Media Derivatives, Inc.
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List of Articles and Statements

The Cannes Festival Opens With a Search for Money by Sharon Waxman; The Wrap May 12, 2010

Trading in Fantasy by Felix Salmon; New York Times may 9, 2010

Where There's Smoke, There's a Smoke Machine – A Case for Movie Futures by Buzz Potamkin; Naked Capitalism May 6, 2010

'Iron Man 2' Now Available Free Online by Eriq Gardner; Hollywood Reporter May 3, 2010

'Chicago' Creative Team Sues Miramax for Profits by Matthew Belloni; Hollywood Reporter April 28, 2010

The Possible Benefits Of Film Futures Exchanges, And… Hope for Film.com April 26, 2010

In a land where no one know anything, we've gotta stop these zany b.o. futures by Schuyler Moore; Hollywood Reporter April 26, 2010

How Is A Movie Like An Onion? By Dorothy Pomerantz; Forbes April 23, 2010

Democracy In Action by Robin Hanson; overcomingbias.com April 22, 2010

Geither: No Ban on Movie Futures by George Stephanopoulos; George's Bottom Line April 22, 2010

How Movie-Futures Trading Could Bring (Gasp!) Truth to Hollywood by Peter McAlevey; The Wrap April 19, 2010

John Damgard Statement; Futures Industry Association April 8, 2010

Picture This – Futures Trading Has An Economic Purpose by John Lothian; John Lothian Newsletter April 7, 2010

Movie Manipulation by Robin Hanson; overcomingbias.com March 31, 2010 the futures are here

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May 14, 2010

Mr. David Stawick, Secretary
Office of the Secretariat
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Media Derivatives, Inc. Application for Approval of Binary Options and Collared Futures for Opening Weekend Motion Picture Revenue Contracts

Dear Mr. Stawick:

In support of Media Derivatives, Inc.'s submission for approval of binary options and collared futures for opening weekend motion picture revenue contracts, we hereby submit the attached media articles and statements for the Commission's review. These articles generally support the notion that the entertainment industry should have an opportunity to use movie box office futures and options as a risk management tool.

We thank the Commission for its consideration of these items.

Sincerely,

/S/

William Boyk
Chief Operations and Regulatory Officer

cc: Phil Colling

in damages are at stake but Disney's participations department has frustrated attempts to execute a full audit.

"Chicago," directed by Rob Marshall and starring Richard Gere, Renee Zellweger and Catherine Zeta-Jones, grossed more than $300 million worldwide and spawned a hit soundtrack. The creative team claims a 1980 deal assigned to Miramax entitles it to a 4% backend of "'Distributor's Gross Receipts' after 'Artificial Breakeven,'" as defined in the deal. They also claim they have been underpaid their 15% royalty on soundtrack sales from the film.

Disney, which is in the process of selling Miramax, declined to comment on the filing.

Miramax was sued on similar grounds in 2006 by Martin Richards, a producer on the film who claimed that deceptive accounting practices shortchanged him by millions. That case was settled in 2008.

The new case, filed by Stanton "Larry" Stein, Daniel Fiore and Maribeth Annaguey at LA's Liner Grode Stein firm, claims causes of action for breach of contract, breach of implied covenant of good faith and fair dealing, intentional interference with contractual relations, accounting, open book account and declaratory relief.

http://thresq.hollywoodreporter.com/2010/04/chicago-lawsuit-miramax-fosse.html

'CHICAGO' CREATIVE TEAM SUES MIRAMAX FOR PROFITS

Wed Apr 28, 2010 @ 06:14PM PST

By Matthew Belloni

EXCLUSIVE: The creatives behind the original Broadway musical "Chicago" are accusing Miramax of some accounting theatrics in connection with the hit 2002 film.

Nicole Fosse, heir to director/choreographer/co-writer Bob Fosse, along with composer John Kander and the estate of late lyricist Fred Ebb, today sued Miramax and Walt Disney Pictures., claiming they've been shortchanged by more than $12 million from "the old razzle dazzle" approach to accounting for profits from the best picture Oscar winner.

