

Analysis of the corporate finance of SMEs in the UK film industry

A report for the UK Film Council

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Foreword

In many ways the findings detailed in this report are unsurprising, in particular where they present a picture of a creative industry largely dedicated to achieving results on the screen rather than on the balance sheet. Others are unexpected; for example the extent to which some companies withhold cash due to their suppliers. It is encouraging to see some businesses using the intellectual property they create to leverage finance to fuel their growth, but disappointing that only a minority of companies appear to have adopted robust business models.

Given that the companies examined by Northern Alliance are responsible for the independent production and/or distribution of the most successful British films, the generally frail state of their balance sheets is a concern. This is especially so as the industry has entered a period of dramatic change precipitated by the rapid development of the Internet as a means of accessing film. The pace of this change will quicken and there will undoubtedly be tremendous opportunities for those companies that are well prepared.

We hope that this report informs that preparation and helps the indigenous industry understand itself better.

John Woodward
Chief Executive Officer
UK Film Council
October, 2009

Executive summary

The financial performance of individual films is often reported, but less attention is paid to the finances of the companies that make, sell and distribute them. Yet without these businesses UK film would cease to exist.

In order to inform public policy and private practice, the UK Film Council commissioned Northern Alliance to analyse the financial results of 73 companies that produced and distributed the most successful UK films in the years 2006-2008. The companies were allocated to the industry sectors shown below and the accounts analysed covered the period 1 March 2004 - 31 December 2008.

General findings

A number of conclusions were relevant to all industry sectors, in particular:

- Accounting by distributors and producers is inconsistent and falls short of the US accounting standard SOP 00-2.
- There is a widespread failure to appreciate and accurately value intellectual property created by the UK film industry.
- Film businesses should do more to use their intellectual property to secure corporate finance.
- There are few instances of private investment in film businesses and the 'equity gap' in the UK film industry is wide.
- There is an almost systemic reliance on dilatory payment of creditors with some companies routinely taking over six months to settle debts.
- Issues of shares via the London Stock Exchange appear to have been of very limited use to those film businesses whose shares are publicly traded.
- Public sector investment in film businesses, as opposed to film projects, is nugatory.

Other findings, listed by industry sector, include:

Sales

- There appears to be a minimum threshold of around £2 million p.a. in turnover in order for a sales agency to prosper, though exceptions exist.
- Branches of overseas companies appear to have the most robust business model - achieving the highest profits.
- UK independent sales companies struggle to operate successfully, typically having limited or no access to corporate finance (other than internally generated working capital).
- Vertically integrated sales companies vary greatly in profitability but had the highest growth in turnover.

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- There appears to be a correlation between the extent to which a sales agent's intellectual property is valued in their accounts and the extent of institutional finance they are able to employ.

Distribution

- All types of distributor increased the number of films released each year and experienced growth in turnover.
- Mini majors and multi-territory distributors operated at much higher levels of trading than vertically integrated and independent distributors, their turnover typically being over three times the former and over 20 times the latter.
- The gulf between the turnover of independent distributors and multi-territory/mini majors is due both to performance (low levels of revenue per film) and volume (number of films released).
- Films released by mini majors and multi-territory distributors generated around six times the gross box office of those released by vertically integrated companies and 12 times that of films released by independent distributors.
- Vertical integration does not appear to offer particular advantage to a distribution company.
- The hit based nature of the industry is reflected across all sub-sectors, but with mini majors least reliant on their best performing titles.
- Distributors' costs have risen significantly in recent years, with mini majors experiencing the most significant increase; 140% during the period of review.
- Distributors' balance sheets are likely to significantly understate the value of the distribution licences they hold.
- It is the ability to collect their own debt faster than they pay others that appears to provide most of the capital for vertically integrated and independent distribution companies.
- The aggregate value of 'extra' trade credit earned in this way could exceed £30 million.
- During the review period distributors could, on average, only cover 16% of their liabilities with cash.

Production

Studio-backed production companies:

- This sub-sector makes the most popular films, and employs the most working capital.
- The most successful companies produce 'franchise' films and are highly profitable.
- The remaining companies typically generate significant losses.

Hybrid, horizontally and vertically integrated production companies:

- This sub-sector has the highest average turnover and above average profitability.
- Staff working in integrated companies on average earn three times as much as those in independent or talent attached companies.
- The TV + film models appear to be the most successful.

Production companies with talent attached¹:

- Companies are typically thinly capitalised (just under half have insolvent balance sheets).
- They generally operate on relatively low turnover.
- The sub-sector's films typically generate the lowest box office.

Independent stand-alone production companies:

- Half of the companies recorded retained losses at their last balance sheet date.
- Companies in this sub-sector are the least liquid; typically unable to cover current liabilities with current assets.
- Excluding studio-backed companies, films produced by this sub-sector tend to be the most popular amongst cinema audiences.

Whilst some of these findings may confirm or reinforce subjective opinion, we hope that by quantifying for the first time the degree to which some of these characteristics exist the industry will better understand itself.

¹ Of course all production companies need to attract talent in some way, however in this context 'talent attached' means those companies where a filmmaker other than a producer (typically a film director, occasionally a writer) is a shareholder and/or director of the company

Introduction

Existing analysis of the finances of the UK film industry is predominantly focussed on entire sectors of the industry or on individual projects. What analysis of individual businesses exists tends to be uninformed by experience of the finances of the industry, confused by the industry's practices, such as the use of single purpose companies, subjective or anecdotal. Better information on the industry's corporate finance could improve the level of debate and understanding amongst executives in the industry, as well as the quality of investment decisions. Such knowledge could also inform policymaking and increase the attention of corporate financiers currently discouraged by the poor quality of analysis.

In order to further these aims the UK Film Council commissioned Northern Alliance to analyse the publicly available financial information on a representative group of companies from across the value chain. An initial pilot study examined the corporate finance of 14 UK film companies and the study was then expanded to analyse the results of a representative group of 73 companies.

The intention was to examine those independent businesses that produce and/or distribute the most successful UK films to UK audiences and those independent sales companies that help finance and deliver them to their markets around the world. The sample was therefore drawn from the population of companies associated with the top performing² 150 films officially certified as British under the 1985 Films Act and adding to this population films in receipt of a BAFTA award for Best Film or Best British Film or an equivalent BIFA award³ in 2006-2008. Distribution companies owned by MPAA members and special purpose production companies ('SPCos') were excluded⁴.

The period of review extended from 1 March 2004⁵ until the latest point at which balance sheet information was available - 31 December 2008. The companies were allocated to sub-sectors informed by previous analysis by the UK Film Council. Using the annual accounts and relevant contextual information about each company and their films, the UK industry's corporate finance was analysed to identify key trends within and between sub-sectors, typical balance sheets were compiled for the various business models and the comparative corporate financial health of those businesses and business models assessed and gaps in access to corporate finance identified.

As the analysis is based on the latest accounts filed at Companies House, and as often those accounts are abbreviated, it is often impossible to arrive at firm conclusions about the nature of the corporate finance of particular companies. Public accounts are typically filed many months after the end of a trading period.

² In terms of UK gross box office

³ Best Achievement in Production, Best British Independent Film, Best British Documentary, the Raindance Award.

⁴ It was considered that analysis of these companies would not further the aims of the review in any significant way.

⁵ Earliest beginning of a financial year ending 2005 for a selected company.

