FILM + TV PRIVATE CREDIT INSIGHTS

“Media Production Lending and Private Credit”

2023

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Introduction

Welcome to the latest Film + TV Private Credit Insights Report, brought to you by the research team at FilmHedge!

FilmHedge (http://filmhedge.com) offers financing opportunities, credit data, risk-ratings, and other financial data solutions for investors interested in Film and TV financing as an asset class.
Overview

In a low-growth, illiquid market, growth and liquidity are priceless.

In this report, we wanted to benchmark the KPIs of Media Production Lending (MPL), a type of Specialty Finance, against other attractive areas for capital allocation by investors like Venture Capital, Real Estate, Public Markets, and Private Equity.

Concurrent strikes in Hollywood seemed to threaten the overall Film and TV production ecosystem but actually ended up strengthening an emergent source of finance for the industry: Private Credit.

With the Screen Actors Guild and Writers Guild threatening to blacklist talent who crossed picket lines to work on studio productions without waivers, studios and streamers were no longer a viable source of funding for producers seeking capital. They, instead, turned to Private Credit and Specialty Financiers like FilmHedge.

With the strikes ending, the opportunity for private credit financing has never been greater. As a much-needed lifeline offered to producers during the 2023 strikes (and during the 2020 Covid lockdowns), producers are now aware that studio financing is not their only avenue to production financing. Private credit has proven to be uncorrelated with markets, resilient during slowdowns, while offering them more control and ownership over their productions versus studio financing.

Investors interested in MPL can use the information in this white paper to better understand how it might fit within their existing portfolios and compare the potential returns to that of the other asset classes referenced.
Notes and Disclosures

Throughout the document you may notice superscript numbers (ex. 123). These superscript numbers reference citations, links, or articles that can be found at the end of the document.

Unless otherwise stated, all financials are unlevered as the costs of doing business and fund structure vary greatly across the industry.

The sample size benchmarking MPL is limited to our own data at FilmHedge (our own lending or lending by our partners) while the trends for VC, PE, RE and others are overall industry trends and the summation of activity across multiple firms who disclosed financial KPIs.

To our knowledge there were no industry-specific datasets or studies on media lending, so we use our own datasets as a proxy for the greater industry. This is because FilmHedge is not just a lender. Rather, we also warehouse financial data related to productions across the entire Film/TV industry.

FilmHedge analyzes the financials of over 300 productions annually which accounts for between 10-15% of all films (2500-3000) released theatrically, on streaming platforms, networks, or cable annually.

Traditionally, the financial data of unreleased Film and TV productions was only available to the banks and studios that financed them. As a platform for media financiers, we have the same level of access to data. This includes anonymized financial disclosures about production budgets, deal size, debt vs. equity finance ratios, State and International tax credits, interest rates, etc.

That said, our data is not comprehensive of the entire MPL industry (and can’t be) without future participation by all media lenders.

The methodologies for collecting the data from various asset classes may differ as the benchmarks were assembled from multiple reports carried out by different teams. The respective asset classes weren’t always of interest in the same ways to the surveyors and researchers, so, in some cases, reports were combined for insights.

We made our best efforts to normalize these disparate data sets so that they could be used for the purposes of this study.

That said, this research was limited by the above constraints and should be reviewed with as much in mind.
Private Credit

Private credit (sometimes shortened as ‘PD’ for private debt) funds have risen sharply over the past decade, with average growth of 13.5% per annum. Investments hit a record $193.4 billion in 2021, and now total $1.21 trillion globally.

Private credit AUM is expected to reach $2.69 trillion by 2026; and may overtake real estate in a few years.¹

As of 2023, private credit makes up between 10% to 15% of total assets under management (AUM) in the private markets, ranking it as the third-largest asset class after private equity and real estate.²

Private credit encompasses a range of alternative credit strategies that can offer higher yields than traditional strategies like fixed income. These strategies provide financing to deals not served by banks and appeal to investors due to potential for enhanced returns.

Private Credit Definitions

The following definitions may be helpful to those unfamiliar with each strategy:

**Senior Debt/Direct Lending** - The vast majority of Senior Debt managers pursue a sponsor coverage model, developing relationships with PE managers. They generate returns from current cash pay coupons composed of a fixed credit spread and a fixed reference rate (usually Libor).