The plaintiffs say an audit of the film has revealed "underreporting of more than $165 million in gross receipts (through December 31, 2006) and the overstating of more than $32 million in deductions and exclusions from those gross receipts." They also say millions more

Harold Vogel's book – a former Merrill securities analyst
Entertainment Industry Economics: A Guide for Financial Analysis
Cambridge University Press; 7th Edition (Expanded and Updated)

Steven Bach's book – financial company buys UA and comic tragedy ensues
Final Cut: Art, Money, and Ego in the Making of Heaven's Gate, the Film That Sank United Artists
Newmarket Press; Revised Edition

NATO, the DGA and the IA – and while it barely does him justice to excerpt those thoughts here, we in the biz are nothing if not copyists, so a few highlights (and "studios" = MPAA/Majors):

Only studios should be allowed to gamble on films! We need to save the public from themselves.

We also need to save the studios from themselves, because a studio might be tempted to manipulate the Exchange by going short on it then tanking its own film.

In the interest of preserving lawyers and legal fees, studios should be required to hedge film risk inefficiently, as they always have done, rather than doing it efficiently on the Exchange.

There would be wild, rampant "insider" trading because everyone at the studios is able to accurately predict box-office results.

(It really is worth a read on its own, but the end is in sight here, so finish first.)

I will just add a few points:

The DGA and the IA want to see production remain under the control of their full-price bargaining agreements; the Majors are much more likely to do so than smaller independent production entities.

There are dogs that haven't barked: as far as I can see, neither the WGA nor SAG has uttered one peep against futures. Is it because their members will do better with the futures exchange fostering more independent production?

Independent production and distribution have long been the homes of "quality film" and the resuscitators of Hollywood creativity many times in the past 60 years. But they need investment sources beyond the usual suspects, and those alternative investors are naturally reticent when it comes to an opaque business that bets it all on one weekend. Don't you think those investors might be interested in some way to hedge the downside risk of lesser movie traffic? (Although not right to the point, wouldn't the Germans who invested $70 million in Battlefield Earth – with the ironically named Franchise Pictures – wouldn't they have been delighted to be able to hedge the downside risk of lesser movie traffic?)

I am no fan of any unregulated OTC derivatives market; we have seen the damage done. I am a fan of a regulated box-office futures exchange, especially one that allows significant and substantial non-Hollywood participants to hedge their risk in a rather uncertain investment. The more comfortable these outsiders are, the more – and perhaps better – movies will be made.

For those wanting more biz background:

Schuyler Moore's book
The Biz: The Basic Business, Legal and Financial Aspects of the Film Industry
Silman-James Press; 3rd Edition (Expanded and Updated)

Next up is Marketing Partnerships. *Iron Man 2* is a good example:

Blue-chip marketers such as Burger King and Dr Pepper as well as smaller brands like Royal Purple motor oil are attached to a marketing bonanza valued at more than $100 million in media buys, retail tie-ins and giveaways.

Besides the three mentioned, other Partners include Audi, 7-Eleven, LG Electronics, Diesel, Oracle, Symantec, Hershey's (Reese's Peanut Butter Cups), and Sony Music. Looks like a $100 million one-weekend bet, not including their considerable internal costs. For only one movie. With the bet placed 18-24 months ago. As you read this, we'll all know whether it's paid off or not, but shouldn't these guys be able to hedge the downside risk of lesser movie traffic?

