



A Serious thought about Business Models for Casual GAMES

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Vocabulary

- **Equity** – an ownership interest (in publicly traded companies, stock; value over debt, claims etc.) risk on success
- **Private Equity** – equity capital available to companies not quoted on stock market
- **Angel Investor** – provides VC funds for small start ups (friends and family)
- **Mutual Funds** – investment fund that continually offers shares and must repurchase shares at investor request
- **Venture Capital Fund** – investment fund that manages money for those wanting to invest in small to mid-sized companies



Vocabulary Con't.

- **Hedge Funds** – fund of investor money for highly speculative investments, not SEC registered, typically do not invest in SEC registered securities
- **Soft Money** – funding from governments or through governmental benefits
- **Senior Debt** – corporate debt with priority recoupment (principal and interest) over other debt and over equity
- **Junior Debt** – subordinate to senior debt
- **Mezzanine Financing** – debt and equity hybrid: debt capital that can be converted into ownership interest.
- **Split Rights Deals** – selling rights by territory or by media



Some thoughts on Soft Money

- Governmental Perspective:
 - Jobs
 - Local spend
 - Build Sustainable local industry
 - Cultural Reasons



Soft Money: Governmental Perspective

- Impact on culture.
 - Encourage Products that would not otherwise be made
- Impact on local economy.
- Impact on the tax base.
- Building a sustainable industry.
 - Build skill sets
 - Maintain an infrastructure and critical mass of practitioners



Soft Money: Governmental Perspective

- Direct Subsidies.
 - Are there per film/videogame caps?
 - Are there annual national/state caps?
- Tax Credits (transferable vs non transferable).
- Marketing Incentives.
- Concierge Services.



Soft Money: Governmental Perspective

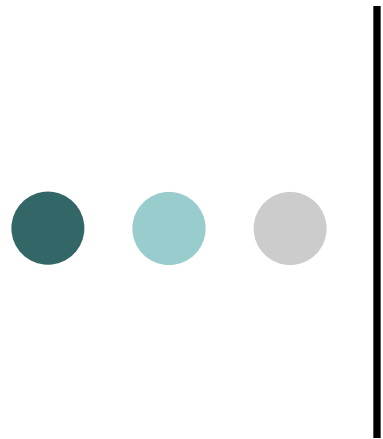
Tax Credits (transferable vs non transferable).

- Who is aid going to (investors or producers or middle-men)?
- Do the transaction costs outweigh the benefit?
- How prone is the scheme to issues of tax avoidance rather than tax deferral.
- How much money is being taken out of the tax base?



How Other Creative Industries Finance Development and Production

- Feature Films
- Network Television
- Book Publishing
- Theatre
- Other Examples: music publishing, record album, etc.



Feature Films



Classic Indie Film Financing

- **The Collateral Package**
 - Presales (Domestic/Foreign)
 - Sales Estimates (for Equity and for Gap)
 - Other People's Money (Equity)
- **The Bank**
 - Cash flow
 - No success risk
 - No delivery risk
 - Only collection risks
- **The Bond Company**



Modern Indie Film Financing

- Bridge Financing
- The Collateral Package
 - 1 Small Presale (Domestic/Foreign)
 - Sales Estimates (Bank Gap and Super Gap)
 - Other People's Money (Equity)
 - The Producer's Money (deferred fees/cash)
 - The Cast's Money (deferred fees)
 - Barter
 - Official Governmental Schemes (Soft Money)



A bit of detail on presales

- MG vs. Back End
- Term, Territory and Media of Grant
- Delivery Issues
- Who has Approvals/Controls
- Credit



Treaty Co Production Example

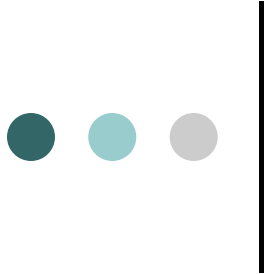
Danish/German/UK/French Co
production
(Danish majority)

Financing Plan – Denmark (80% maximum)

