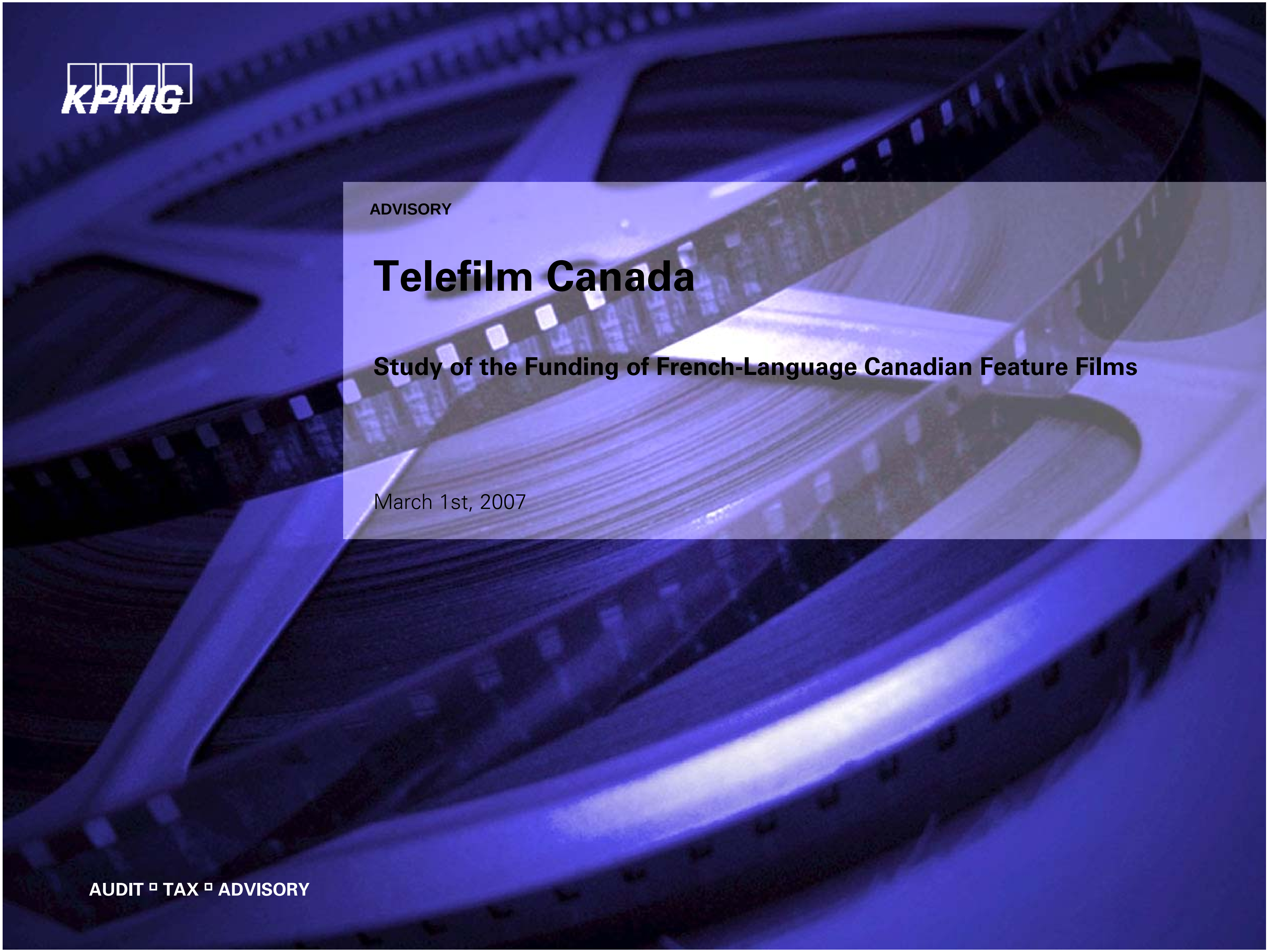


KPMG

ADVISORY

Telefilm Canada

Study of the Funding of French-Language Canadian Feature Films

March 1st, 2007

AUDIT ▫ TAX ▫ ADVISORY

Important Information

This document was produced by KPMG LLP./S.E.N.C.R.L. (“KPMG”) for Telefilm Canada ("Telefilm") with the aim of identifying alternative funding agencies for French-language Canadian feature films, and may only be used for the above-mentioned purpose.