My own favorite is Licensing and Merchandising (L&M). Except for Disney, L&M was mostly overlooked by Hollywood until toy-company-supported TV production showed the Majors how to do it. Until then, most Majors didn't have large L&M groups, with many of the deals left to a small cadre of independent agents like "Honest Ed" Justin, who when representing The Flintstones always signed his minuscule NY Times display ads "Not Needy, Ju$t Greedy." A man after my own heart. Now L&M is a major income stream for franchise pictures: everything from Toys, Mobile Apps, Games, and Books to Bedding and Condoms – and just about any other consumer product you care to name. All sold with royalties ~7% or so. Excepting maybe the condoms, these products also take 18-24 months to design and produce. Massive business from a hit, and disaster from a flop. Let's look at Namco, a mobile app/games producer, who's sold 23 million iPhone copies of Pac-Man:

[Namco] has hired Chris Lucero, formerly of United Talent Agency, to head up licensing for the company, and the company is kicking things off with the big … feature-film release The Wolfman from Universal Pictures.

(snip)

The licensing game has been tricky for many game developers that have promised certain returns, and then ended up with losses when the titles didn't perform as well as they would have liked. Lucero would not quantify how many licenses the company will try to acquire this year. "It's about what feels appropriate. There's countless opportunities out there." For him, the Wolfman game was a no-brainer. "The Universal monsters go back to the 30s. To be a part of this relaunch is an incredible honor."

You all remember The Wolfman, right? February 12 of this year ring a bell? Depending on who you believe, the budget ran $85-150 million, plus P&A of let's say $50 million, maybe more. Opening Weekend Gross a grand total of $31.5 million; total Worldwide Gross to date $138 million. (For your own amusement, do the math with a 50% rental number.) Wonder how many copies of the game Namco sold? They barely feature it on their own site now. Shouldn't Namco and all other Licensees be able to hedge the downside risk of lesser movie traffic?

And so on to film production itself. Schuyler Moore has forgotten more about outside investment in film than I will ever know. He has skewered the anti-futures arguments from the MPAA,

$6.65 gross profit per head; split ~60/40 film/food.

A non-major market exhibitor I knew called his multiplexes "junk food joints with entertainment." He got very upset when the younger demographics were underserved, and he was known during the summer to run mature romantic comedies only at night, while during the day he double-screened youthful fare at deep discount ticket prices – without ever lowering the price of popcorn. Not that any of that was covered in his film rental agreements; if you wanted your film to track on his screens, tough luck.

While I was writing this, one of the larger chains (with a non-major market bias) announced Q1 results underscoring these economics of exhibition.

Said the CFO:

Carmike's patrons spent $10.34 on average per visit during the first quarter of 2010, up 8.0 percent versus the comparable 2009 period. Average admissions advanced 7.4 percent to $6.85 as 3-D premiums of $2.50 and higher increased the average ticket price per attendee. Concessions and other revenue per patron increased 9.4 percent to $3.49, versus $3.19 in the prior year period. [My query: what's the difference between a patron and an attendee?]

Dig a little deeper, and FEC is now 56%, with Concessions costs around 10%. Scribble out a few figures, and gross profit per patron/attendee is:

Film admissions $3.01
Concessions $3.14

That's a 51/49 split in favor of junk food.

Now let's return to ancillary markets.

In these markets there are significant non-insider (i.e., not part of nor controlled by the distributor) real world parties/industries who currently have no way of laying off their significant risk: Exhibition, Malls, Fast Food, Soft Drinks, Other foods, Video/computer Games, Toys, Books, Apps, Clothing, Collectors' Art, Bedding, Kitchen Furnishings, it goes on forever.

Exhibition is obvious: empty theaters don't make money and sell no popcorn. While NATO is now supporting the MPAA in opposition to futures, I wonder how long that will last. If I were running a business that relied upon the kindness of others to provide me with my meagre gruel, I would be seeking a way to cover my downside risk.

Malls are not so obvious. In this time of lighter consumer spending, mall operators are one of the main causes of Commercial Real Estate strain. Many multiplexes are co-located with malls, with movie traffic driving substantial added mall traffic – and the absence of movie traffic doing the reverse. Mall traffic falls, mall operator income falls. Mall operator income falls, mall operator faces default. Shouldn't a mall operator be able to hedge the downside risk of lesser movie traffic?