Senior debt funds can be levered or unlevered. Unlevered gross returns tend to be around 6% to 10%; levered gross returns may reach 15%.

**Distressed Debt** - Distressed corporate credit managers typically target middle- to large-capitalization companies and purchase deeply discounted debt securities, either in the market or bilaterally. They then endeavor to generate returns through negotiation, using the leverage they are afforded as creditors.
**Mezzanine** - Mezzanine managers provide junior capital to finance buyouts or acquisitions, typically making subordinated loans to lower-middle-market and upper-middle-market borrowers. Returns come from cash coupons over 10%, prepayment penalties, PIK interest, purchased equity/warrants, and penny warrants. Document negotiation is constrained by senior lenders and pricing closely follows market trends.

**Special Situations/Specialty Finance** - Managers target niche industries, requiring highly specialized expertise and unique lines of inquiry.

Media Production Lending (MPL) is a type of Specialty Finance.

**Venture Debt** - Venture debt financing is a finance strategy used by early-stage companies looking to raise capital but who do not yet have a proven track record of generating revenues. Unlike traditional forms of debt financing, venture debt is typically provided by specialized lenders who are willing to take on a higher level of risk (against speculative receivables) in exchange for the potential of higher returns.

**Trade Finance** - Short duration and risk-adjusted returns uncorrelated with traditional investments. Trade finance lenders often have priority claims, or liens, on the goods being financed. This strong asset security helps ensure recovery rates are high and default rates low.

These various strategies span a risk/return spectrum from capital preservation to return maximization. Capital preservation focuses on predictable cash flows from debt-like instruments. Return maximization targets greater upside through distressed debt or equity-like exposures but where risk is still managed.
Private Credit Strategy Performance Index

<table>
<thead>
<tr>
<th>Performance Measures</th>
<th>All Funds</th>
<th>Direct Lending</th>
<th>Distressed Debt</th>
<th>Mezzanine</th>
<th>Special Situations</th>
<th>Venture Debt</th>
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<tr>
<td>Internal Rate of Return (IRR)</td>
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<td>110</td>
<td>137</td>
<td>128</td>
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<td>137</td>
<td>128</td>
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<tr>
<td>Mean</td>
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<tr>
<td>SD</td>
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<td>0.18</td>
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<tr>
<td>Public Market Equivalent (PME) - HY</td>
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<tr>
<td>Mean</td>
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<tr>
<td>Public Market Equivalent (PME) - S&amp;P 500</td>
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Source: Böni, Pascal and Manigart, Sophie, PRIVATE DEBT FUND RETURNS, PERSISTENCE, AND MARKET CONDITIONS; June 28, 2022; Financial Analysis Journal, forthcoming, Available at SSRN: ssm.com/abstract=3932445 or dx.doi.org/10.2191/issn.3932445

Ranking Private Credit Strategy Performance

<table>
<thead>
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<th>Rank</th>
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The above charts analyze the performance of private debt funds with different strategies: Direct Lending/Senior Debt, Distressed Lending, Mezzanine, Special Situations (a.k.a niche opportunities and specialty finance), and venture debt.

Specialty Finance offered the highest possibility for returns (Mean IRR of 12.62% with a Standard Deviation of 23.10 suggesting returns can vary wildly above the average).

This means that both on a dollar-for-dollar basis, and considering outlier scenarios, Specialty Finance outperforms other asset classes.
Ranking Private Debt (PD) Strategy Performance

Private Credit managers employ specialized expertise to source deals and manage portfolios. Investment processes diverge after funding a loan or purchase. Exits rely on assets reaching maturity or having predictable cash flow streams.

Distressed credit thrives on volatility while mezzanine struggles.

Senior debt is the most resilient. Specialty strategies (like media production lending) depend on the strength of underlying assets and collateralized receivables.

Risks include scale requiring extensive infrastructure, leverage potentially forcing asset sales, and legal jurisdiction impacting creditor rights. Thorough due diligence is critical before investing.

In summary, private credit encompasses a wide range of alternative strategies that can enhance portfolio diversification and yield. However, the complex strategies require in-depth manager evaluation to align with investor objectives and risk preferences.
Key Insights

Private credit is a broad category encompassing strategies that provide financing to companies not served by traditional lenders and banks.

Private credit managers provided over $750 billion in financing globally in 2020.

