case. Essentially, the data in the table indicate that equity outflows and inflows will be approximately equal with a cost of equity capital of 7.18%. In other words the early interim financing operation, as modelled, yields an annualized return of 7.18% for equity investors. As in the case of the gap financing operation, when this return on equity is compared to the historical stock market returns, the opportunity appears uneconomic for private sector investors.

Table 32 Estimate of Early Interim Financing Opportunity, Net Present Value

	(all amounts in dollars unless indicated otherwise)	Year 1	Year 2	Year 3	Year 4	Year 5	Total
A	Cash flow earnings to equity	37,695	125,091	52,625	166,641	157,695	
B	Discounted value of cash flow to equity	37,695	116,711	45,811	135,344	119,499	455,059
C	New injections of equity capital	(1,332,800)	(333,200)	(333,200)	(666,400)	0	
D	Discounted value of equity capital injections	(1,332,800)	(310,879)	(290,053)	(541,245)	0	(2,474,977)
E	Terminal value of shareholders' equity	n.a.	n.a.	n.a.	n.a.	2,665,600	
F	Discounted value of terminal value of shareholders' equity						2,019,947
G	**Net present value (B+D+F)**						**29**
	Cost of equity capital (required rate of return)						**7.18%**

Source: Nordicity Group estimates
n.a. - not applicable

Between 1926 and 2001, the Standard and Poor's 500 Index posted an annualized average return of 10.2%.[36] If one assumes that the stock market's future returns will be similar to its historical performance, then an equity investment in the early stage interim financing operation is uneconomic. The investment would only be economic if the investor could tolerate a lower return on equity. For example, BDC, in its 2003/04 annual report states that its target rate for return on common equity is 7.7%.[37] This rate is meant to be in line with the federal government's long run cost of borrowing. Still, the return on equity offered by the early stage interim financing operation falls short of this benchmark as well. A Crown financial institution such as Telefilm, which may have a better tolerance for a lower return may be a more appropriate investor in this venture.

Line A in Table 32 represents the annual inflows to equity holders. In Year 1, the inflow is $37,695. Line B is the present value of the amounts in Line A. Line C represents the equity capital that the investors must inject into the early interim financing operation in order to maintain a loan-to-capital ratio of 10 to 1. In Year 1, investors provide $1,332,800 in equity capital. In Year 2, investors provide an additional $333,200.

[36] Curt Morrison, "An Investment in the S&P 500 Is a Poor Choice Today," at http://news.morningstar.com/doc/document/print/1%2C3651%2C119823%2C00.html
[37] Business Development Bank of Canada, *2004 Annual Report. 2004,* p. 33.

Line D is the discounted value of the annual equity injections. By the end of the five-year period, the present value of all equity injections is $2,474,977. Line E represents the cumulative value of the equity injections during the five-year period – that is the sum of the amounts in Line C. By the end of the five-year period, investors have provided a total $2,665,600 in equity capital. At the end of the five-year period, the early interim financing operation is closed and all of the capital is returned to equity investors. The present value of the returned capital is Line F, $2,019,947.

The net present value of the gap financier business opportunity is arrived at by summing the *Total* column for Lines B, D and F. With a discount rate of 7.18%, the net present value is $29, or approximately zero.

Table 33 details how the total revenues for the early stage interim financing operation are derived. The total size of the early stage interim financing market is held constant at $272 million annually (see market size estimate in Section 6.5). In Year 1, the financial institution captures 20% market share, and provides new loans of $54.4 million. By Year 5, the financier increases its market share to 40% and provides new loans
$108.8 million.

Table 33 Estimate of Early Financing Opportunity, Income Statement

(all amounts in dollars unless indicated otherwise)	Year 1	Year 2	Year 3	Year 4	Year 5
Total Canadian early interim financing market	272,000,000	272,000,000	272,000,000	272,000,000	272,000,000
Market share	20%	25%	30%	40%	40%
New early interim financing loans	54,400,000	68,000,000	81,600,000	108,800,000	108,800,000
Book value outstanding loans	13,600,000	17,000,000	20,400,000	27,200,000	27,200,000
Outstanding loans	13,328,000	16,660,000	19,992,000	26,656,000	26,656,000
Prime rate	4.5%	5.0%	5.5%	5.5%	5.5%
Interest rate on loan	6.5%	7.0%	7.5%	7.5%	7.5%
Interest charges	884,000	1,190,000	1,530,000	2,040,000	2,040,000
Set-up fees	136,000	170,000	204,000	272,000	272,000
Total revenue	1,020,000	1,360,000	1,734,000	2,312,000	2,312,000
Interest expense	419,832	599,760	809,676	1,079,568	1,079,568
Provision for Impaired loans	272,000	340,000	408,000	544,000	544,000
Income before administrative expenses	328,168	420,240	516,324	688,432	688,432

Source: Nordicity Group estimates

Early stage loans are assumed to be outstanding for an average of three months. As such, at the end of Year 1, the financial institution's outstanding loans have a book value of $13.6 million (25% of the total value of new loans). After deducting for the value of impaired loans, the total value of income generating loans is $13,328,000 in Year 1.