Clash of the Titans 2
GI Joe 2
Hancock 2
The Hobbit 2
Monsters Inc 2
X-Men Origins: Magneto (replaced by rush-produced X-Men: First Class in 2011)
The Avengers (includes Iron Man and other Marvel characters)
Dr. Seuss (another book – probably Lorax)
Godzilla (again)
The NeverEnding Story (again)
Yellow Submarine (again)

While these franchises can return upwards of $100 million in film rentals (not theatrical gross), and that makes a nice start on recoupment, their real break-out value is across multiple consumer-facing platforms – many of which are not included in discussions of DVDs, premium TV, etc. For a hit franchise directed against a younger demographic (and nearly all are), the ancillary markets can be as/more profitable than the media markets, and with a far longer tail.

One more moment though, as we take a look at some finance:

Film rentals are what the Exhibitor (theatre operator, mostly chains) actually pays to the Distributor (overwhelmingly The Majors). Rentals in theory are a previously agreed percentage of admissions income (the famous "box office gross"), arrived at usually by bidding a complex formula with aggregates, sliding scales, floor payments and house nuts, and just as frequently post-fact recalculated in more arcane processes and acrimony – in other words, as the one holding the cash the exhibitor wants to keep it, while the distributor uses whatever threats possible to get it, and the process can be rather heated. After all is said and done, the exhibitor is left with a "gross profit on film admissions" in the range of 44-50%. Note that film exhibition cost (FEC) percentages appear to be trending up with the premiums tacked on for 3-D, leaving the exhibitors with gross profits percentage near the lower end. (This range is of the largest chains, and it varies across the year. Together they control over 45% of the total screens.)

All the popcorn and sticky drinks are another story. In Concessions, the exhibitor has no substantial supply chain problems, no "partner" demanding a recount, audit, or renegotiation, and the last time I looked popcorn was a true fungible commodity. So the gross profit margin on Concessions is about 85-90%.

Thus:

The gross profit per head from film admission (tickets) is around $3.85; it differs by market (can be under $3.00 in non-major markets), and will probably trend up with the new premiums for 3-D. (One chain is now over $4.00.)

The gross profit per head from concessions is around $2.80; it also differs by market, but can actually be higher, over $3.00, in non-major markets. (As to why, let's leave that to the "fighting fat food" crowd.)

http://agriculture.house.gov/testimony/111/h042210/Moore.pdf or to subscribers of Lexis/Nexis or Westlaw.)

WGA – Writers Guild of America, West
The writers' union. Fought hard to get penultimate card.

DGA- Directors Guild of America
The union for directors and director's team. Always gets the last card.

A few weeks ago our humble blogger ran a guest post by Gonzalo Lira regarding film exhibition (or "box office") futures – an "ah ha" moment for me: a post on my business, one I don't have to scratch my head to get. Lira wrote a nice rant, and I share his gut feelings for the biz – but I respectfully disagree with his opposition to futures.

Before I go on with that respect, a few data points, and of each it could be said "there is no doubt whatever about that."

The MPAA is a rapacious, oligopolistic cartel. Its control of Washington has no equal, and puts the Securities Industry to shame.

NATO is its domestic partner, locked in longstanding sado-masochistic embrace.

And the IA is concerned that continuing film production remain under its bargaining agreements. (That is, when the president of a local isn't being voted out by gun fire, as happened at Local 52 in 1969.)

Now back to the regularly scheduled respect.