Strategies include direct lending (largest segment at over 50% of assets), distressed debt, mezzanine financing, and specialty finance.

Private credit offers potential for higher returns than traditional fixed income. Median net returns were 8-12% for private credit vs 3-5% for fixed income from 2010-2019.

Private credit investments tend to have low correlation to other assets like public equity and real estate, improving portfolio diversification.

Capital preservation strategies like mezzanine and senior debt seek predictable returns with lower risk. Target returns are mid to high teens.

Return maximization strategies like distressed debt and capital appreciation target higher returns, from mid-teens to 20%+.

Leverage is widely used by senior debt funds to enhance returns but brings risks of forced asset sales.

Legal jurisdiction greatly impacts creditor rights and recoveries. US, UK, Canada have strong creditor protections.
Venture capital (VC) in the latter part of 2023 nearly hit the lowest levels in deal counts and deal values within a six-year period. Although these headline figures are significant for understanding overall progress, without proper context, they can create confusion.

There was a decrease in early stage deals as well as in megadeals of over $100 million. The latter went from comprising 60% of deal value in Q4 2021 to 48.5% of deal value in Q3. In terms of industry trends, software deals are at a multiyear low while life sciences investments have seen an increase in relative share since 2020.
In 2022, a majority of capital was concentrated in the hands of the biggest funds, with almost half going to those valued over $1 billion. The proportion of money invested in funds between $100 million and $1 billion surged throughout the year, making up nearly two-thirds of all investments in 2023 so far.

In spite of this stronger performance from midcap funds, it has been a challenging year for emerging managers seeking to raise their first fund, with nearly three out of every four dollars raised in 2023 being allocated to an established manager, and first-time funds close to their lowest count in a decade.

Overall, the market is still under great strain. More businesses are taking bridge loans or have had to downsize; inner financing rounds are at record highs; and there are fewer rounds where a new lead investor gets a seat on the board than ever before.

“Overall, the venture capital market is still under great strain.”

Investors and entrepreneurs alike are striving for security and cash flow. Nevertheless, the market is well funded, and additional sources of liquidity from federal programs such as the Inflation Reduction Act and CHIPS & Science Act will soon be accessible. Additionally, sectors such as AI and life sciences are tapping into key competencies within US research and industry. Further investment into research-intensive industries like these could unlock substantial value. Even though the past 18 months have seen levels of chaos that would have been unimaginable just years ago.

**Key Insights**

Here are a few key points about venture capital performance in comparison to public markets as an asset class prior to 2020:
• VC has historically outperformed public market returns over longitudinal time horizons (5, 10, 15 or 25-years). This outperformance tends to be substantial, often in the range of 300-500 basis points per year above public market returns.

• The outperformance tends to increase with higher allocations to VC by limited partners (LPs). Investors putting 15% or more into VC saw returns 300 bps higher than those with <5% in VC over a 10-year period per the Cambridge data.

• However, VC comes with higher risk, low liquidity, long time horizons, and more complexity than public markets. The outperformance is compensation for these factors.

• Overall, VC has been an attractive asset class for investors, provided they have the risk appetite, time horizon, capabilities, and access to tap into this outperformance.
An Upset Market: U.S. Venture Capital Trends as of Q3 2023

Venture capital funds have seen sharp declines in returns over the past year, registering their first negative quarters in over a decade. This downturn reflects the broader slump hitting tech startups, as VC funds finally mark down inflated valuations of companies they invested in at peak prices.

“This marks the fifth straight quarter of declining returns in venture capital.”

Data shows VC yearly internal rates of return dropped to -7% in Q3 2022, the lowest level since 2009. This marks the fifth straight quarter of declining returns, the first time this has happened in 10 years and a stark drop from pre-2020 levels. While investors remain optimistic about long-term potential in sectors like AI, some are re-evaluating VC exposure after the severity of the declines, making more discerning choices on which new funds to back.

The boom years saw record VC returns, attracting increased investment, but easy money led to inflated startup valuations that now require markdowns. Funds deploying capital at peak prices will likely see poor returns. Major players like SoftBank and Stripe have already taken big valuation hits. Industry analysts say more write-downs are coming as startups raise cash at lowered valuations. A full recovery will take years of business growth at the new, lower valuations.