The financial institution earns revenue from a set-up fee equal to 1% (annualized) of the loan amount, and interest charges. The research pointed to set-up fees of 1% as being typical in film and television interim financing. Borrowers are charged 200 basis points above the prime rate to account for the increased risk of the early stage financing, when compared to regular interim financing which is priced at 100 basis points above prime. In Year 1, the prime rate is assumed to be 4.5% with the financing interest rate of 6.5%. By Year 5, the prime rate is assumed to have increased to 5.5%; the financing interest rate increases to 8.5%, therefore.

Interest charges and set-up fees generate total revenues of $1,020,000 in Year 1. By Year 5, total revenues reach $2,312,000.

Table 34 details the operating expenses of the early stage interim financing operation. In addition to salaries and other personnel costs (payroll taxes and benefits), the early stage interim financing operation incurs expenses for office rent, travel and hospitality, computer hardware and software, marketing and promotion, telecommunications services, and miscellaneous office expenses. The assumptions behind each of these expense line items are described at the end of the section. The operating expenses grow during the five-year modelling period, as wages and certain other expenses grow with inflation.

Table 34 Estimate of Early Interim Financing Opportunity, Statement of Operating Expenses

(all amounts in dollars unless indicated otherwise)	Year 1	Year 2	Year 3	Year 4	Year 5
Salaries and wages					
Financial analysts (number)	1	1	1.5	2	2
Average salary	75,666	77,179	78,723	80,297	81,903
Total professional compensation	75,666	77,179	118,084	160,595	163,807
Account managers (number)	1	1	2	2	2
Average salary	89,000	90,780	92,596	94,448	96,336
Total professional compensation	89,000	90,780	185,191	188,895	192,673
Administration (number)	1	1	1	1	1
Average salary	36,012	36,733	37,467	38,217	38,981
Total administrative compensation	36,012	36,733	37,467	38,217	38,981
Grand total compensation - all personnel	200,678	204,692	340,743	387,706	395,461
Payroll taxes and benefits	28,095	28,657	47,704	54,279	55,364
Total salaries and wages	228,773	233,349	388,447	441,985	450,825
Office rent	25,000	25,000	25,000	25,000	25,000
Travel and hospitality	10,000	10,000	17,500	20,000	20,000
Hardware & software	9,500	9,500	11,750	12,500	12,500
Marketing and promotion	5,000	5,100	5,202	5,306	5,412
Telecommunications	7,200	7,200	10,800	12,000	12,000
Miscellaneous expenses	5,000	5,000	5,000	5,000	5,000
Total other administration expenses	61,700	61,800	75,252	79,806	79,912
Total operating expenses	290,473	295,149	463,699	521,791	530,737

Source: Nordicity Group estimates

The financial institution is assumed to have financial analysts, account managers, and an administrative assistant. In Year 1, the financial institution is comprised of a financial analyst, account manager and an administrative assistant. In Year 3, it adds another financial analyst (for one-half of the year) and an account manager to assist in growing the firm's market share. The personnel structure of the firm remains like this for the remainder of the five-year period. Because there is no early stage interim financing operation to model the personnel structure on, the proposed structure is somewhat conceptual.

Table 35 details the balance sheet data for the early stage interim financing operation. The assets of the financial institution are equal to loans provided by the firm. Total assets are equal to the gross book value of outstanding loans less the value of impaired loans.