Scope of Study

The analyses presented were conducted using data provided by Telefilm representatives as well as data from outside information sources. KPGM did not conduct any independent verification of the information appearing in this document, and as a result, KPGM therefore makes no warranty regarding the accuracy or completeness of this document, and assumes no responsibility for any statement (direct or indirect) or omission respecting this document.

Statistics provided by national film agencies, professional organisations and the professional media contain asymmetries due to the differences existing in different national statistical practices. This report must therefore be read with the preceding remarks in mind.

Note

Some analyses which were of particular interest to Telefilm, including particularly the sharing of funds among participants, could not be achieved for numerous reasons, such as the absence or disparity in available information between the different countries.

Table of Contents

Background of the Study

As the administrator of the Canada Feature Film Fund ("CFFF"), Telefilm is seeking solutions to the funding crisis currently facing the French-language Canadian feature film sector in order to maintain the success levels that have been achieved since the CFFF was instituted. Telefilm intends to compare the funding methods used for French-language Canadian productions with those used in other countries with markets that are comparable to the French-language market in Canada.

The results of this study are intended for deliberation by the CFFF Working Group set up by Telefilm, and may serve as the foundation for a possible action plan to be implemented by Telefilm.

Scope of the Study

Objective

The purposed of this study is to identify, document and analyze alternative funding structures for French-language Canadian feature films with the goal of maintaining a critical mass of feature films in the French-language market.

Methodology

International Benchmarking and Documentation of Main Alternative Funding Mechanisms

This phase is aimed primarily at documenting the main alternative funding mechanisms listed. Research was extended to cover available sources of information on selected comparable countries.

In addition, the international KPMG network as well as some professional audiovisual institutions were contacted in order to gather more information and validate the results of the study.

Analysis of Canada's French-Language Feature Film Industry

Meetings were held with members of the CFFF Working Group finance sub-committee in order to gather their points of view on the current state of Canada's French-language feature film industry.

This stage facilitated the conceptualization of the problem as it stands today, and the development of a practical implementation context for the documentation of alternative funding mechanisms.

Scope of the Study

Phase I – International Benchmarking

Identification of Reference Countries

This first step consists of identifying countries whose film industries are comparable to Canada’s French-language feature film industry.

Selection criteria used:

- Population
- Human Development Index

Canada's French-Language Feature Film Industry Among its Peers

The objective of the second step is to rank the comparable countries according to the comparison criteria and then rank Canada’s French-language feature film industry among its peers.

Selection criteria used:

- Number of national productions
- Investment in national productions
- Market share of national productions

Overview of Comparable Countries

This third step presents the principal funding mechanisms used in the selected reference countries.

Public and Private Funding of National Feature Films

This section presents the public and private funding shares in national productions of some reference countries.

Summary of the Primary Funding Mechanisms and Sources Listed

This last step is aimed at summarizing the primary public and private funding sources and mechanisms used elsewhere in the world. It serves to identify the advantages and disadvantages of each mechanism.

Scope of the Study

Phase II – Analysis of Canada's French-Language Feature Film Industry

A Few Facts and Figures

This section sets out some statistical facts and figures respecting the Canadian film industry over the last few years in order to inform the reader of recent developments in Canada's French-language feature film industry.

Understanding the Issues

Using simple concepts, this second step of phase II facilitates understanding of the challenges faced by the Canadian film industry.

Main Observations and Key Success Factors

Here we present a number of findings and identify the industry's main key success factors in anticipation of the following step: Recommendations.

Recommendations

This last step consists of making recommendations to Telefilm on funding mechanisms apt to enable it to meet its objective (to maintain a critical mass of French-language Canadian feature films), based on our analysis of the industry and the listed funding methods from reference countries.

Identification of Reference Countries

Objective

This first phase of the benchmarking consists of identifying countries with film industries that are comparable to Canada's French-language feature film industry.

The total number of comparable countries identified through an analysis chart developed by KPMG was set at 15.

Although the study centres on the funding of French-language Canadian feature films only, the whole of Canada was chosen as a reference basis, with no language distinction made.

Methodological Limitations

Though rigorous, the methodology used in the study has limitations to the extent that other criteria for comparison and ranking methods could have been used in order to determine the inter-comparability of the countries.

The following page presents the details of the methodology approach used.

Selection Criteria

Population (2005)

Population was used as a selection criterion in order to ensure comparability among the countries in terms of the size of the market in which the film market as a whole evolves.

