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## The film production industry and its use of **private debt**

*An interview with the Align Group, a film financing specialist*

### **The film production market post Covid**

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- A fast growing market decorrelated from the financial markets
- The growing success of streaming platforms
- A new, dynamic environment, offering opportunities and attractive returns

### **Why opt for private debt?**

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- Specific financing needs for each project
- A market neglected by traditional banks
- Debt instruments that meet the needs of productions

# The film production industry and its use of private debt

## What major trends are currently driving the film production market?

At the moment, **the growing success of streaming platforms** is the key trend driving the sector's development. Netflix, Amazon, Disney and other platforms experienced a growth surge during the extensive lockdowns caused by Covid.

The widespread closure of cinemas accelerated their development, transforming the sector's dynamics. According to the Motion Picture Association's figures, **the global film market** amounted to more than **\$320 billion** in 2021. It regained, and even rose above, its 2019, pre-Covid, levels. Within the sector as a whole, **digital services clearly exploded**. In 2019, they totalled slightly more than \$40 billion. In 2021, they climbed above the \$70 billion mark, again according to the MPA's figures.

Before the Covid epidemic erupted, in March 2020, cinema receipts made up the largest share of the revenue from films. This was then supplemented by sales to TV channels, DVD distributors and VOD services, and followed a well-ordered timetable and process.

Now, however, streaming platforms have become so dominant, both downstream and upstream of the chain, that these rules no longer apply. Production companies accustomed to traditional distribution channels must now deal with a new environment.

## Which area has the development of Netflix & Co had the greatest impact on?

Mainly content production, which is an area that is growing strongly. Streaming platforms are competing fiercely with each other to gain ever more subscribers. **During the third quarter of 2022, Disney+ and Netflix each had around 220 million subscribers.**

These days the outcome of this competition is largely decided **by content, in terms of either volume or quality**. Platforms need to develop subscriber bases with increasingly demanding consumption habits. This is resulting in sector growth that is all the stronger as the number of projects is rising in step with production budgets.

Last year, \$220 billion were invested in film content globally, and streaming platforms alone financed \$50 billion!

## Why have you chosen to operate in the film production sector?

We **have been active in this sector for the last twenty years**, but we have rarely seen as many opportunities as now. The film production industry has some highly advantageous characteristics. It has been **growing at a strong rate** for the last dozen years or so, but this growth has recently shifted up a gear with the arrival of streaming platforms.

**The sector is also completely decorrelated from the financial markets.** When we raise funds from investors who are active in these markets, we therefore offer them an attractive alternative, especially in the current period.

Lastly, in the field that we specialise in, namely independent films, our role is to make up for the shortage of financing and the limited bank presence, which make financial tools and instruments more complicated to access.

## What is this segment's size?

**Between \$15 billion and \$20 billion.** It may be a high profile universe, but its size is proportionally very small, which is why **banks have little interest in it**. The market is not huge, and financing methods vary greatly from one film to the next. Banks are therefore not able to analyse every project and design solutions, which they wouldn't be able to standardise in any case.

## What makes you a legitimate operator in this segment?

We have worked in film production and financing **for around twenty years.**

We started off in Belgium in 2004, with Umedia, setting up an initial investment fund thanks to the system of tax incentives offered by the government. **We have managed to raise more than €500 million, which have been used to finance several hundred films.**

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## What positioning have you chosen, more specifically with your company Align?

We operate **two debt funds, which are used to finance the production of independent films or TV series**. Through these two funds, we therefore play the role that banks play in other industries.

The advantage of debt funds is that they offer attractive returns without risk-taking at the box office being part of the risks that they assume.

We are in a sector where **demand for financing is rapidly growing**, but supply is not keeping up. We are also operating in an environment where the competition is still fairly limited.

## How are films usually financed?

The financing structure of films includes several instruments, although models vary considerably between projects.

The first source of financing that producers focus on is **the grants and subsidies awarded by regions or states**, or by the European Union, to support cinema and culture while attracting the economic activity generated by film production to the region or country in question. This is the least expensive financing method.

Next come **presales**. For some films, distributors may buy screening rights before production has even been launched. In this case they pay an advance. In most cases, however, distributors don't commit to a film until it has been wrapped up. This is why we get involved, with our debt instruments, **to cover the cash flow needs necessary for production**.