Table 35 Estimate of Gap Financing Opportunity, Balance Sheet Data and Summary of Equity Capital Injections

(all amounts in dollars unless indicated otherwise)	Year 1	Year 2	Year 3	Year 4	Year 5
Assets					
Book value of loans	13,600,000	17,000,000	20,400,000	27,200,000	27,200,000
Less: impaired loans	272,000	340,000	408,000	544,000	544,000
Net book value	13,328,000	16,660,000	19,992,000	26,656,000	26,656,000
Total assets	13,328,000	16,660,000	19,992,000	26,656,000	26,656,000
Liabilities					
Debt	11,995,200	14,994,000	17,992,800	23,990,400	23,990,400
Shareholders' equity					
Initial capital	1,360,000	1,360,000	1,360,000	1,360,000	1,360,000
Book value of capital injection	(27,200)	306,000	639,200	1,305,600	1,305,600
Retained earnings	0	0	0	0	0
Total shareholders' equity	1,332,800	1,666,000	1,999,200	2,665,600	2,665,600
Total shareholders' equity and liabilities	13,328,000	16,660,000	19,992,000	26,656,000	26,656,000
Injections of equity capital	1,332,800	333,200	333,200	666,400	--

Source: Nordicity Group estimates

As discussed above, the financial institution is assumed to maintain a loan-to-capital ratio of 10 to 1. So for every dollar of loans outstanding, the financial institution borrows 90 cents at 100 basis points below the prime rate.

Other Assumptions for Operating Expenses:

Salaries and wages: Each employee's average salary was derived from Statistics Canada Census 2001 data. The CEO salary was based on the average full-time earnings for *A013 Senior managers - Financial, communications carriers and other business services.* The account manager salary was based on the average full-time earnings for *A301 Insurance, real estate and financial brokerage managers*. The financial analyst salary was based on the average full-time earnings for *B012 Financial and investment analysts*. The salary for administrative personnel was based on the average full-time earnings for *B510 General office clerks*. The full-time earnings data were for 2000, so each amount was increased by an annual rate of 2% in order to derive estimates for 2005 earnings levels. The 2005 average earnings levels were used to construct Year 1 average salaries in the model. To account for wage inflation, each average salary was increased by a rate of 2% per annum during the modelling period.
Payroll taxes and benefits: Payroll taxes are calculated at 8% of salaries and wages; benefits are set as 6% of salaries and wages.
Office rent: $5,000 per year multiplied by the number of employees expected in Year 5.
Travel and hospitality: $5,000 per year per professional employee (excludes administration employee)
Hardware and software: Comprised of a fixed annual charge of $5,000 plus $1,500 per employee.
Marketing and promotion: For gap financier, marketing and promotion in Year 1 is $20,000 for company launch; thereafter it is $10,000 per year growing with inflation at 2% per annum. For the interim financing operation, marketing and promotion is assumed to be $5,000 in Year 1; thereafter it grows with inflation at 2% per annum.
Telecommunications: $200 per employee per month.
Miscellaneous expenses: Gap financier, $10,000 per annum; early stage interim financing, $5,000 per annum.

8 Conclusions and Recommendations

This section presents the conclusions and recommendations derived from the analysis. A brief implementation plan is also presented outlining the initial steps to realizing each of the recommendations. The conclusions and recommendations address the study findings with respect to the completion guarantee market in Canada; this was a central focus of the analysis. The conclusions and recommendations also include the two new service opportunities – gap financing and early stage interim financing – for which business case analyses were prepared. In addition, conclusions and recommendations are presented for the two other financing enhancements identified in the research – contract performance guarantees and faster tax credit payments.

8.1 Completion Guarantee Market

Conclusion

Since January 2003, Canada has had only one domestic provider of completion guarantees – Film Finances Canada. While Film Finances Canada is the only Canadian supplier, two Los Angeles-based firms do, from time-to-time, provide completion guarantee services to Canadian producers. While this industry structure would suggest a quasi-monopoly in Canada, rates charged by Film Finances Canada are, in fact, in line with rates in other countries.

Two major factors combine to make entry of a new competitor into the completion bond sector in Canada uneconomic. First, the market is a declining one. Trends in production activity in Canada and the growing track record of Canadian producers are such that the market for completion guarantees has been in decline. The analysis indicates that the total budgets suitable for completion guarantees in Canada has nearly halved since 1999/00. Without a strong reversal in trends in Canadian international treaty co-production, it is unlikely that volumes will rise considerably to warrant another supplier. The second factor is that re-insurance capacity is limited to one supplier, Lloyd's of London.

In 2004, a Montreal-based company, Globex Media, attempted to make a foray into the completion guarantee business. It was short-lived; and thus demonstrates that entry on a purely economic basis is very difficult.

A new entrant with a Canadian-based re-insurer might offer a different service level and act as another service provider in this business. However, it is a limited and declining market with an entrenched provider who has international ties. It is not clear that producers would be exposed to substantially different terms, although the prospect of an available alternative would always be viewed favourably.