Human Development Index"HDI"(2002)

The HDI was used since it is a well-known composite indicator which measures a country's growth according to three basic human development criteria: health, longevity (measured through life expectancy), knowledge (measured through literacy and schooling rates) and standards of living (calculated by the GDP per inhabitant).

Identification of Reference Countries

A Two-Step Methodological Approach

1 – Raking by Comparison Criterion

For every comparison criterion used, population or HDI, a ranking was made in order to determine which countries were most comparable to Canada. Every country was attributed a score equivalent to its position according to the gap between it and Canada (e.g., the country ranked sixth closest to Canada was attributed an indicator of 6). Countries that obtained identical gaps were attributed the same score. Both criteria evaluated were assigned the same level of importance.

As reference country, Canada was attributed a zero score for every criterion. The differences observed in population and HDI were analyzed in absolute terms.

2 – Overall Raking

The countries were further ranked according to the total marks obtained in each of the comparative criteria above. The 15 countries that obtained the lowest totals, and therefore the closest to Canada (zero score), were retained (see results on the next table). Three countries were eliminated because one of the scores was considered extreme, being above 20. These include the United States, Japan and South Korea.

Germany

With a population of over 80 million inhabitants, Germany was excluded from the countries comparable to Canada. However, due to the presence of some funding mechanisms that have been successful in Germany in recent years, we thought it wise to include it in the analysis.

Identification of Reference Countries

	Classification	Country	"Population" Ranking	"HDI" Ranking	Total
	Reference Country	**Canada**	0	0	0
1	1	**Netherlands**	3	1	4
2	2	**Belgium**	5	1	6
3	2	**Australia**	2	4	6
4	3	**Sweden**	6	4	10
5	4	**Switzerland**	8	8	16
6	5	**Austria**	7	11	18
7	6	**Spain**	1	18	19
8	7	**Iceland**	17	3	20
9	7	**United Kingdom**	12	8	20
10	8	**Finland**	11	10	21
11	9	**Denmark**	10	13	23
12	10	**Luxembourg**	16	12	28
13	10	**France**	15	13	28
14	10	**Norway**	13	15	28
15	10	**Italy**	9	19	28

The table on the left illustrates the ranking of the 15 reference countries selected.

Countries considered closest to Canada are ranked from 1-15 in terms of population and HDI based on their total scores.

As mentioned above, both comparison criteria were given the same level of importance in determining the final scores.

Hence, the Netherlands, followed by Belgium and Australia, are identified as the 3 most comparable to Canada, while Luxembourg, France, Norway and Italy come in last, with 28 points.

Countries with the same points occupy the same position.

Canada's French-Language Feature Film Industry Among its Peers

Objective

The objective of this second step is to classify the comparable countries according to the selected comparison criteria and thereby position Canada's French-language feature film industry among its peers.

Methodology

We identified three comparison criteria for the film industry in a local industry development perspective.

The indicators were compared on an average of the last three years as well as on the basis of a tendency observed during the last five years.

Statistical data for some countries or some dates could not be obtained. The tables and illustrations in this report therefore highlight only the countries with available data.

Canada and French Canada have been presented as distinct states among the comparable countries.

Selected Comparison Criteria

- Total national productions
- Investment (total budgets) in national productions
- Market shares of national productions

Limitations of the Analysis

Statistics given by the different organisations contacted are not uniform due to the differences existing in national statistical practices.

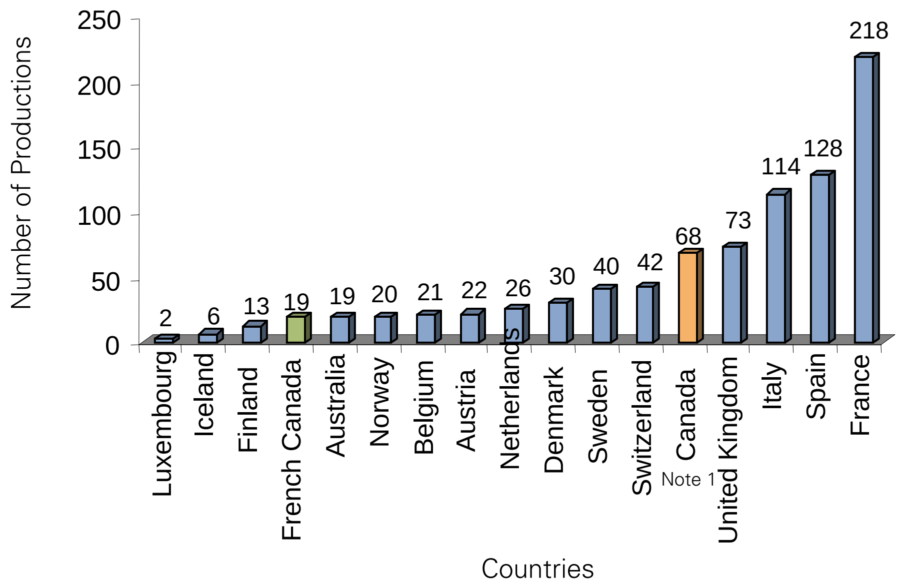
It is therefore important that readers bear this in mind in reading the benchmarking exercise aimed at positioning French Canada among a number of countries considered comparable in terms of population and HDI.

