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Independent TV Financing in the Digital Age: Who's In?

Guest blog: What true appetite do potential financiers have for financing independent television productions, and where is the money coming from?

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In recent years there has been a proliferation of Netflix, Hulu, YouTube/Google, Amazon and other digital distribution platforms. Netflix alone has over 36 million streaming members worldwide, and internet goliaths like Amazon, Hulu and YouTube/Google are ramping up their own subscription streaming services.

Each subscriber pays a yearly or monthly subscription fee to stream content, and these fees form a large part of the digital distributor's revenue.

But in order to attract an extensive group of subscribers, digital distributors need to continue to provide an immense amount of original, high-quality content.

Netflix's CEO and co-founder Reed Hastings recently said in GQ that "the goal is to become HBO faster than HBO can become us." So far in 2013, Netflix has aired "House of Cards" and "Hemlock Grove" and is planning to debut "Orange Is the New Black" (by "Weeds" creator Jenji Kohan), Season 4 of "Arrested Development" (which previously aired and then was canceled on Fox) and Season 2 of "Lilyhammer."

Netflix has been able to attract programming with the promise of a large and diverse audience and its binge-viewing model, which allows subscribers to watch an entire season in one sitting. In some instances, Netflix has also offered a full-season commitment, which gives producers the assurance that their series will not be canceled halfway through the season.

Likewise, Hulu plans to air its first animated series "The Awesomes" (co-created by Seth Meyers and "SNL" alum Michael Shoemaker) this summer and has distributed around 25 new series in the last two years.

These new distribution platforms have resulted in increased competition for high-quality content by both digital distributors and the established cable channels and networks. Digital distributors need to continue acquiring content in order to attract new subscribers and networks and cable channels need to provide quality programming to compete. As a result, more producers have been able to enter the market to fill the demand for content, and the need for independent financing for new productions has increased.

But what true appetite do potential financiers have for financing independent television productions, and where is the money coming from? As with many markets, the option is either debt or equity financing.

DEBT FINANCERS

Television debt financiers (i.e., banks, funds, individuals) are generally the same group that provides debt financing for independent films. They are looking for low-risk lending opportunities and typically do not share in the production's upside or downside.

Although these financiers have been somewhat active, they struggle with television loans because:

1) Although there are some exceptions, television productions typically are not "bonded." In most film loans, a completion guarantor agrees in favor of the financier that the film will be timely completed and delivered to the various distributors of the film and that any overages will be covered. This is crucial because the distributor's license fee is due upon delivery, and the license fee serves as collateral for the loan.

Bond companies tend to have difficulty bonding television productions because they are not accustomed to making multiple episodic deliveries confined by tight delivery schedules. For films, the completion guarantor usually only makes one delivery to each distributor and there is some cushion to adjust the delivery date. For television, episodes need to be delivered on time to meet weekly airdates.

Another issue is that bond companies require the ability to takeover a production if, in their view, the production is not being timely completed. This presents a challenge because networks, cable channels and digital distributors often require the same right of takeover from the producer.

2) Unlike film distributors who are accustomed to debt financing documentation, television distributors may not be accustomed to signing the complex financing documentation. Debt financiers require distributors to waive certain contingencies and requirements that distributors seek from producers if those contingencies and requirements could affect the payment of the distributor's license fee.

For example, in order to give a contract value, a financier requires a distributor to agree that it will pay its license fee even if the series is cancelled (as long as the producer has delivered the show to the distributor).

3) Unlike film loans that are partially collateralized by foreign pre-sales and gap, television productions tend to have less (or no) pre-sales to foreign distributors. This is the natural result of the time in which we are living where many series receive orders for only 10 episodes, whereas foreign distributors typically require at least 13 episodes in a season.

Many foreign distributors also want to make sure the series is commercially successful and has a multi-season run before they decide to buy. The combination of these two factors usually means a foreign distributor will not buy a series until its second season.

EQUITY FINANCERS

Television equity financiers are most often non-bank entities that are willing to take more risk than debt financiers in return for a piece of the backend. These financiers are typically unsecured. We have not yet experienced a meaningful entrance into the market by equity financiers for two reasons:

1) The ultimate value in a television production is a syndication deal, and syndication deals remain very difficult to secure. Because the budget for most television productions is greater than the license fee that a distributor pays for the series, productions operate at a deficit until a syndication deal is in place. The product has to be deemed worthy of a syndication deal which is seldom considered, even for a very successful series, until 100 episodes have been broadcast.

2) The producer must have a proven track record. Equity financiers frequently seem less concerned with the potential success of a series than with the competence of the producer's management team.

The future of independent television financing with the growth of digital distribution business models remains undetermined. The two core groups of financers are starting to adapt at different speeds. While debt financiers appear to be growing more comfortable with financing television productions, equity financiers may remain hesitant to enter the financing arena until more independent producers are proven successful and the potential for syndication deals is established.