It is not clear who would promote a new entrant in the completion guarantee sector. A start-up could be financed in part by the BDC, but that organization has no mandate (or expertise) to find an entrepreneur or existing business to enter into competition with Film Finances Canada. From a public policy perspective it is not clear the benefits would be significant. Having a functioning completion guarantor operating in Canada is preferable to dealing with outposts of Los Angeles-based guarantors. Stimulating the interest of a re-insurer for domestic projects – possibly to work with Film Finances Canada – might be an initiative to explore.

Recommendation:

- To address the rates and completion guarantee terms offered to Canadian producers, PCH (or its agency, Telefilm) could consider exploring with Canadian insurance companies if any has an appetite to enter on a limited basis the completion guarantee business as a re-insurer. PCH may also want to consider FIDEC as a possible candidate to provide re-insurance – assuming that it has no intention of entering the market as a full-fledged competitor.

Implementation Plan:

- Identify government relations persons at major Canadian insurance companies. Identify insurance industry relations persons at Department of Finance and Industry Canada.
- With the participation of Department of Finance and Industry Canada, Initiate discussions with Canadian insurance companies regarding re-insurance for completion guarantees service by offering them information on the Canadian production industry and the completion guarantee market in Canada.

8.2 Foreign Receivables Insurance

Conclusion

In 2004, EDC completed approximately 25 to 30 deals in which it insured approximately $25 million in foreign receivables for Canadian producers. Its volume of business has been higher in previous years. In its peak year for activity, two EDC underwriters completed about 50 deals worth $50 to $60 million in foreign receivables. The EDC is a very valuable component of the project financing for film and television projects. However, because of some problem cases in the relatively near past, EDC is examining its commitment to this sector.

The research indicates that the Canadian film and television production industry generated foreign receivables that totalled as much as $227.0 million in 2003/04. This amount excludes an estimate for the receivables from blue chip American broadcasters.

With a 90/10 co-insurance rate, there was an estimated $204.3 million (90% of $227 million) in foreign receivables in the Canadian film and television production industry in 2003/04 from which interim financing could be obtained if EDC insurance was obtained. It appears that the size of the potential market in 2003/04 offers significant room for the EDC to expand.

With an average duration of six months and an insurance premium of 2% (annualized), EDC revenues from the film and television production industry in 2003/04 could have been as high as $2.0 million in 2003/04, if it had tapped the full potential of the film and television production industry's foreign receivables.

The service opportunity, then, is to seek to obtain a commitment by EDC to this sector, to make changes as appropriate that would reduce its risk, and expand its marketing activities to elicit more interest among producers to consider its insurance product. With more volume, it could justify further EDC investments in marketing and steps to lower its risk. The danger to the industry is that EDC proceeds in the opposite direction and withdraws from the foreign insurance service business. Loss of EDC insurance would eliminate a chunk of project financing that is provided through EDC – of some $25 million per year.

Recommendation:

- PCH could explore with EDC how the latter can strengthen its own performance in offering foreign receivables insurance to film and television producers and distributors in Canada, and as well, expand this line of business through more active marketing.
- PCH could facilitate improved linkages between EDC and the other financial stakeholders serving the sector, e.g. the banks, Film Finances Corporation, and FIDEC.

Implementation Plan:

- Initiate discussions with EDC's film and television industry underwriters in order to understand what obstacles exist to it expanding its market presence in the film and television industry.
- Investigate the options available to PCH with respecting to assisting EDC in expanding its market presence.

8.3 New Service Opportunities - Gap Financing

Conclusion

The research indicates that the lack of domestic gap financing in Canada represents a major hole in the market. The estimates indicate that there could be as much as $50 million annually in gap financing in the Canadian market. At present, the only domestic provider, FIDEC, only operates in Quebec, providing loan guarantees for the gap loans of Quebec-based producers of English-language productions. Producers outside of Quebec must use foreign financial institutions for gap financing.

FIDEC is planning to expand outside of Quebec in 2005; however, its focus will be on larger-budget productions that offer the lowest degree of risk. As such, there may be scope for another entity to provide gap loan guarantees to lower-budget, higher-risk productions.

A high-level business case analysis points to the gap financing operation as being uneconomic from a private-sector perspective. However, Crown financial institutions that can tolerate a lower return on equity may be potential investors in a newly formed gap financing entity. The analysis suggests that the return on equity offered by a gap financier may be somewhat below the required rate of return that investors would likely seek from such an entity. As such, there may some requirement for direct public involvement in the form of loan guarantees to offset the increased risk and lower returns.

Like other financial services firms in the film and television industry, success requires a highly experienced professional team that understands the global film and television industry and has worked with sales agents around the world. This kind of experience may be difficult to find and procure.