As a result, the information referred to in this report is all, to some degree, historical. This analysis should therefore not be relied on to make judgements or draw conclusions on the current condition of individual companies and the information has been made anonymous to that end. However, by assembling the most recent data available on a representative cross section of companies and comparing and contrasting the information available publicly, it is possible to gain an insight into the financial health and the recent trading of the types of company that form the UK industry and consider the implications of this analysis.

Sales sector

Summary

- There appears to be a minimum threshold of around £2 million p.a. in turnover in order for a sales agency to prosper, though exceptions exist.
- Branches of overseas companies appear to have the most robust business model - achieving the highest profits.
- UK independent sales companies struggle to operate profitably, typically having limited or no access to corporate finance (other than internally generated working capital).
- Vertically integrated companies vary greatly in profitability but had the highest growth in turnover.
- There appears to be a correlation between the extent to which a sales agent's intellectual property⁶ is valued in their accounts and the extent of institutional finance they are able to employ.

⁶ in this case principally the licences to sell the films they represent.

Analysis

The accounts of 13 sales companies were analysed over a period that ranged from: 1 April 2004 to 30 June 2008. These companies were allocated into three types whose average results can be summarised⁷ as:

£000's unless stated		Independent (5 companies)	Vertically Integrated (5 companies)	Branches of overseas companies (3 companies)
Turnover		1,588	8,415	11,814
Pre-tax profit/(loss)		(291)	(88)	1,764
Fixed assets		329	4,944	355
Current assets		2,448	3,636	17,798
Creditors < 1 yr		(595)	(4,013)	(13,506)
Creditors > 1 yr		(686)	(2,381)	(4)
Total net assets		1,496	2,186	4,643
Represented by:				
Share capital and other reserves		3,523	12,068	1,177
Retained earnings (losses)		(2,027)	(9,882)	3,466
Shareholder's funds		1,496	2,186	4,643
Latest:				
Quick ratio		83%	8%	15%
Current ratio		359%	78%	127%

All subsectors exhibited growth in turnover, with vertically integrated companies showing the most (174%) and UK Independent companies the least (13%) over the period of review.

In terms of overall profitability, even adding back payments made to directors, UK independent agents appear to be struggling to operate successfully. The performance of vertically integrated sales companies is more chequered, with

⁷ This table (and the similar tables summarising the distribution and production sectors) shows the average trading results, and balance sheet information across the period of review, with the exception of liquidity ratios, which are for the latest available balance sheet only. The results of each company were averaged before being used as the basis for the average sub-sector result. The trading results of some companies are not available, the trading results therefore represent the average of the average results for only those companies that have filed this information at Companies House. (This methodology is adopted throughout the report). The 'current ratio' represents the relationship of current assets to current liabilities, whereas the 'quick ratio' excludes debtors, ie it is an indicator of how much of the immediate liabilities of the company can be settled before waiting for trade and other debts to be collected - please see the Glossary for more details.

average annual results ranging from profits of £2.85 million to losses of £300k. One vertically integrated company had accumulated retained losses of over £3 million, by the end of the review period.

Except for one company, which generated modest average losses of £195k over the period under review, UK sales businesses with owners based outside the UK appear to have the most robust business model, generating average profits of £3 million (excluding the loss-making business), though perhaps with greater associated risk; one company included in this sub-sector has purportedly encountered problems funding films since the end of the review period.

Perhaps because they have back office functions serviced from home offices located outside the UK, the branches of overseas companies earn their relatively high profits with fewer staff. On average they employ between 14 and 15 staff (including directors) who are paid £61k p.a. on average, generating average added value of £135k p.a.⁸ each.

Vertically integrated companies employ an average of 17 people⁹ on similar average salaries to those who work for companies with overseas parents but who generate significantly less added value.

There are fewer staff in independent sales companies (nine on average) and they are paid less (£37k p.a. on average), probably because they generate losses, before deducting director's emoluments, of approx £9.5k p.a. per head.

In terms of liquidity, vertically integrated companies tend to be relatively illiquid, and are unable to cover their immediate liabilities, whilst overseas companies are slightly better positioned. UK independent companies tend to be very liquid: operating with an average current ratio across the period of review of 412%, though this had fallen to 359% by the last year of review.

Across both vertically integrated and overseas sub-sectors, current ratios have risen over the period of review. Independent sales companies current ratios have, on average, fallen over the period, but, as noted above, typically remain relatively high.

UK independents are also best able to cover their current liabilities with cash; the only sub-sector able to do this. Overseas and vertically integrated companies are unable to do so, typically holding enough cash to account for less than a quarter of their current liabilities. This may not necessarily be a result of weaker balance sheets in these sub-sectors but may instead be a reflection of efficient cash

⁸ ie their average contribution to operating profit after deducting their own salary.

⁹ One company's dramatic increase in staff (from 28 to 91) would drive this average up from 17 to 27 staff and therefore their results have been excluded.

management across the groups of companies they belong to¹⁰. Quick ratios have fallen amongst vertically integrated and overseas companies during the period of review whilst the independent sub-sectors have tended to increase.

Vertically integrated companies are better at collecting debt than independent companies, who in turn are far better than overseas companies (debtor days of 56, 57 and 81 respectively). Over the period of the review it appeared to become more difficult for independent and vertically integrated sales agents to collect debts.

Whilst vertically integrated companies have the most respectable track record of settling liabilities, paying trade creditors within 42 days on average, overseas companies (47 days) and in particular UK independent companies (140 days) are slow at paying their trade creditors. The trend is for an increase in the time taken to pay creditors across all sub-sectors. The smaller UK independent sales agents in particular appear increasingly reliant on trade credit to maintain their liquidity.

Vertically integrated and overseas companies rely on longer term financing and funding, particularly from other group companies. The average creditors of more than one year were £2.4 million for vertically integrated companies compared with £686k for UK independent sales agents. Vertically integrated businesses also include more fixed assets and investments in their balance sheet than UK independent sales agents (vertically integrated £4.92 million, UK independent £329k).

The incidence of institutional finance is greater amongst the vertically integrated and overseas agents, and there appears to be a loose correlation between the extent to which their IP is valued in the accounts and the extent of that institutional finance, though cause and effect may be in the reverse order:

¹⁰ It was beyond the scope of the work to research other parts of what might often be complex groups of companies domiciled in many different parts of the world. Some exceptions were made however, throughout the review, the research was mainly limited to the information available on those companies immediately responsible for the development, production, distribution and international sales of the films in the sample.

Organisation ¹¹	Sub-sector	Value of IP (per the accounts) ¹²	Institutional finance
SO1	Overseas	Over £10m of unamortised film rights	\$90m loan facility
SVI1	Vertically integrated	\$82m valuation specifically undertaken to raise finance and noted in accounts	\$45m facility from a leading US investment bank
SO2	Overseas	£1.7m of unamortised film rights	\$20m revolving bank facility
SI3	UK independent	Films valued by way of note	\$9.63m of loan notes secured against revenue from five films
SVI2	Vertically integrated	Not valued	Bank overdraft: £840k Loan: £327k
SI3	UK independent	Intangible fixed assets capitalised at £112k	Bank overdraft facilities of £250k

Another independent sales agent has spent the last three years looking for institutional finance without success.

In addition to securing loans against film rights as noted above, SI3 has obtained working capital by issuing a series of loan notes, convertible into shares, to individual shareholders that had reached a total £292k in the last year of review, despite accumulating losses over the period of review, which had reached almost £3.6 million by the end of 2008.

The remainder of the independent sub-sector appears to rely on self generated working capital. The overseas companies adopted a variety of approaches in financing their businesses¹³.