Danish Co-Producer:	%	Finance Specification	Rights	Budget (Euro)
Danish Film Institute (governmental subsidy)		Danish Production Support		
TV 2/Denmark		License Fee Pre-Sale	Danish Free-TV	
Equity from TV Station		Equity Investment		
Nordic Film - & TV- Fund		Scandinavian Production Support		
MG, Nordisk Film Biografdistribution		Minimum Guarantee	Nordic Distribution Theatrical/Video	
SVT Sweden		License Fee Pre-Sale	Swedish Free-TV	
Equity Investor		Equity Investment		
Sales Agent	45.26%	Minimum Guarantee	International Sale	
Media (Support Subsidy)		European Production Support		
Euroimages	53.74%	European Production Support		
				3201.773, 18 46.05%

Financing Plan – France (no less than 10%)

FrenchCo-Producer	%	Finance Specification	Rights	Budget (Euro)
Canal+		License Fee Pre-Sale	French Pay-TV	
Arte		License Fee Pre-Sale	French Pay-TV	
French Equity		Equity Investment		
French Equity		Equity Investment		
Sales Agent	19.70 %	Minimum Guarantee	International Sale	
Eurimages	23.13 %	European Production Support		
				1.391.916,44 20.02%



Financing Plan – UK (no less than 10%) (sale leaseback or other schemes)

UK Co-Producer:	%	Finance Specification	Rights	Budget (Euro)
UK Equity Investor		Equity Investment		
Sales Agent	15.34 %	Minimum Guarantee	International Sale	
Sale and Leaseback		UK Tax Benefits	Negative Ownership	
				966,787.06 13.91%

Financing Plan – Germany (no less than 10%)

German Co-Producer:	%	Finance Specification	Rights	Budget (Euro)
Arte/ZDF		License Fee Pre-Sale	German Free-TV	
Filmstiftung (governmental subsidiary)		German Production Support		
German Equity		Equity Investment		
Sales Agent	19.70%	Minimum Guarantee	International Sale	
Eurimages (support subsidy)	23.13%	European Production Support		
				1,391,916.44 20.02%



The Money-Making Life of a Film

- Theatrical
- Airlines/ships
- Video
- Pay Television
- Free Television (Network/Syndication)
- PPV, VOD, download (subscription or PPV-based; internet or mobile phone)
- Merchandising, Publishing, Music
- Remakes, Sequels, Television, etc.



Some Numbers

- US Average Ticket Price 2006: \$6.41
- US Tickets Sold 2006: about \$1,448,000,000
- US Box Office 2006: about \$9,281,000,000
- Top Grossing Films 2006 (all G to PG-13)
 - 4/10 live-action Sequels (2006: 29 total sequels)
 - 3/10 original Animated (2006: 26 total animated)
 - 1/10 Animated sequel
 - 1/10 based on famous book
 - 1/10 live action original script (star driven)



Some Numbers

- Poseidon:
 - Production Budget: \$160,000,000
 - Domestic Box office: \$60,674,817
 - International Box office: \$121,000,000
- Little Miss Sunshine:
 - Production Budget: \$8,000,000
 - Domestic Box office: \$59,642,016
 - International Box office: \$32,865,532 (not released everywhere)



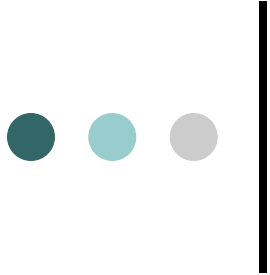
Some Numbers

- Devil Wears Prada:
 - Production Budget: \$35,000,000
 - Domestic Box office: \$124,740,460
 - International Box office: \$199,110,108
- 2/10 of the top grossing “stars” ever (total box office, not on a per-film basis) are voice actors
- 2007 look-ahead: 3 big sequels (Spider-Man, Shrek, Pirates)



Video Costs include

- mastering
- authoring
- production/duplication
- pick, pack and ship
- advertising (trade v. consumer)
- returns (reserves and liquidation issues)
- extras/chaptering (note sometimes several releases with different extras)



Pay TV = pay for the premium station

- Window – 2-3 months after DVD
- Output deals and presales - licence fees tagged to box office, rentals or P&A
 - e.g. \$10 mil rentals = \$5.5 mil fee
 - e.g. \$40 mil rentals = \$12.5 mil fee

note: output deals terminating, renewals expected to be less lucrative or non-existent, as pay networks do original programming

- Windowing with free TV



Free TV

- Gov't sponsored vs. selling eyes to advertisers
- Network – historically, 20 months post theatrical
 - Few sales/ high fees (Pirates reported at \$20-25 mil)
- Syndication – historically 31+ months post theatrical
 - Long term but lower fees (package driven)
- Expenses (conventions, editing, delivery, collection)