Phase I –International Benchmarking

Canada's French-Language Feature Film Industry Among its Peers

	Countries	Inhabitants by Feature Film Produced[2]
1	Iceland	47.368
2	Switzerland	179.141
3	Denmark	181.319
4	Sweden	224.196
5	Norway	233.898
6	Luxembourg	250.000
7	France	291.319
8	Spain	336.605
9	French Canada	355.263
10	Austria	378.462
11	Finland	410.526
12	Canada	477.958
13	Belgium	498.707
14	Italy	511.438
15	Netherlands	636.456
16	United Kingdom	824.471
17	Australia	1.076.618

Number of National Productions
Annual Averages from 2003 to 2005



Sources: Telefilm Canada, Australian Film Commission (AFC), Focus 2006, World Film Market Trends, European Audiovisual Observatory
***Note 1:** Statistics for Canada include French Canada **Note 2:** The number of feature films correspond to the annual average from 2003 to 2005*

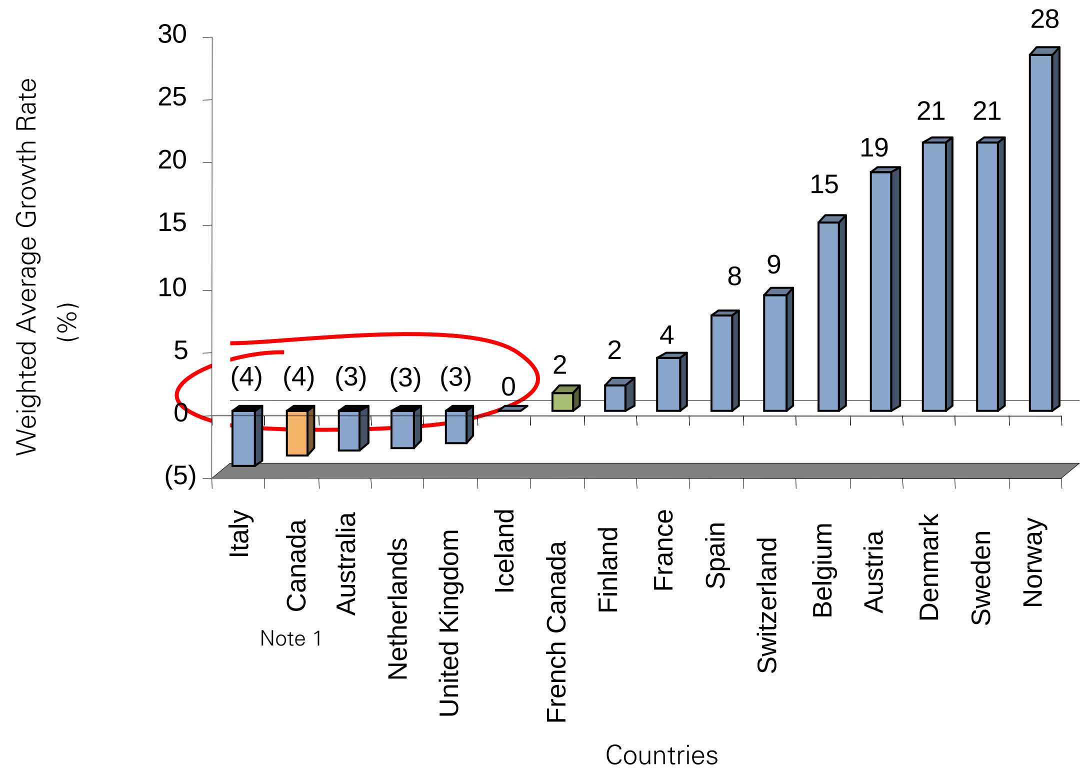
Canada's French-Language Feature Film Industry Among its Peers

From 2001 to 2005, the number of local productions decreased by an average of 4% a year in Canada but grew by 2% a year in French Canada.