¹¹ This refers to the companies analysed and allocated into the various type of business, e.g. SO1 is the 1st Overseas sales company selected for analysis.

¹² Includes additional notes provided in the accounts ie those not necessarily linked to balance sheet entries.

¹³ Of these three companies, one is domiciled in a tax haven and files accounts that are sparse in detail, one had significant intra-group transactions and balances, treasury apparently being managed at a group level, whilst the other appeared to be funded more like an independent company with most capital generated internally.

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Despite typically making losses, most vertically integrated companies were able to secure some sort of institutional finance; only one company in the sub-sector has not had a bank overdraft at some stage during the period of review.

Amongst all sales agents, profitability appears to be correlated to turnover:

	Sales agents making:	
	Profits	Losses
Average turnover (£k)	11,475	3,209
Average profit (loss)	1,915	(238)
Correlation co-efficient	.79	.36

Amongst the loss making agents, one company made marginal losses (net margin of 1%) on relatively high average turnover of over £9 million. Excluding this company reduces the average turnover of the loss making group to £1.7 million and it appears that there is, in general, a minimum level of turnover of around £2 million p.a. that a sales agency should target if it is to be routinely profitable.

Within these generalisations, there does appear to be a type of smaller, self-financed, owner-managed UK sales company that is able to operate profitably. It is typically focussed on servicing relatively large numbers of indigenous producers of lower budgeted British films without recourse to third party finance and, probably as a result, without the resources to advance significant sums towards the financing of productions.

At the other end of the scale of operations, the inclusion of US independently produced films in one overseas sales agent's film catalogue apparently differentiates them from their more UK/European focussed peers. There appears to be a relatively smooth continuum from the lowest performing UK focussed companies to the highest performing overseas based companies until there is a point at which LA based productions can be routinely incorporated in a sales business' 'proposition'. It is at this point that there appears to be a step change in the scale and performance of a sales business¹⁴.

In between these two extremes, there appear to be a number of sales companies that are struggling for survival¹⁵.

¹⁴ This conclusion is based on a relatively narrow evidence base and caution should be used in extrapolating it across the entire Sales Sector.

¹⁵ To what extent losses can continue to be absorbed is a decision for the directors of those companies. The presence of retained losses or net liabilities in a balance sheet may be inconsequential if a shareholder or another investor is prepared to support that company. Directors may also legitimately trade despite generating losses provided they can genuinely foresee a satisfactory turnaround in performance, however please note this is an attempt to summarise more lengthy and complex company law and reliance should not be placed on this or similar statements made in this report.

Is the UK's film intellectual property fairly valued?

The great majority of companies analysed in this report either did not value their intellectual property (IP) or, where they included it in their balance sheets, appeared to undervalue it. Those companies that appeared more diligent in valuing their IP, not necessarily in their balance sheet but also by way of note in their accounts, appeared to be more successful in raising institutional finance. That is not to say that cause and effect are in that order, it may be the case that improved representation of intellectual property is simply a by-product of raising slabs of corporate finance to build businesses, however there does appear to be a correlation.

For example, the two vertically integrated sales businesses that valued their intellectual property secured institutional finance and reported profits. Their peers who did not ascribe values to the licences they held all recorded losses.

It seems to be that, in terms of intellectual property within the film business, 'you get what you measure'.

*"Entertainment and Media businesses should do more to exploit their most valuable assets – intangible assets. Over the next few years market conditions will force them to take intangible assets out of the 'too difficult' box and look much harder at ways in which they can be used to support greater volumes of lending or lending on better terms"*¹⁶

US film companies are obliged to account according to a clear methodology for valuing their films (Statement of Position (SOP) 00-2, Accounting by Producers or Distributors of Films).

SOP 00-2 provides for consistent accounting within the US motion picture industry, codifying the practice of timing revenue recognition, classifying film costs, and facilitating estimates of the future value of transactions.

In contrast, UK companies adopt a largely incoherent, often idiosyncratic set of policies that Grant Thornton's media team have analysed in detail in successive reports¹⁷. The first of these appealed for the development of a clear code of accounting practice that could provide the UK with its version of SOP 00-2.

"Accounting by distributors and producers in particular is not consistent across the industry and is often poorly disclosed...in our last survey we recommended the development of a statement of recommended practice for the UK film and

¹⁶ PricewaterhouseCoopers; On Media: Navigating Choppy Waters, 2009

¹⁷ Grant Thornton's UK financial reporting benchmarking survey was first published 2001 'What do we tell the shareholders?', and was followed by "What happened next?" in 2002, and more recently by "Five years on" published in February 2007

television industries and still see it as the way forward for the industry based around the well developed US standards, principally contained in SOP 00-2...¹⁸

Whilst adopting a common standard will not immediately transform underlying performance, it could facilitate comparison across industry sub-sectors and allow owners, managers and potential investors to better understand businesses that are often more complex than their modest size implies.

¹⁸ "What Happened Next"

Distribution sector

Summary

- All sub-sectors increased the numbers of films released and experienced growth in turnover.
- Mini majors and multi-territory distributors operated at much higher levels of trading than vertically integrated and independent distributors, their turnover typically being over three times the former and over 20 times the latter.
- The gulf between the turnover of independent distributors and multi-territory/mini majors is due both to performance (low levels of revenue per film) and volume (number of films released).
- Films released by mini majors and multi-territory distributors generated around six times the gross box office of those released by vertically integrated companies and 12 times that of films released by independent distributors.
- Vertical integration does not appear to offer particular advantage to a distribution company.
- The hit based nature of the industry is reflected across all sub-sectors, but with mini majors least reliant on their best performing titles.
- Distributor's costs have risen significantly in recent years, with mini majors experiencing the most significant increase; 140% during the period of review.
- Distributor's balance sheets are likely to significantly understate the value of the distribution licences they hold.
- It is the ability to collect their own debt faster than they pay others that appears to provide most of the capital for vertically integrated and independent distribution companies.
- The value of 'extra' trade credit earned in this way could exceed £30 million.
- During the review period distributors could, on average, only cover 16% of their liabilities with cash.¹⁹

¹⁹ The quick ratio calculated for the entire sector (as represented by the companies selected in footnote 19) from a sector balance sheet derived from the average sub-sector results weighted by the number of companies in the sub-sector.

Analysis

The accounts of 19²⁰ distribution companies were analysed over a period that ranged from: 1 April 2004 to 31 December 2008. The analysis of the UK film distribution sector was divided into 4 sub-sectors whose average results can be summarised as:

£000's unless stated	Independent (6 companies)	Vertically Integrated (7 companies)	Mini majors (3 UK subsidiary companies)	multi territory (horizontally integrated) (3 UK companies)
Turnover	1,241	8,546	28,387	30,123
Pre tax profit/(loss)	(75)	589	(4,477)	(279)
Fixed assets	57	1,031	2,568	1,216
Current assets	672	4,575	28,679	17,812
Creditors < 1 yr	(736)	(4,660)	(26,490)	(12,498)
Creditors > 1 yr	(109)	(59)	(4,368)	(38)
Total net assets	(116)	887	389	6,492
Represented by:				
Share capital and other reserves	2	1,705	5,779	7,167
Retained earnings (losses)	(118)	(818)	(5,390)	(675)
Shareholder's funds	(116)	887	389	6,492
Latest:				
Quick ratio	15%	4%	9%	14%
Current ratio	95%	95%	104%	136%

Turnover averages split the sub-sectors into two levels of operation: mini majors and multi-territory distributors operated at around £29 million p.a. contrasting with vertically integrated and Independent distributors which operated at lower

²⁰ One company has been excluded from the averages due to its exceptional size.

levels of trading. Across each sub-sector, turnover has increased over the period of review and all sub-sectors experienced an increase in the number of releases.