Ancillary Rights

- Music Publishing
- Soundtrack Album
- Merchandising
- Novelization/Publishing
- Computer Games



Music Publishing and Soundtrack Album

- Music Publishing
 - income over years
 - commissioned score: publishing often split w/ composer and producer
- Soundtrack Album
 - marketing
 - film budget
 - royalties payable to artists & composers



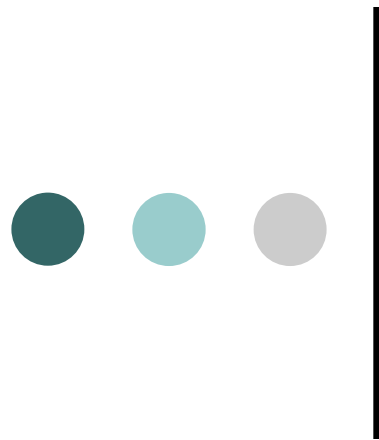
Merchandising and Publishing

- Can be significant (Star Wars, Harry Potter) or entirely insignificant
- Advance/MG/Royalty structure
- Talent issues
 - contractual approvals and compensation
 - rights of publicity



Allied Rights

- Remake/Sequel/Prequel
 - Spider-Man; Bond; Star Wars
- Television
 - Greek Wedding; Stargate
- Other - theatre
 - Witches of Eastwick



Network Television



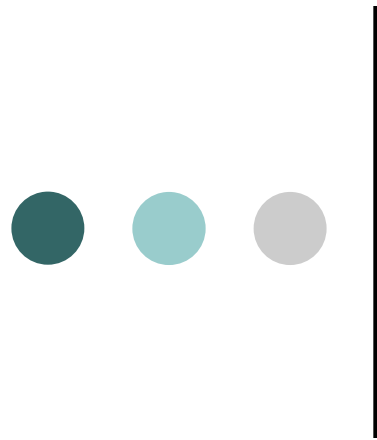
Classic Deficit Financed TV

- The Classic model:
 - Producer funds 1/2; Network funds 1/2
 - Network takes US network TV for a time
 - Producer gets syndication, DVD, foreign



Classic Deficit Financed TV

- Issues with classic model:
 - Producer/developer loses money (million plus) for each episode.
 - Producer/developer has little control over exhibition and, hence, value.
 - Many seasons prior to added value
 - Network selling eyeballs to advertisers vs. producer selling older show to consumers.



Book Publishing



Books

- Historically – Hit driven business
- Amazon.com and other on-line retailers level the field
- Trade hardback/paperback vs. Educational/Professional
 - Different marketing (getting a curriculum approved for e.g.)
 - Different price points (Professional are higher)



Books

- Most involve sweat equity
 - Some involve investments of cash to create photographs or to do research
- Publishers commit
 - Advances against royalties
 - Print runs
 - Overhead
 - Marketing costs
 - Stock write down
 - Returns
- Self publication is common



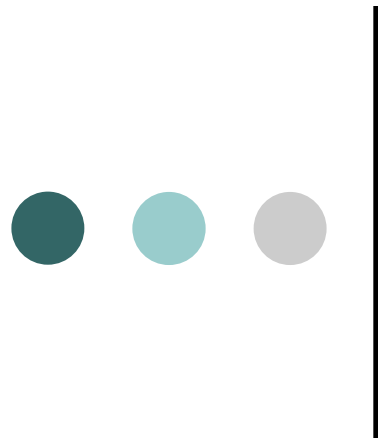
Books

- Trade Hardback Example: Per Unit
 - Manufacture cost = \$2.50 hardback
 - Distribution = \$2
 - Marketing = \$1.75 (varies widely)
 - Author royalty @ 10% = \$2.50
 - Store profit = \$11.75
 - Cost of returns = \$1
 - Fixed OH for pub = \$2
- Retail price = \$25 (note that increased popularity of book rarely changes price point up)
 - Harry Potter used as a loss leader at stores



Books

- Author risk/reward
 - Advance
 - Percentage of cover price vs. percentage of wholesale price
 - Issues: returns, discounting



Theater



Theater: Broadway

- Pure Equity: investors fund development, rehearsal and production (range for Broadway play is \$1 to \$3 million; range for musical is \$5 to \$10 million or more).
 - Lord of Rings \$25 million in Canada and another \$25 million in London
 - High Fidelity \$10 million
 - Spring Awakening \$6 million
- Creative team takes low to no salary for a part of profits.
- Percentage of box office to investors and to creators.
- Copyrights held by creators subject to license to producers/investors.