Key Insights

In the previous section, we outline the historic profile of venture in comparison to public markets. In this section, we explore the changed state of venture capital in 2023:

- Deal value and count (number of deals done) in Q3 2023 were the lowest in years, with $36.3B invested across 2,935 deals.3
- This continues a downward trend from the 2021 VC peak, with 2023 annual deal value pacing to be the lowest since 2019.3
- Pre-seed and seed deal activity has fallen back to pre-pandemic levels, with $3.2B invested across 1,214 estimated deals in Q3.3
- Median seed deal size remains at record highs of $5.3M, but deal count is pacing to fall below pre-pandemic levels.3
- Early-stage deal value in Q3 was $8.5B across 1,341 estimated deals, the lowest quarterly totals since 2017.3
- Median early-stage deal size is down 27% from 2021 to $4.9M but remains above pre-pandemic levels.3
- Late-stage deal activity continued to decline in Q3, with $13.3B invested across 1,074 estimated deals.3
- Late-stage median pre-money valuation has fallen 13% in 2023 to $130.3M.3
- There was an increase in Q3 exit value to $35.8B across 284 estimated exits, largely driven by the IPOs of Instacart and Klaviyo.3
• But IPO performance remains challenging, with public listing exit value down 50% since early 2022. ³
• 344 funds have raised $42.7B in 2023 so far, the lowest count since 2014 and pacing to be a 9-year low. ³
• 73% of capital raised has gone to established managers, while first-time funds are on pace for their lowest count in 10 years. ³
• Median fund size remains elevated at $164.7M, on par with 2021 record high. ³
Closely related to venture capital is angel investing. Angel investors also take risk investing in earlier stage companies but even earlier in the life of high-risk companies than VCs. In fact, venture capital is a significant driver of value for angel portfolios and follow-on investments by VCs is a big part of the typical angel strategy.

Analysis on Angel Capital Association (ACA) data reveals how it, as an investment strategy, benchmarks against other asset classes.

The analysis finds that while angel investing has the potential for extremely high returns, with 25-30% average internal rates of return over multi-year periods, the dispersion of outcomes is also very high.8

A few "grand slam" investments account for the majority of gains (much-like like venture). Therefore, angel investors should diversify across a portfolio of early-stage investments and limit their allocation to this high-risk, high-return asset class. John Harbison of ACA recommends investors make angel only 10-20% of their overall portfolio.

The data shows angel returns exceed even the top quartile returns for public equities, bonds, and most other asset classes over comparable multi-decade periods.
In their study, ACA compared the return performance from two of their vintage portfolios against various asset classes and found they outperformed them all by nearly 20 points.

<table>
<thead>
<tr>
<th>Index</th>
<th>5-Year Return</th>
<th>10-Year Return</th>
<th>15-Year Return</th>
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</thead>
<tbody>
<tr>
<td>DJIA</td>
<td>9.9%</td>
<td>11.8%</td>
<td>9.4%</td>
</tr>
<tr>
<td>NASDAQ</td>
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<td>15.8%</td>
<td>12.7%</td>
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<tr>
<td>SP500</td>
<td>11.8%</td>
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<td>Russell 2000</td>
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<tr>
<td>Emerging Market Index</td>
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<tr>
<td>Bloomberg VC Index</td>
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<td>16.4%</td>
<td>10.3%</td>
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<tr>
<td>CTAN (17-Year)*</td>
<td>-</td>
<td>-</td>
<td><strong>31.0%</strong></td>
</tr>
<tr>
<td>TCA (25-Year)*</td>
<td>-</td>
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<td><strong>25.2%</strong></td>
</tr>
</tbody>
</table>

CTAN is the Central Texas Angel Network and TCA is Tech Coast Angels, two groups of angel investors. The IRR for Central Texas Angels Network’s 115 outcomes between 2006-2022 is 31.0% and the IRR for Tech Coast Angels’ 247 outcomes between 1997-2022 is 25.2% (assuming equal allocations to all companies in the portfolios).

The blended average of the two ACA portfolios is 28.1%.