It would seem the larger the company the more stable the rate of release; the mini majors showed least volatility in the numbers of films released, followed by multi-territory distributors.

The vertically integrated sub-sector showed the most variance in numbers of films released with producer/distributors releasing far fewer films than other configurations. A variety of integrated business models were evident, though most appear to be relatively unsuccessful to date; only two companies in the sub-sector had recorded retained profits of any significance by the end of the review period, both of these were nestled in broader based businesses rather than pursuing vertical integration directly in international sales or production.

The gulf between the turnover of independent distributors and multi-territory/mini majors is due both to performance (low levels of revenue per film) and volume (number of films released).

Whilst gross box office recorded by films released by mini majors and multi-territory distributors' averaged between £900k and £1 million, on average the vertically integrated sub-sector's films achieve only £161k of gross box office and independents only half that amount.

The hit based nature of the industry is reflected across all sub-sectors; almost every distribution company's most successful film represented at least a quarter of their corresponding annual average gross box office excluding that title, with the mean at 60%.

Only the mini major sub-sector is able to be substantially less hit reliant (29%). The vertically integrated sub-sector appears most hit dependent; its most successful films represented 95% of their distributor's yearly average gross box office excluding that title.

There was conflicting evidence that distributors were beginning to benefit significantly from the exploitation of new media, with one stating in its 2007 accounts:

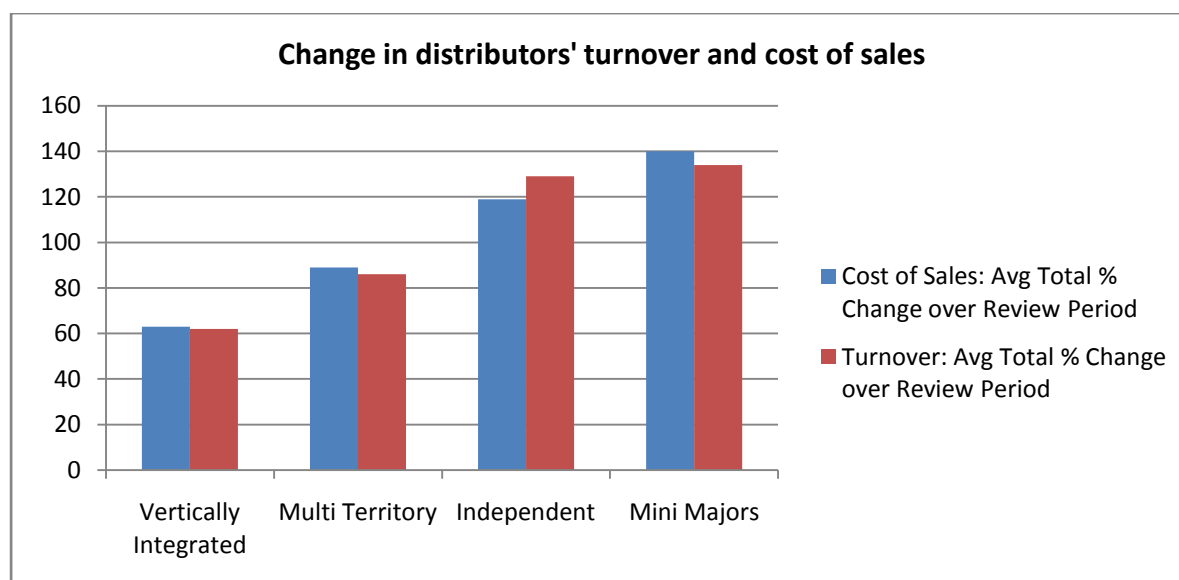
"Another factor contributing to the company's growth the past year is the increase in revenue from Video on Demand. This is the fastest growing income stream"

and another in its 2008 accounts;

"There is still no great evidence of the emergence of video on demand distributed by the internet, which is still constrained by broadband capacity and lack of simple

connectivity between PC and TV. However the technology will undoubtedly improve in the medium term"

Cost of sales have risen over the period of review for most distributors, increasing marketing spend was noted as a major problem by one company in its accounts. On average costs of sales have increased over the whole period of review for each sub-sector with mini majors seeing the greatest increase, these increases largely mirrored the change in turnover, though mini majors' increased cost's outstripped their turnover by the highest margin.²¹



From the available accounts of the 19 distributors analysed, only five²² companies carry intangible fixed assets in their balance sheet; whilst most others carry film investment as stocks in current assets.

Nine companies have long term credit facilities, six companies utilised overdraft facilities during the period.

One independent distributor had drawn down over £200k of a long term bank loan note. Another had utilised an interest free loan note from an investor to provide a short-term injection of working capital with £182k drawn in 2007 being fully paid off by 2008. The two independent distributors that had successfully raised third party institutional finance were quite different; one was a relatively large company with average turnover of more than £6.5 million whereas the other

²¹ It has not been possible to compare the change for each year for every company in each sub-sector due to a lack of data. However, an average of each company's change over the period of review; typically over 3 years between 1 April 2004 to 31 December 2008, has been averaged in each case to illustrate the general trend.

²² Excludes one company's Goodwill figure.

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only turned over £378k. It was the former company that had only used the loan notes as a temporary measure.

As you would expect when looking at multi-territory, mini major and vertically integrated models, inter-group lending plays a significant role. The most extreme example was owed over £21 million and itself owed £19.8 million to other group companies at the end of the period of review. Being part of a larger media group appears to have supported steady and significant growth in this business including increasing amounts committed to purchasing new films over the period of review. In another case substantial tangible assets in one group company were the basis of the solvency of the wider group of companies.

Distributors typically rely heavily on their position as 'gatekeeper' within the film value chain to leverage the working capital available to their business. On average debtors equal £6.7 million and the mean number of days to collect payment is 64 days.

The average amount owed to creditors within one year is £8.5 million. The average²³ number of days taken to pay creditors is 69. Mini majors and multi-territory distributors take less than the average time to pay their creditors: 41 and 22 days respectively. In contrast vertically integrated and independent distributors rely more heavily on trade creditors for working capital taking 103, and 91 days respectively to settle their debts.

It is this ability to collect their own debt faster than they pay others that appears to provide distributors at all levels of operation with most of their capital.

The top five²⁴ distributors benefiting from 'extra' trade credit:

Company	Debtor days	Creditor days	'Extra' days	Value of 'extra' trade credit (£k)
DVI7	114	277	163	158
DVI5	59	202	143	257
DX ²⁵	15	138	123	30,993
DI6	20	71	50	192
DI4	63	112	49	516

²³ Average as weighted according to the size of each sub-sector's average creditors relative to the average creditors for the sector as a whole.

²⁴ Of all distributors filing the relevant information in unabbreviated accounts.

²⁵ The result for the company excluded from sector and sub-sector averages because of its irregular size.

Analysing the number of 'extra' days obtained by companies paying creditors later than they themselves are paid indicates that vertically integrated and independent distributors present the most extreme examples, companies comprising the other two sub-sectors tend to pay their creditors relatively quickly and therefore do not benefit to the same extent.

Is the stock market a useful source of finance?

A small number of companies analysed as part of the review are quoted on the Alternative Investment Market ('AIM') and investment in their shares can therefore attract ostensibly valuable tax relief for investors.