Among the 16 countries ranked on the right (including Canada and French Canada), six show a zero or negative growth rate in national productions over the last five years.

Number of National Productions

Weighted Average Growth Rate from 2001 to 2005



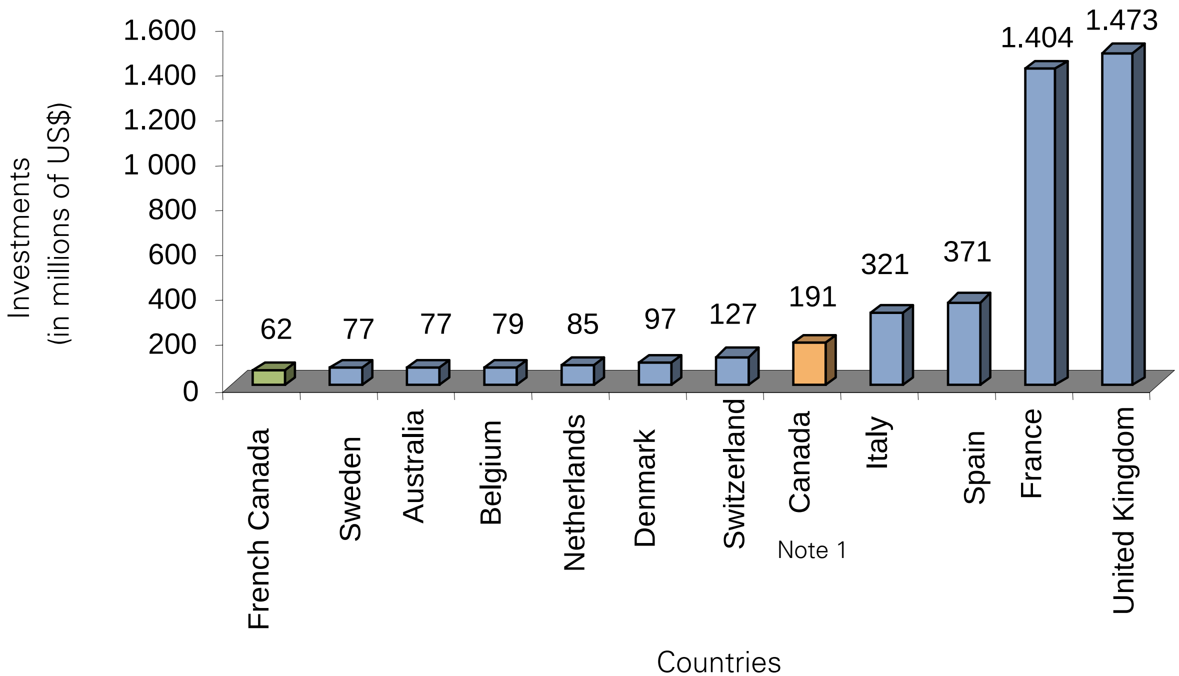
Source: KPMG Analysis Chart

Note 1: *Statistics for Canada include French Canada*

Canada's French-Language Feature Film Industry Among its Peers

In terms of total annual investment during the past three years, Canada ranks 5th among countries for which information was available.