**Key Insights**

- The internal rate of return (IRR) for the CTAN portfolio of investments between 2006-2022 was 31%.
- The IRR for 247 outcomes from the Tech Coast Angels between 1997-2022 was 25%.
- Previous studies (of different angel portfolios) consistently show IRRs for angel investing was in the 22-27% range.
• 66% of all VC funds yield less than 10% returns, per CB Insights data.
• Angel returns outperformed even the highest quartile returns for public equities, bonds, hedge funds, and other asset classes over comparable multi-decade periods, per Blackrock data.
• At Tech Coast Angels, 8 companies representing 3% of outcomes produced 77% of dollars returned. Like VC, a few companies accounting for the majority of returns indicate an effective investment strategy.
• A Monte Carlo simulation by researchers shows a wide dispersion of potential returns for a portfolio of 25 angel investments.
• The dispersion of returns is much higher for early-stage angel investing than for most other asset classes like public equity, VC, hedge funds, etc.
• Experts recommend limiting angel investment to 10-20% of overall portfolio, given high risk and return dispersion.
Venture Debt

Venture debt is a form of financing that provides capital to early-stage startups and growth companies in the form of debt rather than equity. Unlike conventional debt, venture debt does not require personal collateral and instead relies on the company’s future potential, contracted receivables, and growth prospects.

Venture debt deals often include warrants which give the lender the right to purchase equity at a preset price in the future if the company succeeds. As debt, venture debt has a senior claim on assets and cash flows. Overall, venture debt allows startups to raise non-dilutive capital, maintain ownership and control, while supplementing equity financing from investors.

This market is dominated by alternative venture capital firms, with banks and credit funds expected to account for $52.2 billion raised next year. The maturation of the venture debt market points to this form of financing becoming a critical piece of the startup funding mix alongside venture capital.

Driving overall momentum is the United States startup and venture ecosystem, which remains the epicenter of activity. The US is expected to generate $28.6 billion in venture debt volume this year, far surpassing other countries.

While venture capital captures more headlines, venture debt is rapidly emerging as a key component of startup capitalization tables. As more investors become familiar with the mechanics of venture lending, debt options will likely continue expanding in tandem with VC to provide startups with a more diverse range of financing options. With projected volume approaching $60 billion, it is clear venture debt is emerging as an essential, complementary piece of the startup fundraising toolkit.
Early-stage venture debt deals have declined since the implosion of Silicon Valley Bank, which had catered to early-stage startups with debt products and other services. This trend is a sign of lenders imposing higher standards of startups with uncertain financial prospects failing to qualify for new loans.

In the first six months of 2023, the number of loans for angel-backed and seed-stage companies fell 44% year-over-year, and early-stage loans fell 45%. That's compared to declines of 27% and 39% for the late stage and venture growth stage, respectively.²

Overall venture debt appears to be on the decline.
Key Insights

- Across all stages, startups closed $6.34 billion across 931 venture debt deals in Q1 and Q2 of 2023, compared to $20.07 billion across 1,513 deals in the same period the previous year.
- Early-stage deals fell by 45% and angel/seed stage deals fell 44% in the first half of 2023 compared to 2022.
- Late stage and venture growth deals fell less sharply.
Media Production Lending

Media Production Lending (MPL) is an area of specialty finance that allows investors to provide private credit solutions to well-collateralized media assets while they are still in production (which eliminates performance risk at the box office or with audiences). MPL is collateralized by receivables issued by mostly public and credit-rated studios & distributors (like Netflix, Amazon, Apple, Disney, etc.) and sometimes smaller but reputable firms (like Highland Film Group or Lionsgate).

The average Media Production loan term is 12-15 months, yielding 15-27.5% APY per loan.

MPL is uncorrelated and most comparable to Trade Finance, another area of Specialty Lending. Like Trade Finance, Media Production Lending offers short duration, high yield, risk-adjusted returns uncorrelated with traditional investments. The average MPL loan term is 12-15 months, yielding 15-27.5% APY per deal unlevered.
MPL differs from media investing in that investment returns are uncorrelated with box office and audience performance, while base MPL returns are not. MPL is a form of lending against media prior to distribution or release. Therefore, MPL is an investment strategy for investors interested in returns from media productions without the risk of being equity investors in media productions.

### Ranking Private Debt (PD) Strategy Performance

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It should be noted, then, Media Production Lending significantly outperforms Specialty Finance:

### Media Production Lending Compared to Specialty Finance

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</tbody>
</table>

Note: The sample sizes in the above examples are admittedly skewed. The underlying data for Specialty Finance looks across returns from multiple funds in that space while Media Production Lending only looks at data from FilmHedge’s own portfolio. This analysis acknowledges it is limited in that regard.