One company issued loan stock convertible into shares to raise modest amounts of working capital during the period under review, however these appear to have been issued to only one investor where the arrangement was likely to have been negotiated in advance and the AIM listing is unlikely to have been a significant inducement for the transaction, If anything compliance with AIM rules may have introduced additional costs and attracted unwanted publicity to the transaction.

Another company has repeatedly used share placings to raise capital, again these appear to have been in the nature of private arrangements made within a public company. In this case the placings were to existing directors of the company and appear to have been necessary to keep the company solvent. Its public listing appears to serve little current purpose and probably contributes to the high administrative costs relative to its peers (the second highest in the relevant sub-sector).

A third company remarked in its own accounts how the administrative cost of a listing and the disruption of undergoing an enforced offer period under stock exchange rules during an attempted re-structuring were noted as the reason for lowered performance and a diversion of resources away from the purchase of film rights. The company has relied on leveraging its intellectual property to raise institutional finance rather than turn to the general public via the stock market for capital.

Another listed film business had a similar history of corporate restructuring and changes of ownership and direction being played out in public arena to little apparent advantage and probably significant cost.

The parent of another company included in the review 'PSB1' was floated on AIM in 2007, successfully using its IPO²⁶ to raise funds for the company's films, raising \$70 million in total. Other than this company, which is perhaps still enjoying a 'honeymoon period' as a listed entity, film company stocks do not appear to be popular.

²⁶ The initial public offering

Analysis of the corporate finance of SMEs in the UK film industry

Industry sub-sector	Co. ref.	Value of trades (£000's) 2008	% of average
Average AIM listed media company	n/a	24,278	100%
Media group backing a UK production Company	PSB1	16,383	67.48%
Independent sales company	SI3	107	0.44%
Vertically integrated sales company	SVI5	63	0.26%
Vertically integrated sales company	SVI1	0.2	<.01%

Taken together these cases seem to illustrate a trend for companies from the film sector to be able to list on AIM but not to use that listing to any great effect. The IPOs may afford the original owners the opportunity to realise the value of their investment and the stock may initially be attractive to investors, however in general those companies currently listed on AIM appear becalmed. There is a very thin market in their shares and the cost and likely success of new issues appears prohibitive. Compliance with AIM rules appears to increase a company's cost base but the cost of delisting, and the possibility of finding private investors willing to buy out the existing investor base, appears equally prohibitive.

Production sector

Summary

Studio-backed production companies:

- This sub-sector makes the most popular films, and employs the most working capital.
- The most successful companies produce 'franchise' films and are highly profitable.
- The remaining companies typically generate significant losses.

Hybrid, horizontally and vertically integrated production companies:

- This sub-sector has the highest average turnover and above average profitability.
- Staff working in integrated companies earn on average three times as much as those in Independent or talent attached companies.
- The TV + film models appear to be the most successful.

Production companies with talent attached:

- Companies are thinly capitalised (just under half have insolvent balance sheets).
- They generally operate on relatively low turnover.
- The sub-sector's films typically generate the lowest box office.

Independent stand-alone production companies:

- Half of the companies recorded retained losses at their last balance sheet date.
- This sub-sector is the least liquid; companies are typically unable to cover current liabilities with current assets.
- Excluding studio-backed companies, films produced by the Independent sub-sector tend to be the most popular amongst cinema audiences.

Analysis of the corporate finance of SMEs in the UK film industry

Analysis

The accounts of 41 production companies were analysed over a period that ranges from: 1 March 2004 to 30 April 2008. These companies were allocated into four types whose average results can be summarised as:

£000's unless stated	Independent (14 companies)	Companies with talent attached (10 companies)	Studio-backed companies (9 companies)	Vertically & horizontally integrated (8 companies)
Turnover	428	456	6,664	6,235
Pre tax profit/(loss)	9	27	752	979
Fixed assets	30	19	94	110
Current assets	177	360	6,379	2,375
Creditors < 1 yr	(223)	(294)	(3,309)	(1,843)
Creditors > 1 yr	(24)	(30)	(1,536)	(47)
Total net assets	(40)	55	1628	595
Represented by:				
Share capital and other reserves	1	(16)	2,040	7
Retained earnings (losses)	(41)	71	(412)	588
Shareholder's funds	(40)	55	1628	595
Latest:				
Quick ratio	29%	53%	52%	28%
Current ratio	67%	129%	202%	104%

Studio-backed production companies

Whilst on a personal level working for a studio might be profitable, at a corporate level, the majority of the companies that enter into long term arrangements with MPAA companies generate significant losses.

However, whilst very few companies in this sub-sector are profitable, those that are typically produce 'franchise' films for the studio to distribute and are highly profitable (before payments to directors are taken into account) with strong balance sheets.

Some companies appear to be operationally relatively independent whilst being fully owned by studios. Others not owned by studios ostensibly retain some independence, but appear to be financially dependent on studio patronage.

At the furthest remove from their studio backers are those companies not owned nor attached by long term production financing deals but connected via, e.g. first look deals. Although these companies may be the most independent of all the companies in this sub-sector, they tend to make fewer films.

On the basis of the accounts, virtually all companies appear not to own the rights in the films they make.

The sub-sector has the second highest average turnover but also has the thinnest operating profit margins. Only stand alone (independent) production companies record lower net profit percentages however average annual profits before director's remuneration is far higher (£882k).

Financially this is a good sub-sector to be employed in, with average annual salaries (including directors) of £65k, the highest of all the production sub-sectors (though excluding director's the average falls to £46k, below the integrated sub-sector average of £61k.)

Perhaps predictably companies in this sub-sector have ample working capital, it is the strongest of all sub-sectors by this measure, and these companies clearly make films that reach the largest audiences, they are also the most prolific, typically producing 1 film every 12 months.

On average the companies have creditors of £3.3 million, the bulk of which are trade creditors and almost certainly much of which is owed to a single MPA member. At its most extreme one company owed £16.9 million to its studio patron.

Analysis of the corporate finance of SMEs in the UK film industry

On average studio-backed business had generated retained losses of £413k by the end of the period of review. This average is flattered by two companies with significant retained profits and the accumulated trading deficits of several of the companies reached seven figures, and in one case eight figures.

Venture capital investment in UK film businesses

Companies finance their business from a variety of sources. On average half²⁷ of SMEs in London have no external funding whilst the balance typically obtain finance from bank and similar lending or venture capital. The latter can be formal private equity (professionally managed on behalf of institutional investors) or informal investment (ranging from family and friends to organised networks of business angels).

Private investment in individual film projects is quite common. Our own research indicates that around three quarters of films made in the UK on low budgets²⁸ rely on private investment. Whilst at higher budget levels the incidence is lower²⁹, it is still a common feature of film finance plans, especially when associated with a tax incentive such as the UK film tax credit and/or an enterprise incentive scheme.

However, on the basis of our research, there are few instances of venture capital investment in those UK film businesses that make, sell or distribute the most successful UK films.

Distributor VI4 is perhaps a 'classic' venture capital success story, having been established with a very modest amount of private equity provided by a business angel, it was subsequently sold to a much larger media business for a price which reputedly will have earned its original investors a handsome return measured in whole numbers rather than percentages. Our research indicates the company is continuing to grow profitably.

Amongst sales agents; SO1 was sold by its owner/managers to another film business, the acquisition being funded by a New York hedge fund. Similarly, distributor MM3 is part of a group funded by a private equity consortium.