Lira comes to the issue with fervent love for quality film; I won't dispute that, and I love quality film too, but the biz is no longer a question of quality film, it's a question of finance. He uses romantic comedies as a touchstone; today it's more a question of tent-pole franchises:

Batman, Spider-Man, Iron Man, X-Men, Shrek, Star Wars, Star Trek, Toy Story, Ice Age, Nightmare on Elm Street, Pirates of the Caribbean, Chipmunks, Kung Fu Panda, Madagascar (Penguins of), High School Musical (TV, then feature), Twilight Saga, et cetera ad infinitum

The lead-time for a franchise feature film is daunting; forget setting one up for release next year – that ship has sailed (unless you're frantic like Fox with X-Men). As of today, here's a list of franchise films scheduled for release in 2012:

Star Trek 2 (actually #12)
American Pie 4
Spider-Man 4
Batman 3
Madagascar 3
Cars 2

http://www.nakedcapitalism.com/2010/05/guest-post-where-there%E2%80%99s-smoke-there%E2%80%99s-a-smoke-machine-a-case-for-movie-futures.html

Guest Post: Where There's Smoke, There's a Smoke Machine – A Case for Movie Futures

By Buzz Potamkin, former studio executive and producer, in the biz for 40+ years, now a consultant

Every investment in film is gambling.
Schuyler Moore, April 22, 2010, testimony before the House Agriculture Subcommittee on General Farm Commodities

Futures are a hedge against some event yet to come, representing the desire by a participant to cover its risk on the unknown.
Composite definition

Marley was dead: to begin with. There is no doubt whatever about that.
Charles Dickens, *A Christmas Carol*

Dramatis personæ
(per customary Billing Block order)

MPAA – Motion Picture Association of America
The distributors: a fraternity of the current six Majors. MGM is out.

NATO – National Association of Theater Owners
The exhibitors: members operate over 30,000 screens.

SAG – Screen Actors Guild
The actors' union. Would rather have top billing.

IATSE – International Alliance of Theatrical Stage Employes, Moving Picture Technicians, Artists and Allied Crafts of the United States, Its Territories and Canada – commonly called the IA (pronounced I-A)
The union for the "below-the-line" film/TV workforce, including projectionists in signatory theaters. Some workers are represented by the Teamsters, the Painters and Allied Trades, and others.

Schuyler Moore – Tinseltown lawyer, author of "the" book on the biz, entertainment tax authority, well-respected adjunct professor at UCLA. As he said in Washington, it was his Entertainment Law Reporter article in 2003 that started serious consideration of film box office futures. (It's no longer available on the web, except as a pdf attachment to his submitted testimony to the House Subcommittee cutting back on their financing thresholds and Wall Street nowhere close to stepping up to the plate, it will fall to places like Abu Dhabi, Singapore, Russia and India (does Big Reliance have a little brother?) along with the reliably star-struck billioniares to fill the gap.

The only bright spot, said producer Ashok Armitraj (who will be feted for completing 100 films at a Variety do this week), is that the cost of production has come down slightly. Movie stars have cut back on their fees, and his Hyde Park Entertainment will be able to make more movies with less capital than in previous years.

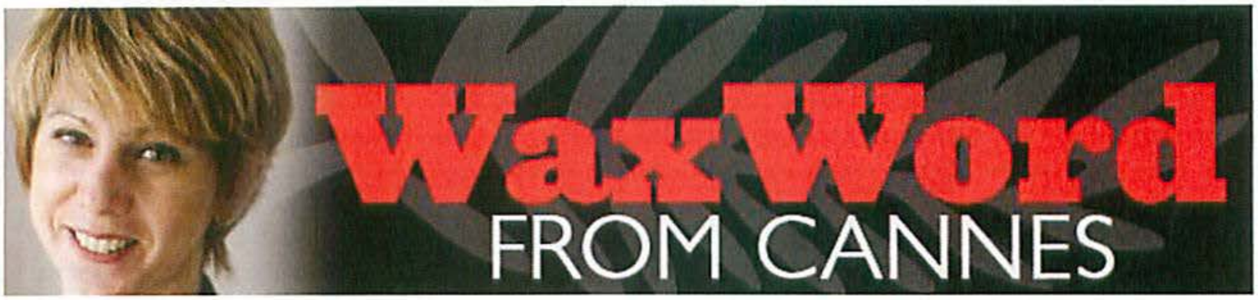
Arthouse distributor Richard Lorber, of Kino Lorber, was one of the few arriving at the festival in a "glass half-full" kind of mood. Lorber sees the landscape changing for the better, and is eager to find opportunities. But he releases movies in a handful of theaters; this festival is made for his kind of business.