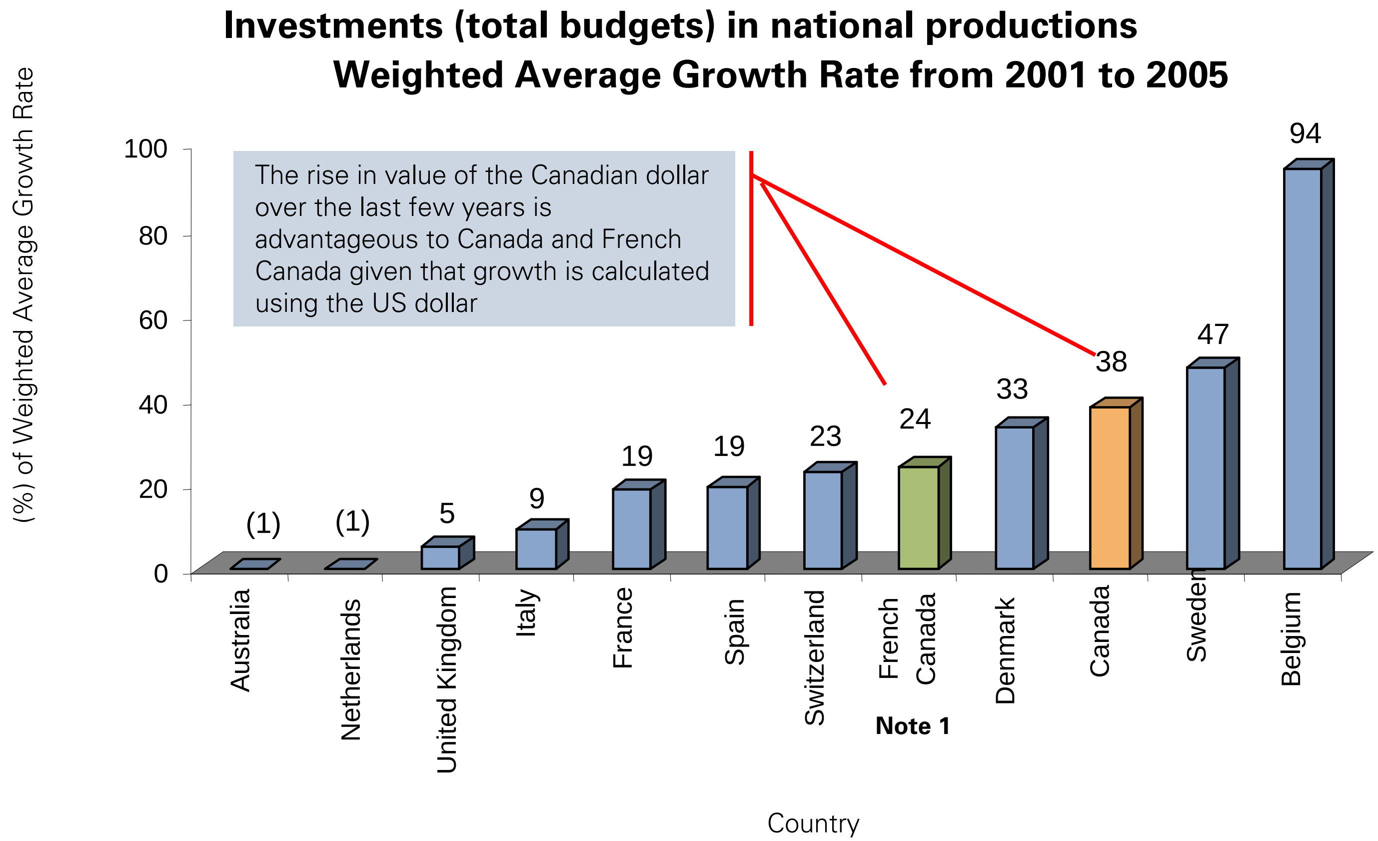
Investments (total budgets) in National Productions Annual Averages from 2003 to 2005



Sources: Telefilm Canada, Australian Film Commission (AFC)
***Note 1:** Statistics for Canada include French Canada*