Sales agent VI4 is ultimately owned, and financially backed by a venture capital fund which has agreed to cashflow the company's development until 2010, producer HHV3 is part of a global production and distribution group majority-owned by a large private equity firm.

We also noted several instances of significant funding being provided by the owners of businesses themselves, eg distributor I6 and producer I7 each relied on a director or directors loaning amounts in excess of £400k in order to support their continued operation. In the case of producer HHV2 the level of support provided was even more significant, over £3 million, however in this last case the investment appears to have paid off, with a single hit film almost certainly generating enough cash to repay the borrowing in full.

²⁷ London Technology Fund/Company Guides

²⁸ 'Low and Micro-Budget Film Production in the UK', June 2008

²⁹ Based on research undertaken by the UK Film Council

Whilst equity investment by third parties is a factor in the corporate finance of the UK's film industry, on the basis of our research it appears to be the exception not the norm. Those exceptions are largely confined to larger groups with an ultimate holding company outside of the UK.

The low incidence of bank and similar institutional lending to film businesses (as opposed to film projects) is noted elsewhere in this report. Taken together this seems to indicate that on the whole UK film businesses do not have ready access to traditional sources of corporate finance other than their self-generated working capital and there is a wide 'equity gap' in the UK film industry.

Hybrid, horizontally, vertically integrated production companies

In the integrated sub-sector the predominant model is of film and television production, though integration with sales and distribution is also evident. Though the latter appears to enable more films to be released and distributed, the performance of those films appears to be relatively poor; vertical integration along the film value chain, with no other diversification of interests does not appear to be the most successful model for a production company.

In general it is the TV and film model that performs best, the more stable and continuous revenue from TV commissions apparently providing an even basis for the more uncertain and irregular returns from film production.

Three companies paid out dividends during the period reviewed (of £2.39 million in total in the last year reviewed). Two of these were TV/film hybrids and one an integrated producer/distributor/sales business.

One highly successful, principally TV company, had net assets of almost £7 million at the end of the review period, the remainder had balance sheet totals of less than £1 million.

None of the companies analysed appeared to value their IP on their balance sheets, and none had secured notable institutional credit facilities, although several companies had overdrafts with their banks and one had lent the support of its balance sheet to the raising of \$135 million in corporate finance by its parent company. Inter-group debtors outweigh inter-group creditors substantially and TV/film hybrids appear able to fund a number of SPCo.s from their own resources, the average debt being over £3.5 million, but this includes TV as well as film production subsidiaries where a commissioning broadcaster is likely to be the ultimate source of cash flow.

In terms of turnover the hybrid, horizontally and vertically integrated companies have the highest annual revenues within the sector. The integrated companies also

Analysis of the corporate finance of SMEs in the UK film industry

tend to be more profitable, average operating profits (before director's emoluments are charged) being just under £1 million. Without recourse to management accounts it is not possible to determine the extent to which turnover and profits accrue from film activities, but integration ostensibly offers an attractive model from the viewpoint of film production.

Integrated companies tend to be large in terms of staff numbers (probably because they tend not to use single purpose companies, at least for some of their activities), with median average headcount (excluding directors) of 30. Average salaries (excluding director's emoluments) were £61k – above their studio backed peers and three times the average salary earned by staff working in stand alone film production companies, or those with talent attached.

Their financial control appears to be good, collecting debt and paying suppliers faster than sector averages.

Their integration with other businesses appears to slightly hinder their productivity, with the average volume of films produced being second lowest in the sector, those films also tend to generate the second lowest average gross box office of all production sub-sectors at £1.7 million.

Trade credit within the film value chain

As can be seen from the above analysis, trade credit; the amounts owed by one company to another, plays as important a part in the corporate finance of most UK film businesses as any other source of funds.

Distributors take the longest to pay their creditors (69 days) followed by sales agents (58 days on average) and producers (50 days). Although the figures appear relatively smooth in their grading, these averages do cloud a huge range in the practice of paying creditors within the industry.

Average payment practice ranges from extremely efficient: a matter of days in the case of one company, to over nine months for another.

The vast majority of trade credit in the UK film industry is tied up within the distribution sector³⁰; over £57 million for the distribution companies analysed as part of this review. Were distributors to cut the time taken to make payment by 50%, around £28 million would be released 'upstream'³¹.

In some instances, given the frailty of their balance sheets, it might be difficult for some distributors to reduce the time taken to pay their creditors as there may simply not be enough money in their business to make a sudden shift in policy, even if they wanted to. However there are some stark examples where the businesses are clearly able to pay their creditors more promptly but, ostensibly, chose not to.

Sales agents are, on average, the second most dilatory sector in making payments, however there is typically less weight of money contained in this part of the film value chain, probably because of the frequent use of collection agents whereby payments are directed to collection accounts rather than to sales agents own bank accounts. £16.4 million of trade creditors was accounted for in total by the companies forming the sub-sector reviewed as part of this study.

The terms on which producers pay creditors are likely to be more varied than is the case with distributors and sales agents, in particular amongst those companies in receipt of support from a well resourced trade creditor such as an MPAA member company. However, there do appear to be instances of inexplicably poor practice; one company in the talent attached sub-sector taking an average of 216 days to settle amounts due to suppliers.³²

³⁰ Distributors may only be enjoying the luxury afforded by the customary terms of trade within the industry whereby accounting is made quarterly. If one assumes that, on average, revenues are received mid quarter, that would give approximately 45 days before the distributor 'ruled off', add another month to issue the accounting statement and around 5 days to make the payment and the 69 day average would appear comfortably in line with industry custom and practice.

³¹ Though a significant part of this would flow upstream to the industry based outside of the UK.

³² This company was not included in the sub-sector and sector averages as it was deemed anomalous

Production companies with talent attached

Average turnover is the second smallest of all the production sub-sectors, less than one-tenth of the next placed sub-sector (the studio-backed production companies).

The sub-sector is very thinly capitalised, this has worsened during the period under review, and the sub-sector also exhibits significant volatility amongst its members' results. Four companies had insolvent balance sheets, the highest deficit being just under £400k. There were no examples of particularly strong balance sheets within the sub-sector, those companies that do make profits perhaps taking the cash out of the business as remuneration as soon as they are able.

The typical (median) company employs four people, but a small number of relatively large employers increased the average number of staff including directors to over five. The average salary including directors is £20k, but this may exclude any fees paid directly by a SPCo, to eg a producer or director of a film, though, as for independent stand-alone films, this appears unlikely³³.

In terms of liquidity the sub-sector in general is able to cover its liabilities with its current assets, with an average current ratio of 123%.

With average gross box office per film of £1.3 million, the sub-sector's films are the lowest performing of all the sub-sectors, just over a quarter of the average gross for all films analysed in the sector. However, they tend to be relatively stable/predictable with 'hit' films averaging only slightly above the average gross box office for all films analysed for each company.

No company analysed or valued the intellectual property they hold on the balance sheet. Two companies had overdraft facilities. One had a six figure facility, this company being one of the most prolific in terms of the number of films produced and having one of the stronger balance sheets in the sub-sector.

The two companies in the sub-sector that appear the most successful have diversified their income streams and receive revenue from operations outside of feature filmmaking, appearing to generate significant revenues from the production of music videos and commercials.

³³ Please see the separate section further analysing this issue.

Public sector investment in UK film businesses

There is substantial public funding of UK film, currently around £280 million p.a.³⁴ Between a third and a half of this is typically provided via HM Revenue and Customs, mainly in the form of the UK film production tax relief³⁵ which is paid to companies that produce films certified as British, including subsidiaries of foreign companies that make films in the UK such as the US studios.