**Private equity** injections are also possible, whereby investors are paid after all the lenders have been reimbursed. In the film production phase, there is some room left for **senior debt**, based on the potential estimated sales of the film to the distributors that haven't prebought it.

Finally, for the remaining budget, there is product placement, which only plays a fairly marginal part.

## How do these various financing methods break down?

Every film is different but, to give you a rough idea, subsidies account for around 20% to 25%,

and presales for around 30%, while the rest of the budget is divided between private equity and senior debt.

## How are you and your debt instruments involved?

We have created **three tranches of debt** in line with the expectations of producers and investors, particularly in terms of risk-adjusted returns.

The first tranche covers **the contract cash flow**. We discount the presales contracts or subsidies as they are usually paid when the film has been wrapped up. Also note in this respect that we take out insurance covering the effective completion of production according to schedule and budget. This aspect is specific to our industry.

The second tranche that we offer is **senior debt**. We provide financing based on the sales that the film is liable to make. Our estimates are quite conservative, as these sales are not contractually guaranteed. Senior debt is therefore riskier, but also brings a higher return.

The third tranche is smaller. We offer a **bridge loan** to cover the expenses to be incurred during the pre-production period, which lasts around two months, when financing is not yet available. In most cases, it is only available from the start of filming. This tranche is therefore very short term, as it is paid back when filming begins, and the rates are very lucrative, at around 1% to 2% per week.

This expertise has led us to identify significant financing needs and devise solutions appealing to both producers and investors.

In practice, we act as intermediaries between creatives and financial backers, as we understand the needs of both.

## What returns are offered on these tranches?

The interest rate on senior debt is between 16% and 20% a year. The contract discounts bring in 8% to 12%, and the return is all the more attractive as the subsidies are granted by high quality institutional counterparties. This sector is therefore worth operating in given the opportunities that it generates.

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## In terms of budgets, what types of productions do you finance?

We typically focus on films with budgets of around between **€3 million and €30 million**.

## Could you give examples of films that you have worked on recently?

This has been a busy year. We co-produced “**Le Petit Nicolas**”, an animated film presented at the Cannes film festival in May, in the out-of-competition official selection.

The film is a retelling of the work’s genesis by its two authors, Sempé & Goscinny, featuring the voices of Alain Chabat and Laurent Laffitte. We also worked on “**Good luck to you, Leo Grande**”, an English-language film starring Emma Thompson. The film was premiered at the Sundance festival in January, then in Berlin in February. It was very well received by critics. In addition, we participated in the financing of “**Paws of Fury**”, an animated feature film, with the voices of Samuel Jackson and Ricky Gervais for the US market. Paramount has bought the rights to screen it on 3,000 to 4,000 screens in the US.

## Are you involved in the production of the films that you finance?

**Of course. This is the added bonus that we offer.** It is important for us to make sure that the projects that our investors have committed to are going ahead as planned. We therefore contribute to **the creative process** so that the films meet our qualitative expectations, and we also participate in the entire **revenue chain, monitoring receipts and looking after our investors’ interests**.

## What is DECALIA SA’s role?

DECALIA S.A. is an independent management company that manages the assets of private and institutional clients.

Its Private Markets activity has developed a **unique positioning as a strategic partner and “accelerator” for emerging and talented management teams**.

After completing extensive due diligence checks, DECALIA has decided to support us as we grow.

DECALIA’s partners have also committed their personal capital to our first and second funds to ensure an alignment of interests.

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Adrian Politowski and Nadia Khamlichi are the CEO and Chairwoman, respectively, of the company the Align Group, launched in 2019. In 2004, they created the company Umedia, one of the biggest film financing and production groups in Europe. Under their management, the group has raised and financed more than €600 million of content and co-produced more than 450 films, while its VFX division has become the largest in the Benelux.

## CONTACT

DECALIA SA  
Rue du Rhône 31  
CH-1204 Geneva

Tel. +41 (0)22 989 89 89  
Fax +41 (0)22 310 44 27

[info@decalia.com](mailto:info@decalia.com)  
[www.decalia.com](http://www.decalia.com)

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