Count on Lorber and IFC and Sony Classics to be picking up quality titles for crumbs.

And stay tuned to see if the Weinsteins actually announce that Miramax deal.

That's just Evening the First. More to come.

http://www.thewrap.com/ind-column/cannes-festival-opens-search-money-17301



The Cannes Festival Opens With a Search for Money

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By **Sharon Waxman**
Published: **May 12, 2010**
ALSO READ: "Cannes to 'Robin Hood'" No Bullseye."

It was a big damn party on the Majestic beach to celebrate the opening of "Robin Hood," as the premiere of the Cannes Film Festival. The live band sang Donna Summer, Medievally-inclined performers twirled fire-batons and the champagne flowed freely as Russell Crowe nuzzled his wife contentedly in the corner of an overhang.

Meanwhile guests exchanged nightmare stories about how long it took them to get around that volcano cloud. (We'd like to give Pete Hammond an extra shout-out for flying via Munich to get here.)

The movie seemed to have been received respectfully, if without any great enthusiasm. Universal is still hoping to see an opening this weekend in the $40 million range.

But that's not what has people talking at Cannes this year. Even en route to the festival, film professionals gearing up for a week of deal-making made clear that the quest is all about finding financing for movies, and less about buying product.

With the arthouse market is on life support, and producers and financiers told WaxWord that fewer movies than ever can expect to be bought this year – a handful, rather than the few dozen that usually get sold out the market.

CAA is here in force -- though they're not throwing any parties on any yachts this year -- and its film finance department is under strict orders to scour the Riviera for anything that smells like money. With the studios

What can we read from Paramount's decision? Is a mega sports event more than a month away a bigger threat than the prospect of piracy *this week*?

We're told Paramount wasn't too concerned about missing its numbers. Theatrical has been holding up well against piracy (home video is another story), and the superhero sequel is already tracking in the $150 million range for its opening domestic frame.

But remember the big stink Fox made last year around this time after "X-Men Origins: Wolverine" leaked before its theatrical debut. Now another major studio is basically shrugging off a leak as "disrespectful," nothing so alarming as to necessitate advance moves to mitigate the damage.

That's quite a sea change, no?

UPDATE:
A statement from Paramount: "Those who blatantly disregard laws and steal our movies electronically are no different from thieves on the street. And no matter where in the world such theft occurs, we work tirelessly with responsible governments to find and prosecute offenders."

http://thresq.hollywoodreporter.com/2010/05/iron-man-2-leak.html

'IRON MAN 2' NOW AVAILABLE FREE ONLINE

Mon May 03, 2010 @ 09:59AM PST

By Eriq Gardner

Paramount's rush to release "Iron Man 2" overseas was reportedly made in order to give it more time before June's World Cup captures everyone's attention.

Despite grossing $100.2 million in international boxoffice this past weekend, there's a downside in releasing it abroad first: Camcorded versions of "Iron Man 2" are now being traded on the Pirate Bay and other torrent sites, well in advance of the film's Friday bow in North America.

Hollywood has an entirely predictable predilection for shooting itself in the fiscal foot, so none of this should come as a surprise. But it is sad that the most intriguing derivatives product to be approved in years will probably be banned by Congress — thanks to the very people who stand to benefit the most from it.

Felix Salmon is the finance blogger at Reuters.

may suspect that smaller and nimbler competitors would get more benefit out of such a market: it's easier to hedge a $10 million project than a $200 million one.