### The Gilded Age: How Hollywood Business Models Have Changed

What is driving the emergence of MPL as a form of financing for Film and TV productions?

The movie industry has gone through a tremendous transformation in the last few years – streaming giants, artificial intelligence, and the rise of independent films have changed the game substantially. But we’re entering a new era that is in many ways the inverse of Hollywood’s ‘golden age’?

In the Golden Age (1927-1969; according to Wikipedia), studios managed every aspect of production in-house. They were both the banks and the bosses to producers and visionary filmmakers. Everything, from the financing, the production crew, the cast and crew (most signed to exclusive deals with the studios), were all in-house – vertically integrated.

This vertical integration allowed for the consistent production of high-quality content. Today, we’re seeing something different – the rise of independent film financiers who are disaggregating the vertically integrated models of old in favor of distributed services. What does that mean?

When producing a Film or TV series independently, disaggregation means the financing and resources that the producer needs in order to get that film finished and released aren’t provided by the same company.
A film producer may have many stakeholders involved: one might handle financing tax credits, another might be an equity investor, companies like FilmHedge (or its partners) might provide the senior debt, and the studio being used for filming might offer some in-kind rental hours as their investment. On top of that, you have other groups who provide payroll servicing, insurance, casting, management, catering, production service et cetera, et cetera.

What does this mean for investors? New opportunities to re-examine film and television financing (more specifically MPL) as a lucrative and scalable asset class.

Modern film financing models work because of groups who aren’t focused on the whims of studio execs (or the whims of creators for that matter). Instead, they focus on the trade, the deals to be delivered and transactions to be completed. This solves a problem for both the buyer and the seller.

Mark Twain coined the phrase ‘the Gilded Age’ to describe a period of immense economic change, great conflict between the old ways and new systems. Huge fortunes were made and lost as a result. Essentially, a time in the world where things shifted from the Reconstruction era to the Progressive era, where Industrialization laid waste to Agrarian empires — similar to how new financial models, new technologies, and new distribution models have gutted the ‘golden’ models of Hollywood.

Like Twain’s gilded age, this too is an era of change where financial structuring, generative content, data, artificial intelligence, social media and so much more are all helping to redefine ‘content’ while also fueling a lot of tension between old ways, where huge fortunes are being made and lost!

What Media Production Lending Has in Common with Trade Finance

Modern film finance is essentially a trade finance business.

Films are the inventory, the producer is the supplier or manufacturer, Film/TV distributors are the buyers, and the streaming platforms, theatres and stores are all the point of sale for consumers. Much like the trade finance industry, companies like FilmHedge provide the working capital to suppliers which allow them to close deals with the buyers who ultimately pay us back.

Assets need to be created so they can be sold or licensed to the groups who will distribute them (ex. Netflix, Amazon, Paramount etc.); States (like Georgia with its 30% tax incentive) and Countries (like Canada) need to generate revenue by offering tax incentives to producers who then spend aggressively in their State or Country working on their productions; Sales Agents have customers in markets around the world who are starving for original content. These are all relationships between buyer and seller, where a trade financier shines.

“This modern film finance is a trade finance business.”

This is also a relatively new model for the entertainment industry. Traditionally, people who put money into Film/TV productions were just betting on audiences to show up and purchase tickets and now, stream at home. If a production was popular, it would make money. If it wasn’t, everyone lost money.
In trade finance, an order has been placed before the product has been shipped or delivered (sometimes known as a negative pickup). In this scenario, no party has to speculate the purchase price because they know before production even begins. This is how a significant amount of modern cinema financing happens.

Media production lenders act as a bridge in the relationship between suppliers and buyers. By cashflowing the suppliers (the Film or TV producer), media lenders solve supplier problems as well as mitigating buyer’s risk (distributors and studios like Amazon or Netflix) who, now, no longer have to take on the risk of financing productions. They can instead acquire completed productions.
In a low-growth, illiquid economy, growth and liquidity are priceless.

In this report, we wanted to benchmark the KPIs of media production lending (MPL) against other attractive areas for capital allocation by investors like venture capital, real estate investing, public markets, and private equity.

“Media Production Lending offers more liquidity, greater returns, and shorter time horizons for similar allocations [by LPs].”