Theater: Broadway

- Remember “The Producers”!
 - Many investors (min investment for recent Sound of Music revival was \$10k)
- A hit can run for years, a flop for days
 - Phantom: 11+ years, global box of over \$3.2 billion
 - No unsold seats in London for 10 years
 - 52 million people saw in London alone, 80 million worldwide
 - 130+ cast/crew/orchestra each night
 - ALW personal wealth: over 750 mil pounds
 - Revivals and touring of Broadway hits accounts for 80% of total national ticket sales.



Other Examples

- Music Publishing
- Record Album
- Core Games
- Fine Art (Commissions, Galleries, Duplication)
- Orchestras, Opera



Game Development – Soft Money



Soft Money for Game Development

○ Hawaii

- 100% Transferable Tax Credit for investments up to \$2mil for qualified high tech companies (performing arts products qualify) – Act 221 – many unused.
 - Front loaded return on investment (35%, 25%, 20%, 10%, 10%)
 - 50% of total company activities on qualified research and more than 75% of total research in Hawaii
- 20% R&D Refundable Tax Credit
- Patent, Copyright royalties from a qualified high tech company are not taxed.



Soft Money for Game Development

- Louisiana
 - Motion Picture Tax credits as template for video game credits.
- France
 - Production tax credits proposed of 30-60 million Euro over 2 years to fund 20% of up to 15-30 projects.
 - Video games declared a “Cultural Industry”
 - Issue: may violate E.U. prohibitions on “subsidies”



Soft Money for Game Development

- Texas
 - Up to 5% of total in-state spend capped at \$250,000
 - 70% of people working on projects must be residents of Texas
 - 80% of project must be done in Texas
 - No “inappropriate content” and cannot “portray Texas or Texans in a negative fashion”
 - “a first step” in supporting developers



“The Serious Business of Casual Games: Rethinking the business models for game development and game exploitation”



Forms of Businesses

- Sole Proprietorship
- Partnership
- Corporation
- Limited Liability Company



Sole Proprietorship

- Pros:

- You are your own boss
- You alone make the decisions
- Single tax return

- Cons:

- You are your own boss
- You are liable for all expenses
- Your personal assets, even those not related to the business are at full risk



Partnership

- Pros:
 - You have others to help get the job done
 - You have others to share the burdens
 - Pass through for income and taxes
 - Can craft a partnership agreement to suit your needs
- Cons:
 - You are liable for all expenses and for those incurred by your partners
 - Your personal assets, even those not related to the business are at full risk
 - Fiduciary duties to minority/limited partners



Corporation

- Pros:
 - Limited liability
 - You have others to share the burdens
- Cons:
 - Double taxation, unless S Corp rules are met
 - Potential tax burdens upon sale or dissolution
 - Potential limits on internal governance
 - Fiduciary duties to minority shareholders



Limited Liability Company

- Pros:

- Limited liability
- You have others to share the burdens
- Great flexibility on internal governance

- Cons:

- Not suited for going public



Using Other Peoples' Money

- Debt investors
- Equity investors



Debt Investors

- Typically, high interest rates for start-ups
- Personal liability, direct or via personal guaranty
- Frequently insist on equity kicker/warrants
- Generally not a security for federal or state law purposes, but can be based upon how solicited



Equity Investors

- Valuation issues, price per share/unit
- Potential loss of control if too much equity is sold
- Fiduciary duties to minority interest holders
- Federal and state securities regulation and compliance



Securities Issues

- Sale of equity interests and some debt obligations generally require compliance with state or federal securities laws and regulations unless an exemption applies
- State regulation – “blue sky laws” - generally require qualification under state rules, unless a state law exemption applies



Securities Regulation

- Federal regulation
 - Registration with the Securities and Exchange Commission
 - Exemptions under federal law
 - Compliance with federal law may preempt application of state law



Federal Registered Offerings

- File registration statement with SEC
- SEC rules require detailed disclosures regarding the business and its management
- SEC rules require audited financials
- Once registration statement declared effective by SEC, can sell to anyone, can promote widely and publicly
- Public company reporting obligations