It is unclear how many of the Crown agencies fit into gap financing and a potential new entity. EDC already guarantees pre-sales, and its experience in this market may not give it the appetite to enter the even riskier arena of gap financing.

While BDC makes venture capital investments and offers subordinate equity, neither of these types of investments are necessarily suited to the equity investment required for a gap financier. One of the critical success factors for FIDEC is that its private investors are all involved in the cultural industries. Therefore, they not only provide equity capital, but also industry knowledge and some of the business relationships necessary for FIDEC to have the information it needs to be successful. The BDC cannot fulfil this role either.

Telefilm does have industry knowledge which could be brought to a Canadian gap financing operation, and Telefilm already makes equity investments in Canadian film and television productions. A possible role for Telefilm is to back gap financing at the relatively higher risk level, e.g. for smaller projects with export promise but little pre-sales commitment. Of course, any loan losses would be taken from Telefilm’s other programs, unless it obtained extra funding for that purpose.

Recommendation:

- PCH could explore with Telefilm how it can work with FIDEC or a newly formed organization to expand gap financing capacity for lower-budget, riskier projects seeking foreign sales. The first step in this exploration should be the preparation of a detailed business plan with input from Telefilm and FIDEC.

Implementation Plan:

- Coordinate with Telefilm to prepare a detailed business plan for a new gap financing entity to operate nationally.
- Identify and recruit potential private sector investors as well as FIDEC to participate in the capitalization and operation of the new gap financing entity.
- Facilitate the investor group to recruit a CEO and professional staff. The staff should have significant experience in and knowledge of production financing, and film and television distribution.
- Execute a Memorandum of Understanding between PCH and Telefilm, which directs the latter to allocate monies to the capitalization of a new gap financing entity.

8.4 New Service Opportunities - Early Stage Interim Financing

Conclusion

Interim financing in Canada appears to be a relatively competitive marketplace. Several large Canadian banks, including Royal Bank and National Bank are active in this market. During the project research, producers did not indicate any overwhelming difficulties in obtaining interim financing. As such, it would appear that there is very little opportunity for the government to take a role in this particular market.

On the other hand, the project research did point to early stage interim financing as one area where there could be room for increased loan capacity in Canada. Canadian producers will often begin pre-production on the basis of a short form contract. The banks however will only offer interim financing against long form contracts. Producers with strong track records and a better working capital position can often self-finance pre-production; smaller, lesser-established producers cannot.

The analysis indicates that there may be as much as $272 million eligible for early interim financing. Because this type financing would only be for up to three months, however, the fees for a financial institution may only be in the neighbourhood of $4 million annually.

A high-level business case analysis points to the early stage interim financing operation as being uneconomic from a private-sector perspective. However, Crown financial institutions that can tolerate a lower return on equity may be potential investors in a newly formed early stage interim financing entity. The analysis suggests that the return on equity offered by an early stage interim financing operation may be somewhat below the required rate of return that investors would likely seek from such an entity. As such, there may some requirement for direct public involvement in the form of loan guarantees to offset the increased risk and lower returns.

The business case analysis modelled this new entity under a scenario in which it held $1 of equity for every $10 of loans; as such, it would have to borrow $9 of debt capital for every $1 of new loans. To provide competitive rates to its customers, this new entity would have to be able raise debt at Government of Canada rates.

Telefilm would seem to be the best equipped among the Crown agencies to participate in or shepherd the development of a new early interim financing vehicle. Telefilm has been involved in interim financing and loan guarantees in the past.

FIDEC is already involved to some degree in this market. It refers to this type of financing as “bridge-to-bridge” financing, so there may be scope for the federal government to expand this type of service by working through an organization such as FIDEC, or other financial institutions. The federal government would likely have to offer some type of loan guarantee to make entry economic for a private sector entity, so that they can expand their loan portfolio into this riskier area.

Another option is for the CTF to provide early interim financing. Each year, the CTF receives its contribution from PCH and then ends up holding it for several months before distributing it to recipients. Instead of keeping the funds in short term financial instruments, the CTF could use it to operate an early stage interim financing fund open to producers unable to access such financing from other sources.

Recommendation:

- PCH could explore with Telefilm, CTF and/or FIDEC how one of these entities can take a direct or indirect role in enhancing the private sector’s capacity for early stage interim financing for film and television producers. This exploration should begin with the preparation of a detailed business plan with input from the potential partner organizations (Telefilm, CTF, FIDEC).