With MPL as the lesser known, and least understood opportunity, our team wanted to objectively contrast the risks associated with each asset class, particularly with venture capital which has become attractive to limited partners (LPs) because of observations like: “Venture capital (VC) has consistently outperformed public markets over 5, 15, and 25-year periods, according to longitudinal data,” a statement made by Alumni Ventures researchers (citing reports by Cambridge Associates).5

Our goal isn’t to suggest VC, PE, or RE should become less attractive areas but to make the case for MPL to become a viable consideration for investors looking for new asset classes to add to their diversified investment portfolios.

Limited partners (LPs) who have high exposure to venture capital or venture debt, both of which are still facing downward pressures from the market, may consider including MPL as part of their forward-
looking strategies. MPL offers more liquidity, greater returns, and shorter time horizons for similar check sizes.

### Index Return Benchmarks (2022-2023)

<table>
<thead>
<tr>
<th>Index</th>
<th>1 Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Venture Capital 2022</td>
<td>2.7</td>
</tr>
<tr>
<td>Venture Capital 2023 (Pitchbook)</td>
<td>-16.8</td>
</tr>
<tr>
<td>Private Equity</td>
<td>6.7</td>
</tr>
<tr>
<td>NASDAQ</td>
<td>-23.5</td>
</tr>
<tr>
<td>Russell 2000</td>
<td>-25.5</td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>-10.9</td>
</tr>
<tr>
<td>Real Estate</td>
<td>25.2</td>
</tr>
<tr>
<td>MPL (Debt)</td>
<td>22.5</td>
</tr>
<tr>
<td>MPL (Debt+Equity)</td>
<td>28.6</td>
</tr>
</tbody>
</table>

### Media Production Lending

Media production lending is a type of specialty finance strategy that offers opportunities for high-yield, short-term, risk-managed transactions against well collateralized productions, usually with pre-negotiated takeout agreements as a form of collateral. For this report, MPL is only referring to Film and TV productions.

As it relates to Film and TV, risk can be managed with 100% downside coverage in the form of specialty insurance called a ‘completion guarantee’ or ‘completion bond’. These specialty insurance policies are offered by rated insurance agencies. In the event of material default by the producer of the media, the purpose of the completion bond is to ensure completion of the property (or payout to the financiers) occurs.

With 100% downside coverage and the completion guarantor in control of production spending, lending to Film/TV becomes de-risked allowing for short-term lending.

In an MPL deal, the borrower (a TV or Film producer) must deliver a completed production to a buyer (a streamer like Netflix or distributor like Sony) who completes the transaction, effectively paying the lender on behalf of the borrower. The receivables offered by the buyer are held as collateral. This relationship between borrower, buyer, and lender means MPL transactions most closely resemble trade finance transactions.

The average MPL deal yields an average of 22.5% on debt and 28.6% when including mezzanine and equity strategies.

### Venture Capital

Venture capital is a form of private equity investing that serves as a catalyst for innovation by ambitious founders and growth for young companies. In the current environment, there’s been a downturn in value
realization across the board at venture capital firms. However, historically, it’s been one of the most resilient, high yielding forms of investing.

The challenges investors have with venture capital aren’t just limited to the current moment. The biggest challenge for investors is that venture allocations are usually mostly illiquid across long time horizons (sometimes a decade or longer).

Investors like VC fund allocations because they offer a way to spread risk across multiple high-risk early-stage companies with the hopes that one or two will find explosive growth and exit at a valuation that is outsized.

A recent filing by the SEC from late 2021 showed that the IRR in VC investments made from 2007 to 2020 ranged from 6% to 36%, the average was 15%.

Assets Under Management (AUM) Compared

The total assets under management (AUM) in the VC sector is an estimated $850 billion.\(^6\)

We estimate total assets under management by media production lenders (MPLs) to be $43 billion (a non-conclusive or peer reviewed number backed into from reports about overall media capitalization of the known media lending firms still active).

Our estimate on media production lending AUM does not include forms of debt used for studio sound stage construction or other forms of debt against content libraries, corporate holdings, or other lending to corporates (like Netflix or Disney). It exclusively focuses on debt available for production finance, including cash flowing State and sovereign tax credits, pre-sale contracts, distribution agreements, and other forms of receivable based lending.

The above chart compares assets under management in VC (in billions of dollars) to allocations to MPL. Although not a new industry, MPL is a niche area of private credit within the greater (but still niche) area
of media finance. The complexity and highly specialized nature of the media industry keep investors from making larger allocations to the space.