Exempt Securities Sales

- Single state offerings – Section 3(a)(11)
- Limited offerings – Section 3(b)
 - Regulation A – Small “public” offering up to \$5,000,000; Registration on Form 1-A with SEC is required; Advertising for interest in the offering is permitted
 - Regulation D Rule 504 for offerings under \$1 million – No general solicitation or advertising



Exempt Securities Sales

- Limited offerings – Section 3(b), continued:
 - Regulation D Rule 505 for private offerings up to \$5,000,000
 - Form 1-A not required
 - Limited to 35 non-accredited investors; integration
 - No general solicitation or advertising
- State law compliance not preempted by Securities Act Section 18, but state law may permit limited offerings without qualification



Exempt Securities Sales

- Transaction not involving a public offering
 - Section 4(2) and Regulation D Rule 506
- State securities laws preempted if Rule 506 satisfied
- Rule 506
 - No minimum or maximum dollar amount
 - No limit on sales to accredited investors
 - No more than 35 non-accredited investors; integration



Exempt Securities Sales

- Rule 506, continued:
 - Accredited investors must meet one of several criteria including, for natural persons:
 - Net worth of not less than \$1,000,000
 - Annual income of not less than \$200,000/\$300,000 for 2 years
 - Rule 502 Disclosures required
 - Accredited investors, none, per se
 - Non-accredited investors – disclosures required, including audited financial information
 - Post sale Form D filed with SEC per Rule 503
 - State filings required, some pre-sale, especially New York



Structured Finance

- Structured Finance Transaction –
Focuses on assets that create cash flow
- Advantages
 - Lower interest rates
 - Higher advance rates, especially for IP assets
 - Loan covenants tend to be less burdensome
 - An equity kicker is generally not required



Structured Finance

- Structured finance eliminates bankruptcy risk by isolating IP assets in a special purpose subsidiary
- Repayment of debt flows directly from cash flow of transferred IP assets
- Lower interest rates due to investment grade rating of transaction



Structured Finance Applications

- Asset-backed commercial paper facilities
- Securitization of royalties, license fees and related game revenue
- Slate financing of new productions



Asset-Backed Commercial Paper Facilities

- Segregate IP assets that produce cash flow (royalties, license fees and other game revenue)
- Pledge only IP assets to a commercial paper conduit facility to support a borrowing from the CP facility
- CP facility is a program sponsored by a large investment bank or commercial bank funded by the sale of commercial paper



Asset-Backed Commercial Paper Facilities

- Borrowing can be term or revolving
- New IP related assets can be pledged as created to increase borrowing capacity
- Third party may insure value of IP assets
- Interest rate generally tied to rate paid on CP issued by CP provider – usually a LIBOR based rate



Securitization of Royalties

- Transfer IP assets (royalties, license fees and other related game revenue) to an SPE
- SPE sells notes to investors
- Cash flows from transferred assets service notes with excess cash flows ultimately released to SPE
- Third party may insure value of IP assets or otherwise guaranty cash flow will be sufficient to service notes



Securitization of Royalties

- When notes repaid, IP assets and cash flow revert to developer
- Interest rates generally tied to margin over equivalent LIBOR
- ABS transaction frequently used to pay-off a CP facility



Slate Financings of New Productions

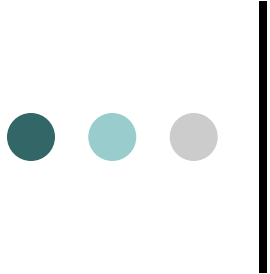
- Financing facility established to fund new productions based upon company's track record
- SPE sells notes to investors based upon anticipated future cash flow, deposits cash in blocked account or secures a fixed line of credit facility
- Transfer IP assets (royalties, license fees and other related revenue for productions) as created to SPE



Slate Financings of New Productions

- Cash drawn to finance an agreed percentage of new production costs
- Cash flows from new productions devoted to servicing notes with excess cash flows ultimately released to SPE
- Third party may insure value of IP assets or otherwise guaranty cash flow will be sufficient to service notes

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Making Structured Finance/ Securitization Work

- One size does not fit all
- Be imaginative – be creative
- Work closely with investment bankers, accountants, investors and attorneys with structured finance/securitization experience
- It takes time, especially the first time
- But, when it works, it's worth the effort