Implementation Plan:

- Coordinate with Telefilm, and/or CTF to prepare a detailed business plan for an early stage interim financing entity.
- Identify and recruit private sector investors as required.
- Facilitate the investor group to recruit an account manager and financial analysts to staff the new entity. The staff should have significant experience and knowledge in banking and production financing.
- Execute a Memorandum of Understanding between PCH and Telefilm, and possibly amend the contribution agreement with the CTF, so as to direct the latter entities to allocate monies to the capitalization of a new early stage interim financing entity.

8.5 Other Financing Enhancements

Conclusion

Two other ways in which the federal government can perhaps intervene to improve the financing environment for Canadians in the audio-visual industry were identified. One area was in performance guarantees for Canadians who supply production services (inputs to the production process) to foreign buyers – namely foreign producers. This is different from completion guarantees in the sense that it does not involve the complete assurance of project completion to a production's financiers; but rather, fulfilment of a contract and delivery of an input to the project. The CCC already offers contract performance guarantees to foreign buyers of Canadian products and services; this is the International Prime Contractor Solution.

The CCC seems to be open to the idea of expanding into other knowledge-based industries. Before it begins offering service, it needs more audio-visual industry expertise, however. One option is for Telefilm to provide this expertise under contract or through the secondment of a Telefilm employee. In effect, PCH would make the investment to launch the service offering. The ideal candidate would have to have a deep understanding of the Canadian production services and new media industries, and at the same time have a financial services background that would allow them to operate in the CCC environment. If a qualified person could not be found within PCH or Telefilm, the CCC would have to create a position and hire someone. The CCC needs to generate over $200,000 in new fees annually to create a position. PCH could agree to subsidise any shortfall in fees during the launch phase of the service offering.

Recommendation:

- PCH (or Telefilm) could consider approaching the CCC to create and staff a position (on a pilot basis) within the CCC. The new position would focus on providing International Prime Contractor Solution and other CCC products to Canadian firms selling production services and new media products to foreign producers.

Implementation Plan:

- Identify a PCH or Telefilm employee with the background needed to work at CCC. The employee should have extensive knowledge of the production industry, and insurance. Experience at a Crown financial institution and in business development would also be necessary.
- Place the identified employee on secondment at CCC for a period of one to two years with the objective of establishing a production services contract performance guarantee practice at CCC. The secondment period should include at least three months of on-the-job training at CCC.

Conclusion

The second area for enhancing the financing environment for film and television producers is by speeding up the payment of the CPTC. The CPTC represents a large piece of a production's financing, yet it is one of the last elements to be paid to the producer. Producers must complete and submit a corporate tax return to claim the CPTC. The Province of Ontario has already embarked on an initiative to advance a share of the tax credit to producers. The industry is positive on this development in Ontario and would like to see the federal government follow suit.

Recommendation:

- PCH could consider exploring with the Canada Revenue Agency and CAVCO in what ways larger portion of the CPTC can be advanced to producers, and thereby reduce the interim financing charges they face.

Implementation Plan:

- Establish a working group comprised of representatives from PCH, Canada Revenue Agency and CAVCO to explore the federal government's options with respect to accelerating the payments of the CPTC.

References

Alliance Tactics Inc. *Study on Financial Instruments for Telefilm Canada*. Prepared for Canadian Heritage, December 2003.

APFTQ (L'Association des producteurs de films et de télévision du Québec). *Survey of APFTQ Members*. 2004.

Avrich Johnson, Kathy. *Canadian Production Finance: A Producers Handbook*. Ontario Media Development Authority and Telefilm Canada, 2001.

Bension, Shmuel. *The Producers Masterguide, Annual*. New York Production Corp, 2004.

Boyle, Charles E. "Hollywood and the Insurance Industry." *Insurance Journal West,* September 11, 2001. Wells Publishing, Inc., 2001.

Business Development Bank of Canada. *Cultural Industries Development Fund, Annual Report 2002*. submitted to Canadian Heritage, 2002.

Business Development Bank of Canada. *2004 Annual Report*. 2004

Business Development Bank of Canada. *BDC and the Cultural Sector*. October 27 2004.

Business Development Bank of Canada. *Summary of Corporate Plan, 2005-2009*. Fall 2004.

Banque de Développement du Canada (La). *Présentation à Équipe Canada inc.* présentation au Ministère de patrimoine canadien, 2004.

Canadian Audio-Visual Certification Office (CAVCO). *2002-03 Activity Report*. 2004.

Canadian Commercial Corporation. *CCC Corporate Plan Summary, 2004-2005 to 2008-2009.*

Canadian Commercial Corporation. *CCC Annual Report 0304*.

Canadian Film and Television Production Association (CFTPA). *Profile 2005: An Economic Report on the Film and Television Production Industry*. February 2005.