Canada's French-Language Feature Film Industry Among its Peers

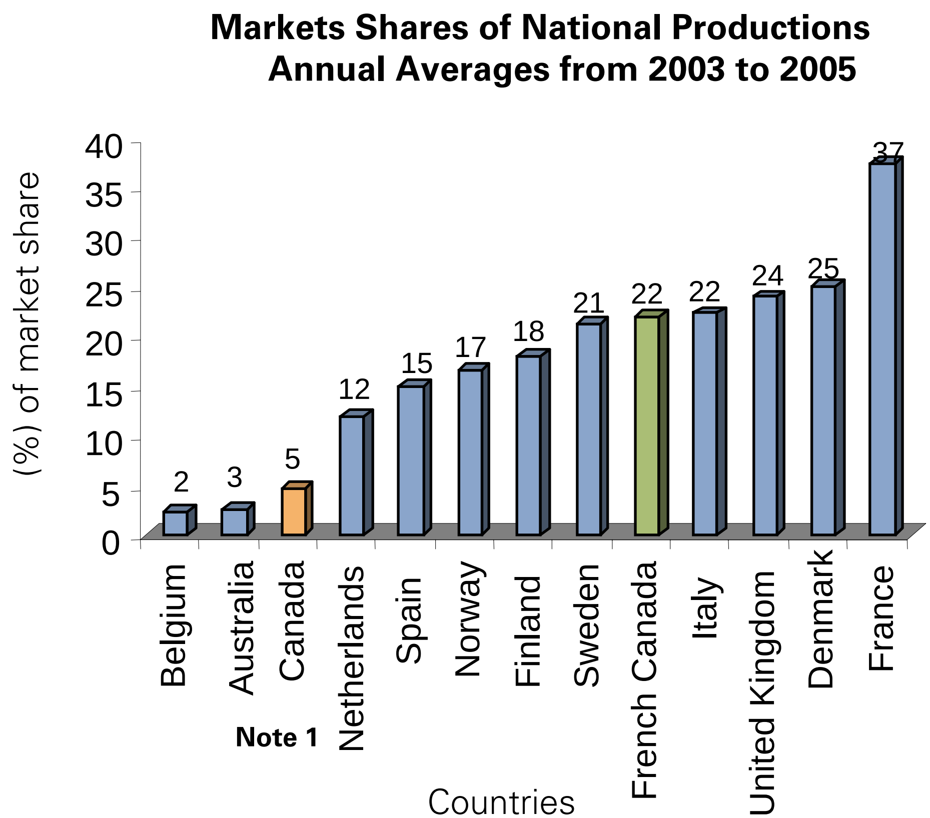
Canada and French Canada rank 3rd and 5th respectively in the weighted annual investment growth rate over the last five years.



Source: KPMG Analysis Chart
Note 1: *Statistics for Canada include French Canada*

Canada's French-Language Feature Film Industry Among its Peers

In terms of market share of national productions, French Canada ties with Italy in 4th position among comparable countries.



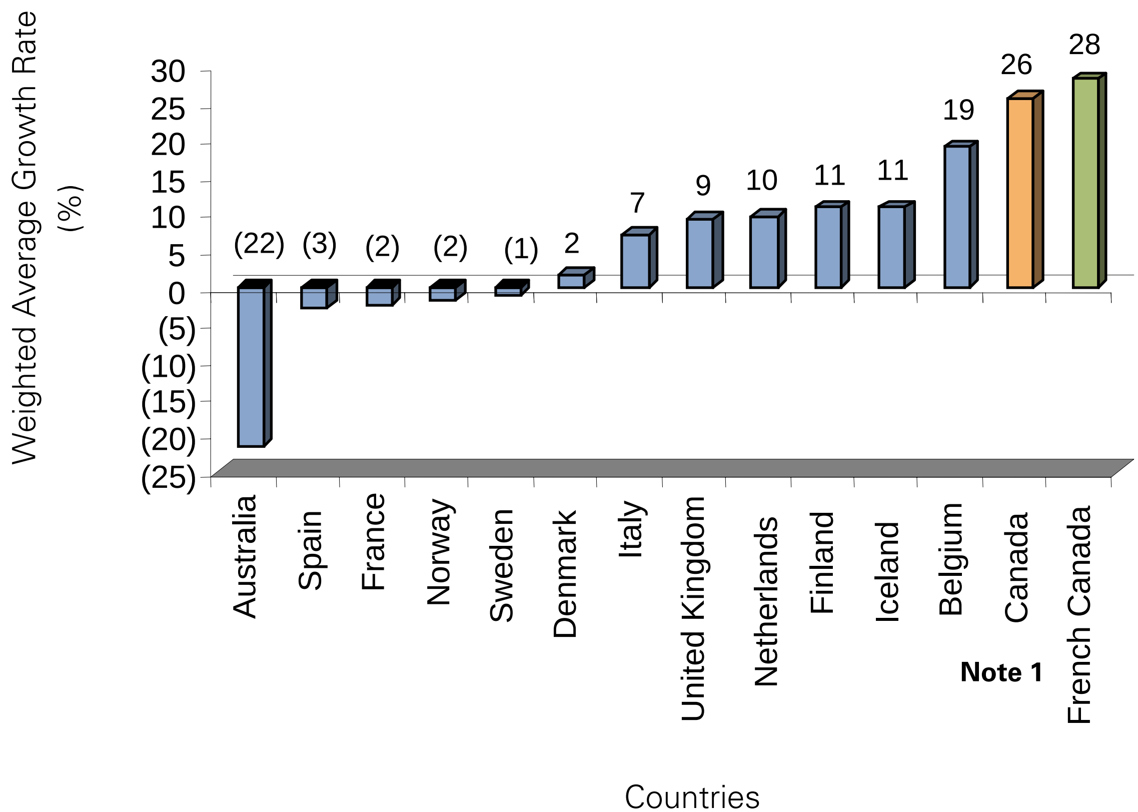
Sources: Quebec Institute of Statistics, Telefilm Canada, Australian Film Commission (AFC), Focus 2006, World Film Market Trends, European Audiovisual Observatory
Note 1: *Statistics for Canada include French Canada*

The Canadian French-language Feature Film Industry Among its Peers

Canada and French Canada are top on the list of comparable countries in terms of growth in market shares, with second and first place respectively.

