FINC-GB.3126.S.010: Financial Analysis-Entertainment & Media
Imperial Studios-Case Summary
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- George Whittles-Studio Head
- Susan-Newest member of the business development team
- Amy Firestone-Imperial's chief financial officer
- Geoff Homes-Head of marketing
- Irving Rosenblatt-Head of Distribution
- Joey Smith-Chief of Studio Operations

Imperial Studios is producing a movie titled as "The Wreck" which is scheduled to release in the coming summer. The project is currently facing problems with respect to deadlines as it is 3 weeks behind and there hasn't even been a rough cut. The total costs post-production are expected to be $55 million. Deadline pressure is mounting in, as the launch has to be within the last week of June to avoid competition from the Pixar's animated picture with the ducks, which is being released early by Disney. The Marketing Budget is a total of around $43 million, which includes for US & International Home video and print costs for 2000 prints i.e. about 3000 screens.

According to Irving and backed by Amy's regression models the video is expected to be 3.5 million units domestic and 95% of that level overseas. Other expected revenue streams are a TV deal with HBO with a minimum guarantee of $2.5 million, 7.5% royalty from an Electronic Arts video game, $2 million from consumer products etc.

Gross Players are majorly Ernst & Matt who get 5% of the Net Revenues. Under the best circumstances a $35 million opening is expected for which the marketing director is trying for a Vogue cover featuring Inge, as a marketing gimmick.

George is considering a possibility of a Lay-Off and learns that Fox & Paramount are interested in a split pot by taking only foreign and leaving the domestic. In order to save time and money Joey suggests cutting down on special effects, adding to George's idea of mixing the foreign and domestic versions at the same time.

Amy Firestone, Imperial's chief financial officer showed Susan, newest member of the business development team how to develop the Profit & Loss. She explained that their retention is running about 54% in the US and between 35% and 37% internationally, Video is wholesaling at $10 for a VHS and $16 for disk, Split rights deal with the big retailers is 50% of the rentals and they have taken their manufacturing costs down to $2.50 in the US and $3.00 overseas. She also explains the economics for online streaming and international rentals. Further she touches on the recognition of revenues and costs describing that a film's P&L can be divided into five line items, the first being revenue from each window, whether it is theatrical, video, television, consumer products or airlines and the military. The second driver is the amortized costs that include development, production costs, residuals, participations and studio overhead. The third line item is margin before exploitation costs and is the real driver of reported profitability. The final line item is exploitation costs that lead to the firms EBITDA. The capitalized costs are amortized over the life of the picture, based on the total amount of revenues expected to generate.

With respect to a loss, the accounting rules require to recognize the ultimate loss in the quarter the film is released. Amy further explained the dynamics with the help of a model table finally concluding that if the numbers look good, the negative has to be written off proportionately to the revenue recognized as a percent of the total. However if it looks too high, the ultimate has to be adjusted and the contribution margin changed. In the worst case, a write down has to be taken place.

As Susan inquired about the cash flow Amy explained that the cash flow is negative going into release as investment in development has to be done up to two years before release, followed by production spending which can vary based on the script and various cast elements. Advertising and print costs are incurred just before the picture is released. Once the picture works, the cash flow is incoming and most of the exploitation costs are recognized in the first 12 months. She ended with warning that they had about a $50 million left and if the budget went much higher, they'll probably need to borrow from the banks at the current cost of borrowing of 8.75%.

As the meeting concluded George faced several questions and asked Susan to run a cash on cash analysis of the ultimates as well as the impact on the operating earnings from "The Wreck" given their discussions.