Independently produced films are typically financed from a number of sources that fund SPCos established with the single aim of producing an individual film. Whilst these tend to be subsidiaries of production companies, the production tax relief typically mitigates the risk for investors in the production and reduces the extent of investment required. The tax relief therefore arguably supports investment in film projects rather than film businesses.

UK film businesses can also utilise tax relief intended to support businesses generally, including Venture Capital Funds and Enterprise Investment Schemes. The latter is often used in combination with the specific production tax relief to fund SPCos and further mitigate the risk for investors. We did not, however, observe³⁶ the use of either VCT or EIS relief in financing any of the film businesses included in this study.

The BBC and Channel4 invest in and buy broadcast licences from special purpose companies, historically spending around £10 million each via their film divisions³⁷.

The UK Film Council invests in film projects, at the development, production and distribution stages. It also supports a range of other activities, either directly or via third parties such as the British Film Institute ('BFI'). The BFI supports film education and film heritage (including the national archive). The direct³⁸ expenditure of the UK Film Council and the BFI is currently around £37 million p.a. each, neither makes any material investment in film companies per se.

The UK's National and Regional Screen Agencies (NSAs and RSAs) also support a wide range of film related activities, spending £40-£50 million p.a. The UK Film Council provides funding to the NSAs and RSAs as do the English Regional

³⁴ £284m for the year ended 31st March 2008. Please see the UK Film Council Statistical Yearbook For a detailed analysis of expenditure

³⁵ The exact amount depends on the value of production spend in any one year.

³⁶ It may be the case that such relief was utilised and not disclosed in the accounts examined, however the use of the relief would typically be reflected in certain entries in a companies accounts, e.g. the issuance of share capital. Whilst we can't be 100% certain, we are therefore confident that their use outside of SPCos is rare.

³⁷ The BBC has recently increased its investment and Channel Four's has decreased, however the aggregate expenditure remains at around £20 million p.a. Please note this excludes amounts paid to acquire licences to broadcast British films after they have been produced.

³⁸ Excluding grants and expenditure delegated to other public organisations

Development Agencies and similar agencies in Northern Ireland, Scotland and Wales. The EU also provides assistance to film companies either directly via its MEDIA programme or via other programmes such as the ERDF³⁹, which is typically channelled through NSAs and RSAs. Despite a significant recent increase in the former, in aggregate EU funding amounts to less than £20 million p.a. All this expenditure is typically directed at individual projects or used to fund training and advice rather than direct investment in businesses.

Taken together, we believe that public sector investment in film businesses, as opposed to financial support for their activity, is nugatory. On average perhaps less than £1 million p.a.

³⁹ European Regional Development Fund

Independent stand-alone production companies

Half of the companies in the sub-sector recorded retained losses at their last balance sheet date and would appear to be unable to repay their creditors in full, even if they could successfully call in all of their debts, should they go into liquidation.

The balance sheets are generally very weak, on average having net liabilities. Four of the seven companies with retained losses have less than £20k in cash. There is one incidence of a director injecting around £0.5 million into their business during the period of review, despite which it had net liabilities of almost £100k by the end of 2008. The worst example of the sub-sector's tendency for precarious balance sheets shows a deficit of almost £800k in 2008. Those companies that do have a solvent balance sheet have average net assets of less than £70k.

Only two of the companies had fixed assets of any significance and only three appeared to have had access to an overdraft. No company valued its IP on its balance sheet. Whilst this may be stating the obvious, the most successful companies in this sub-sector appeared to be those that make more films. In general independent production companies are, however, the most infrequent producers of films, 1 every 18 months on average, compared to 1 every 12 months for the talent attached sub-sector.

At £15k p.a., average annual profits before director's remuneration are the lowest of all the models; around 40% of the talent attached sub-sector and a mere 1% of the studio backed sub-sector's average results. This may understate the amount earned by the directors; producer fees may be paid directly to them from the single purpose companies established to produce their films, however this does not appear to be the case⁴⁰. For other staff the average salary is about the same as for production companies with talent attached, but about half of earnings in companies backed by a studio and only a third of average earnings in a hybrid business.

The current ratio for the sub-sector compares poorly with other models, it is the only sub-sector unable to cover current liabilities with current assets. In addition, very little of their liabilities are covered in cash, the second lowest of all the types of business, perhaps because their directors take what cash is available out of the businesses as soon as they are able.

It appears to be the case that, as a class, independent producers are highly effective as well as being economic (in terms of the fees they receive). Taking the highest grossing films from each production sub-sector (excluding studio-backed

⁴⁰ Please see the separate section further analysing this issue.

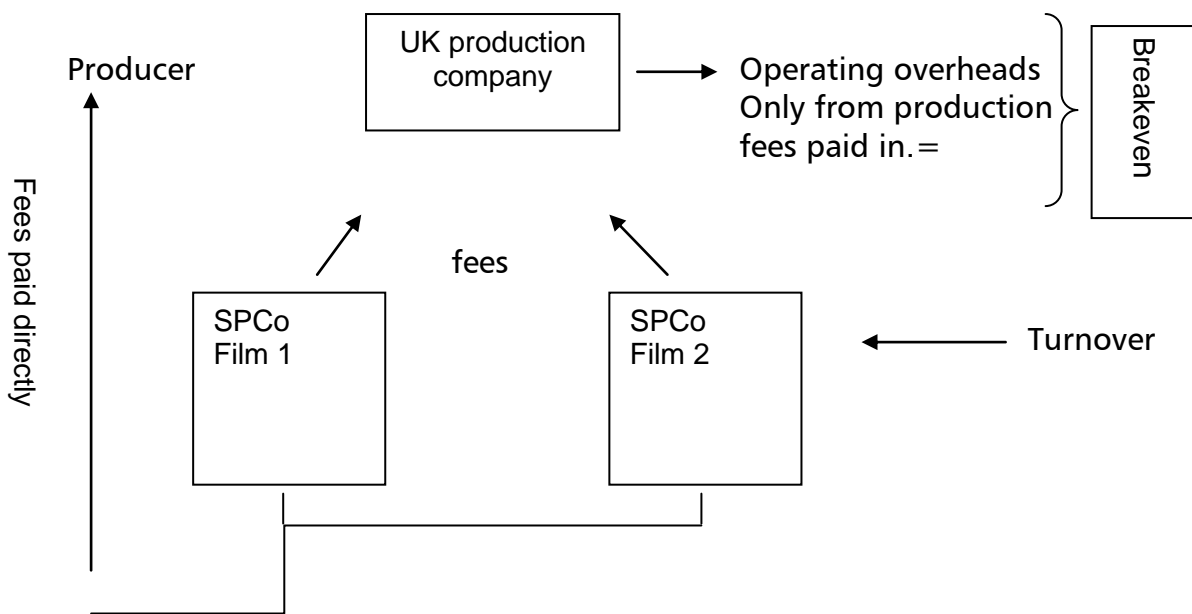
companies), those produced by businesses in the independent sub-sector tended to be the most popular amongst cinema audiences⁴¹.

⁴¹ In terms of box office, whereas 80% of films produced by independent stand alone producers were at or above the median, only 40% of films produced by 'talent attached' companies or integrated companies were. The analysis was performed on a limited sample of the five best performing films produced by companies allocated to each sub-sector and whilst the sample frame is narrow and does not take account of other factors, such as size of production budget or marketing spend, there appears to be a strong correlation of higher than average result with production by a stand alone independent production company.