Davis, James C. "Billion-dollar Budget Bonders." *Daily Variety.* November 27, 2000. p. B1. Reed Elsevier Inc., 2000.

Du, Alex. "Gap financing in Canada." *Playback Magazine.* September 6, 1999. p. 21. Brunico Communications Inc., 1999.

E&B Data. *Une filière d'envergure : La production audiovisuelle et les industries connexes dans la region de Montréal et au Québec*. mars 2004.

Edwards, Ian. "Completion bond businesses blend." *Playback Magazine.* January 20, 2003. p. 1. Brunico Communications Inc., 2003.

Export Development Canada. *2004-2008 Corporate Plan Summary*. March 2004.

Exportation et Développement Canada. *Services financiers axés exclusivement sur le commerce international.* présentation au Ministère de patrimoine canadien.

Goodmans LLP. *Location Canada: A Guide to Producing in Canada and Doing Business with Canadians*. June 2003.

Jutras, Dominique (SODEC). *Dix ans d'aide fiscale au cinéma et à la production télévisuelle au Québec*. mai 2001.

Madigan, Nick. "A Job Well Done: Co-prod'n boom fuels bond biz." *Daily Variety.* November 27, 2000. p. B1. Reed Elsevier Inc., 2000.

Madigan, Nick. "When films are at stake." *Daily Variety.* November 27, 2000. p. B7. Reed Elsevier Inc., 2000.

Morrison, Curt. “An Investment in the S&P 500 Is a Poor Choice Today,” at http://news.morningstar.com/doc/document/print/1%2C3651%2C119823%2C00.html

Nordicity Group Ltd. *Canada’s Competitiveness in Treaty Co-Production*. prepared for Telefilm Canada, May 2004.

Nordicity Group Ltd. and Duopoly Inc. *Nova Scotia Film, Television and New Media Industry: Impact Analysis and Long-Term Strategy Integrated Report*. prepared for the Nova Scotia Film Development Corporation, July 2004.

Observatoire de la culture et des communications du Québec. *Statistiques sur l’industrie du film, édition 2003*, juillet 2003.

Rice-Barker, Leo. “Doing the bank thing.” *Playback Magazine.* April 11, 1994. p. 27. Brunico Communications Inc., 1994.

Rice-Barker, Leo. “New players, new risks in booming A/V banking.” *Playback Magazine.* May 4, 1998. p. 1. Brunico Communications Inc., 1998.

Rice-Barker, Leo. “New competitor in bond market: Presner named FFC prez.” *Playback Magazine.* August 10, 1998. p. 10. Brunico Communications Inc., 1998.

Rice-Barker, Leo. “MPB winds down operations.” *Playback Magazine.* April 29, 2002. p. 5. Brunico Communications Inc., 2002.

Rice-Barker, Leo. “Financing more of a public/private mix.” *Playback Magazine.* February 17, 2003. p. 23. Brunico Communications Inc., 2003.

Rice-Barker, Leo. “Globex Media enters completion bond sector.” *Playback Magazine.* April 28, 2003. p. 2. Brunico Communications Inc., 2003.

Royal Bank of Canada. *Annual Report 2004*.

Appendix A - List of Interviews

The following persons participated in research interviews for this project.