MPL is notably different from broader areas of media finance (equity and mezzanine) which are viewed as more accessible and have larger capital contributions as a result.

Our definition of MPL only considers senior, collateralized lending to Film/TV productions and not allocations to sound-stage construction, streaming royalties/residuals, production companies, or vertically integrated studios.

Each of those areas alone has hundreds of millions of dollars allocated per annum. Perhaps, because of their accessibility, those areas are more crowded and deals are more competitive, meaning yield is lower and outsized returns are less frequent.

Internal Rate of Return (IRR) Compared

An SEC filing from late 2021 showed that the IRR in VC investments between 2007 to 2020 ranged from 6% to 36%. The average was 15%.

Historically VC has outperformed public market returns over longitudinal time horizons (5, 10, 15 or 25-years). This outperformance was substantial, often in the range of 300-500 basis points per year above public market returns.

However, in the current environment, research\(^4\) shows venture capital is suffering from negative IRR which suggests: (1) funds aren’t seeing enough returns from successful companies to offset failing ones, (2) fund managers aren’t deploying capital at normal rates, (3) LPs are no longer making capital calls (either out of an abundance of caution or a lack of personal liquidity), or (4) some combination of all of these.

Looking back at 2022, we observe that VC IRR was suppressed as well, coming in at a modest 3%.
The IRR of the two asset classes is drastically different.

MPL as a pure lending strategy is just behind only real estate as an investment strategy. However, when coupled with mezzanine and equity strategies, it outperforms even real estate offering liquidity in less than 15 months per deal.
VC deals (in terms of quantity) also seem to be trending down aggressively while deal sizes seem to have stagnated at around Covid-19 (2020) levels. The market may also be saturated as the number of micro-VC firms (funds with less than $100M AUM) has spiked in recent years.

This means for nearly the past five years; venture capital has entered a period that either will eventually be seen as an aberration or as the new normal.

Venture debt, a strategy targeting the same early-stage, high-risk companies that offer the potential for outsized yield, too seems to be on the decline, both in performance, and with LPs.
The Angel Investor Alternative

Even when compared to angel investing, touted to ‘outperform all asset classes’, MPL offers greater returns and shorter time cycles to liquidity for investors. The blended angel return of 28.1% in the ACA study was over a 15-20-year period.

The average MPL loan is 12-15 months, yielding 15-27.5% APY per deal, unlevered. It makes a great supplement or alternative strategy angels looking to diversify.

Venture Debt on the Decline

As a strategy, venture debt was an attempt to bring private credit-like consistency and stability to the highly volatile world of venture capital. However, this strategy both historically and presently seems to be on the decline.

With over $850 billion in allocations by LPs to venture strategies, it makes sense that LPs may be souring on future allocations to venture.

VC themselves also may be looking for new strategies to offer yield to their LPs.

"Media Production Lending outperforms all asset classes including real estate, venture capital, angel investing, and specialty finance."
The Case for MPL

MPL offers both – new strategies for LPs and for adventurous VCs who are looking to employ alternative investment strategies to offer shorter-term liquidity and returns to offset longitudinal losses in their portfolios.

MPL offers shorter vintages (2-5 years) versus venture funds (which tend to lock up capital from 5 to 10 years).

MPL offers exposure to a thriving industry (Film and TV) with the reliability and overcollateralization investors are used to finding only in real estate or specialty finance with the opportunity for exposure to the outsized return profile that usually only comes from high-risk/high-reward strategies like venture.

MPL combines the best of private credit strategies, specialty finance, trade finance, with limited exposure to equity which can offer returns that exceed that of even venture capital in its prime.
Citations

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7 Private Credit Strategies: An Introduction
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8 ACA: Angel Returns Beat All Asset Classes but Pose Greater Risk
   https://www.angelcapitalassociation.org/blog/angel-returns-beat-classes/
Contact

If you’d like to learn more about media production lending (MPL) or other opportunities in the space, contact our team at FilmHedge:

Lenders and investors interested in learning more about opportunities in the space can contact: lender@filmhedge.com

TV/Film producers can email: producer@filmhedge.com

If you have a question about the data in this report or want to consult our data team, contact: data@filmhedge.com

For more reports and research like this, please visit: http://filmhedge.com/reports

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