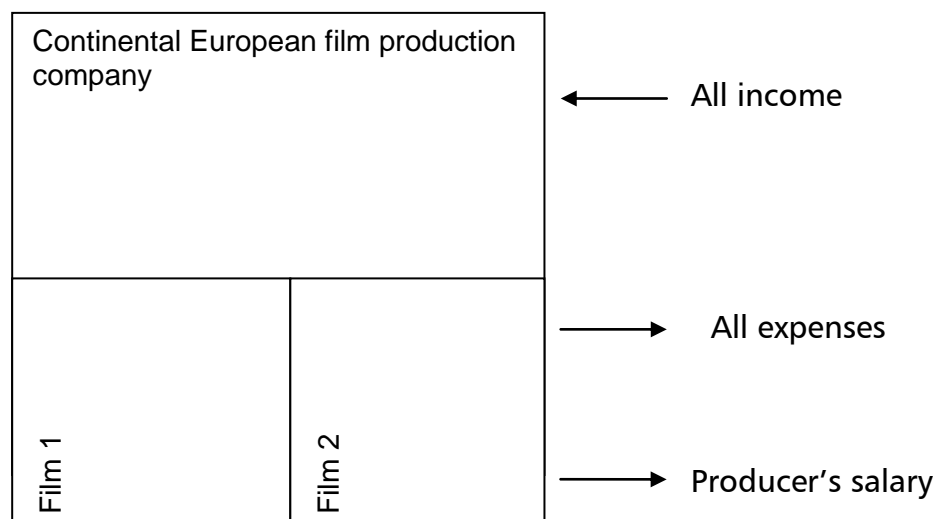
Producer's fees: hidden value?

UK film production typically employs single purpose companies to produce individual films whereas in continental Europe this practice is much less common. The UK structure potentially allows the owners of production companies to earn fees without these transactions being reflected in the main production company's accounts, in which case the observations made during our research may have failed to capture the 'hidden value' of being a producer (or a writer or director that owns/co-owns a production company).

**UK production model
(Hypothetically allowing the 'siphoning-off' of fees):**



The continental production model:



Analysis of the corporate finance of SMEs in the UK film industry

In order to gauge the value of these potential 'off balance sheet' transactions all films produced by the independent stand alone production companies and production companies with talent attached included in this report and co-financed by the UK Film Council during the period of review were identified. Films produced by companies filing abbreviated accounts were excluded, leaving films produced by five companies. All other appropriate publicly available accounting information, including for the relevant special purpose companies, was analysed along with the final cost report for each film.

During the period of review, of the five companies, only one recorded a turnover figure lower than the amounts⁴² ostensibly payable to it. Even in this solitary instance, an amount that could represent fees paid appears to be included as administrative and other operating income. In all other instances there appears to be a correlation between the amounts payable per the cost reports and the income recorded in the accounts of the production companies.

It is beyond the scope of our research to attempt to arrive at a definitive answer, to do so would require access to information on individual transactions, however on this limited evidence base it appears that there is no wholesale understatement of the income generated from the business of production as postulated by the first diagram above.

Given the frail state of many balance sheets in the sector and the low frequency of production, it is unlikely that even what 'off balance sheet' value there might be in being a truly independent producer would significantly alter the fundamental corporate ill health of much of the sub-sector.

⁴² These amounts being: all development expenditure, and production, producer's and, where relevant, director's fees, from the films' budgets.

Appendix I: Glossary

CALCULATIONS

Averaging of results (with reference to footnotes 7 and 21):

Due to the variation in availability of annual accounts for the sample companies, average results for each company were generated from the available information and then averaged again to give sub-sector averages. Sector averages were calculated by taking the average results for each company and averaging them again (i.e. rather than simply totalling the sub-sector averages and dividing by the number of sub-sectors).

Creditor days: The **creditor payment period** is an efficiency test that measures how long a company takes to pay its bills.

$$\text{Creditors collection period} = \frac{\text{Trade creditors}}{\text{Cost of sales}} \times 365 = \text{days}$$

Current ratio: The **current ratio** expresses a company's current assets in relation to its current liabilities; this indicates its ability to meet short term obligations.

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}} \times 100 = \% \text{ ratio}$$

Debtor days: The **debtor payment period** is an efficiency test that measures how long on average customers take to settle their bill: ie how long the company takes to get paid.

$$\text{Debtors collection period} = \frac{\text{Trade debtors}}{\text{Turnover}} \times 365 = \text{days}$$

Gross profit margin: Expresses **gross profit** as a percentage of turnover, the operating profit margin does the same for operating profit.

$$\text{Gross profit margin} = \frac{\text{Gross profit}}{\text{Turnover}} \times 100 = \% \text{ ratio}$$

$$\text{Operating profit margin} = \frac{\text{Operating profit}}{\text{Turnover}} \times 100 = \% \text{ ratio}$$

Quick ratio: The **quick ratio** (also known as the **acid test ratio**) expresses a company's cash in relation to its current liabilities; this is a more stringent indicator of a company's liquidity.

$$\text{Quick ratio} = \frac{\text{Cash}}{\text{Current liabilities}} \times 100 = \% \text{ ratio}$$

Return on capital employed: ROCE measures the amount of profit earned as a percentage of capital employed.

$$\text{ROCE} = \frac{\text{Operating profit}}{\text{Total assets} - \text{current liabilities}} \times 100 = \%$$

TERMS

Equity gap

Many SMEs require much greater funding than that which can be provided by business angels, but do not need the levels of funding venture capitalists would consider (typically > £2m). The gap between these two financing situations is known as "the equity gap".

Hit film

For the purposes of this analysis each company's 'hit' film is that which records the highest UK gross box office for the period reviewed; a company's best performing feature film in the UK.

Independent company

A company operating as a single entity rather than being under the control of a larger company or group.

Insolvent balance sheet

A balance sheet exhibiting negative net assets, ie the company's liabilities exceed its assets. Please note, this does not necessarily mean that the company is insolvent, it may be the case that the company owns assets that are not valued or undervalued in the accounts or that it can rely on the support of a parent company, a shareholder or a third party, (eg a studio) for financial support.

Mini major

A distributor operating the same model as an MPAA member (major) studio, with interests in production / financing, sales and distribution, employing economies of scale and distributing mainstream films (albeit on a smaller scale), but without being an MPAA member or matching their scale of operation.

Hybrid, horizontally, vertically integrated company

A company operating in more than one business sector, eg a vertically integrated film production and film sales company, or a horizontally integrated company operating film and television production businesses.

Special purpose vehicle or single purpose company

A company separate to the permanent production company, set up for the production of an individual film through which the finance for that film flows.

Appendix II: About Northern Alliance

Northern Alliance Limited

Analysis of the corporate finance of SMEs in the UK film industry

Northern Alliance is a Chartered Accountancy firm that provides accounting, tax, financial, management and business consulting services to private and public sector organisations and individuals, especially to those operating in the media, entertainment and creative industries.

We have substantial practical knowledge of and expertise in how both the private and public sector work. The range of our experience extends throughout Europe, Asia and North America.

The Northern Alliance team that performed the analysis of the corporate finance of SMEs in the UK Film Industry consisted of Michael Franklin and Mike Kelly.

Northern Alliance Limited is a member of the Institute Of Chartered Accountants Practice Assurance Scheme, which has been designed to demonstrate to the business community and the wider public the Institute's commitment to upholding and developing public standards that command public confidence. Further details can be obtained from; www.icaew.com.

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