	Name	Title, Organization	Stakeholder Group
1.	Michael Spencer	Chairman Emeritus, Film Finances Canada Ltd.	Financial Services
2.	John T. Ross Jim Sternberg	Chairman, Film Finances Canada Ltd. Executive Vice-President, Film Finances Canada Ltd.	Financial Services Financial Services
3.	Doug Holliston	Vice-President, Business and Legal Affairs, Film Finances Canada Ltd.	Financial Services
4.	Charles Bernier Sylvie Ratte	Business Development Bank of Canada Business Development Bank of Canada	Financial Services Financial Services
5.	Paul McKenna	Director, Structured Finance, Trade Programs & Project Financial Risk Management, Canadian Commercial Corporation	Financial Services
6.	Ed Gathercole	Senior Vice-President, Film and Entertainment Industry Team, B.F. Lorenzetti & Associates Inc.	Financial Services
7.	Kim Matheson	Export Development Canada	Financial Services
8.	Dan McMullen Joanne Gordon	RBC Royal Bank, Commercial Markets RBC Royal Bank, Commercial Markets	Financial Services Financial Services
9.	Pierre Leblanc	General Manager, FIDEC	Financial Services
10.	Danny Chalifour	Director, International Operations and Development, Telefilm Canada	Film and TV Funding Agency
11.	Carolle Brabant	Chief Operating Officer, Telefilm Canada	Film and TV Funding Agency
12.	Caroline Leclerc Sophie Labesse	Financial Analyst, SODEC Financial Analyst, SODEC	Film and TV Funding Agency Film and TV Funding Agency
13.	Raina Wells Gina Vanni	Manager, Research & Strategic Planning, OMDC Acting Director, Tax Credits & Financing, OMDC	Film and TV Funding Agency Film and TV Funding Agency
14.	Guy Mayson Susanne Vaas	President & CEO, CFTPA Vice-President, Business Affairs, CFTPA	Film and TV Production Film and TV Production
15.	Claire Samson Nathalie Leduc	President & CEO, APFTQ Director, Financial Sector, APFTQ	Film and TV Production Film and TV Production
16.	Steve Ellis	President, Ellis Entertainment	Film and TV Production
17.	Margaret O'Brien	CFO & COO, Barna-Alper Productions	Film and TV Production
18.	Sylvie Desrochers	Groupe Pixcom	Film and TV Production
19.	Michael Prupas	President, Muse Entertainment	Film and TV Production
20.	Jean-Yves Martel	President, Jam@ti Inc.	Film and TV Production
21.	Marie-Andree Poliquin	Radio-Canada	TV Broadcaster
22.	Corrie Coe	Vice-President, Drama Acquisitions, CTV	TV Broadcaster

Appendix B - Interview Guide

Nordicity Group Ltd.
Study on Completion Guarantees and
Financing Tools in the Audio-Visual Industry

Interview Guide – Key Informant Interviews

A. Trends/experience in interim financing and risk mitigation?

1. What are the main issues in financing productions in terms of access to credit, interim financing and risk mitigation against non-payment by buyers?

2. Has there been a difference in the financing of projects between English and French production companies? Among different types of production: features, television series, industrial/non-theatrical? Among different genres?

3. How have the banks and other financial institutions been involved in the financing? What covenants have they put on extending credit to production companies? What collateral have they accepted/required? From foreign markets?

4. Have you had any contact or experience with federal crown corporations (EDC, BDC, CCC) that provide financial support to Canadian companies? What financial products have they offered? What use could you see in accessing these products?

B. Completion guarantee practices

5. What kind of impact is the payment for completion guarantees on project financing? What percent of the budget? For all projects or some? Which type of projects? Who requires completion guarantees?

6. What form of completion guarantees have financial institutions required? Do conditions differ by type of project? By the credibility/track record of the producer? Is there a trend away from completion guarantees as the industry (financial institution and producer) matures?

7. What form of completion guarantees have government agencies required? What causes any variations in the requirements?

8. What is the profile of a typical applicant for a completion guarantee? How are applications rated and risk profile assessed? Are there different rates and different conditions for different kinds of applicants?

C. Other financial instruments supporting working capital/cash flow

9. What other risk mitigation products are in the marketplace for the production sector? What about guaranteeing delivery to foreign buyers of the production?

10. What about guaranteeing Canadian producers payment by buyers from foreign markets? Are there foreign markets for which there is no current way to monetize a minimum guarantee or license fee commitment?

11. Are there other areas where interim financing is not available, has too many conditions, or is too expensive for independent producers?

D. Structure of the financial service market

12. What is the history of the suppliers of completion bonds and other financial services in the industry? Who are they and are what are their qualifications? What is the required capitalization level? What are the default rates, and what steps are taken to intervene when trouble is spotted?

13. Who are the main providers of completion guarantees and other services in Canada? Is there competition among them? What are the origins of known service providers in Canada? Are they capitalized in Canada? Are the profits re-invested in the Canadian industry?

14. Are you aware of how completion guarantees and other services that factor into the production financing in other countries - e.g. U.K., France, Australia, Germany, U.S.? Is there much competition within each financial instrument? Are there lessons to be learned, positively or negatively?

E. Potential government involvement

15. How do Crown agencies such as EDC, BDC and CCC assess files for audio-visual industry companies? Are these files processed differently, or in the same manner as files from companies in other industries? Is it possible for EDC, BDC and CCC to use different evaluation criteria when assessing audio-visual industry files?

16. Would the involvement of government in backing private sector institutions be useful? Feasible? What would be the benefits and costs to this involvement? What agency would make the most sense - Telefilm, CCC, BDC, EDC? What about a private-public partnership arrangement?

17. How should initiatives by the government agencies mesh with existing private sector service providers? Would it lead to more attractive terms for the producers? Would they be complementary or competitive with private sector agencies?