Yet as Lionsgate Films, one of the few studios supporting the market, has recognized, a futures contract on box office receipts would be great news for the industry. For one thing, if the market got big enough, it would allow studios to easily hedge their investments in movies just by entering into a simple derivatives transaction. Studios could essentially sell contracts on their movies' grosses into the open market, and pocket the proceeds. They would lose money on the contract if the movie does well, but in that case they'd make enough money on the movie itself to cover their derivatives losses.

That kind of thing would be a lot easier, and a lot cheaper, than the studios' current methods of trying to hedge exposure and sell risk: the financing arrangements behind a typical Hollywood movie, with countless co-producers and incomprehensible accounting, make the average collateralized debt obligation look simple and transparent.

And even if the studios didn't participate in the market, they would still benefit. People care much more about things they bet on, and the fake-money version of these contracts — the online Hollywood Stock Exchange, in operation since 1996 — has done wonders for increasing awareness of coming films among its users, without a single dollar of publicity and marketing money being spent.

What's more, the contracts for the proposed market would be based on the first four weeks of box-office results, not just the opening weekend. A lot of people, of course, would be betting on that opening-weekend number, which is more a function of hype than a movie's long-term chances of success. Just as many, however, would wait until the movie comes out, watch it on its opening weekend, make their own qualitative determination of how well it will continue to perform over the rest of the month and then place their bets accordingly.

Today onions are the only commodity for which futures trading is banned. Not coincidentally, onion prices remain extremely volatile: they doubled in 2008, and then fell by 25 percent in 2009.

Today, no one is silly enough to ask a member of Congress to simply outlaw futures trading in a certain type of contract — no one, that is, except Hollywood film producers. Under the proposed financial-reform legislation making its way through the Senate, the bit of the 1958 bill saying "except onions" would be amended to read "except onions and motion picture box office receipts."

Hollywood was scared into pushing for the new language after the Commodity Futures Trading Commission, which regulates futures trading, recently approved two applications for markets in contracts based on movie grosses. But if the new provision makes its way into law, the biggest losers will be the very film producers who lobbied for it.

The proposed contracts are simple: they would allow traders to bet on the total box-office receipts of movies in their first four weeks of release. A contract on "Iron Man 2," for instance, might be trading at $390, meaning that the market is expecting the film to gross $390 million in its first four weeks. If you think it's going to make more than that, you would go long, or buy the contract; if you think it's going to make less, you would go short, or sell it. At the end of the four weeks, the contract would expire at whatever the four-week gross is. If you went long at $390 and the film ended up earning $450 million in its first four weeks, then you'd make $60 for every contract you bought.

Hollywood's mouthpiece, the Motion Picture Association of America, has argued that the new market could tarnish "the reputation and integrity of our industry" and would constitute "unbridled gambling" — though there's nothing "unbridled" about the regulatory strictures involved in being listed on a Chicago commodity exchange.

The real reason most of Hollywood is opposed to this development is unclear, but it is probably simply the age-old story of large, conservative institutions being averse to change. Top executives at the biggest studios http://www.nytimes.com/2010/05/10/opinion/10Salmon.html

Trading in Fantasy

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OFFICIAL SELECTION SUNDANCE FILM FESTIVAL

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By FELIX SALMON
Published: May 9, 2010

IN the 1950s, onion growers were often shocked at the low prices they were getting. Casting around for a villain to blame, they alighted on derivatives traders, and they persuaded Congress to ban any futures trading in onions.

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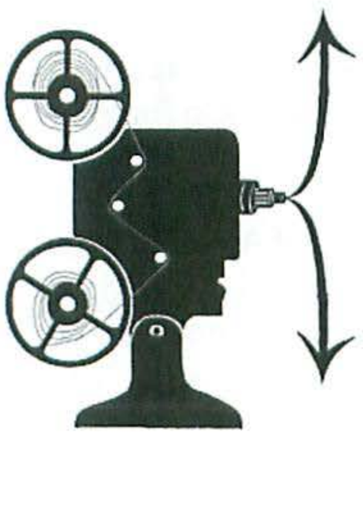

Dave Plunkert