It should be noted that Canada's ranking is essentially attributable to the performance of the French segment.

National Production Market Shares
Weighted Average Growth Rate from2001 to 2005



Source: KPMG Analysis Chart
Note 1: *Statistics for Canada include French Canada*

Overview of Comparable Countries

Objective

The following section briefly presents certain characteristics of the film industry of the selected reference countries.

As mentioned earlier, Germany is included even though it was not initially selected among the reference countries.

Methodology

Each country is presented in an overview from three perspectives:

- Some data and statistics
- Funding sources from government support agencies
- Main public funding mechanisms used

Limitations

Statistics provided by national film agencies, professional organisations and the professional media contain disparities due to the differences existing in different national statistical practices.

Information on the funding sources of government support agencies does not include the funding of supranational agencies.

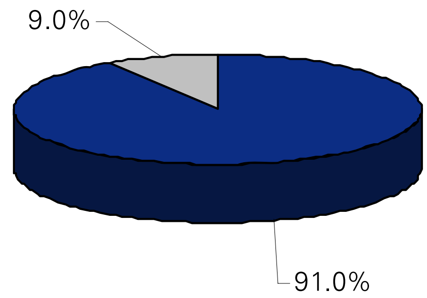
The following section must therefore be read with the above remarks in mind.

Overview of Comparable Countries

Canada[1] (2005/2006)
- Number of productions[2]: 31
- Investments[2] – national productions (in millions of CA$): 147.2
- Local market share: 5.3%

Canada (2005/2006)
- Number of productions[2]: 13
- Investments[2] – national productions (in millions of CA$) 49.3
- Local market share: 26.6%

CFFF Funding Sources (2005/2006)



Total funding (in millions of $): 49.3

Government   Recoveries and other revenues

Main funding mechanisms used

- Selective and performance-based government support
- Tax incentives

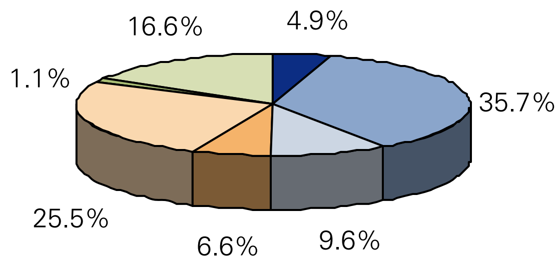
Sources: Telefilm Canada, CFFF only
Note 1: *Statistics for Canada include French Canada*
Note 2: *Feature films financed by Telefilm Canada, CFFF only*

Overview of Comparable Countries

Germany

- Number of productions in 2005: 135
- Investments – national productions, 2005 (in millions of US$): 845
- Local market share: 17%

Funding from public agencies (2002)



Total funding (in millions of EUR): 211.4

- Government (+EU)
- Communities/regions
- Tax on cinema tickets
- Video revenue taxes
- Contribution by TV networks
- Other bodies
- Recoveries and other revenues

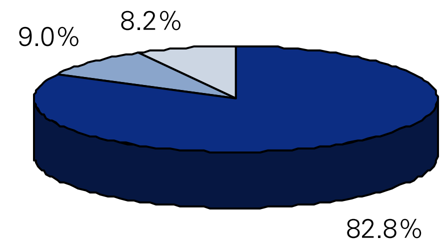
Main funding mechanisms used

- Selective and performance-based government support
- Private investment fund
- Tax incentives

Australia

- Number of productions in 2005: 22
- Investments – national productions, 2005 (in millions of US$): 81
- Local market share: 3%

Funding from public agencies (2005)



Total funding (in millions of EUR): 19.7

- Government
- Other taxes
- Recoveries and other revenues

Main funding mechanisms used

- Direct government assistance through public agencies such as FFC and AFC
- Tax incentives

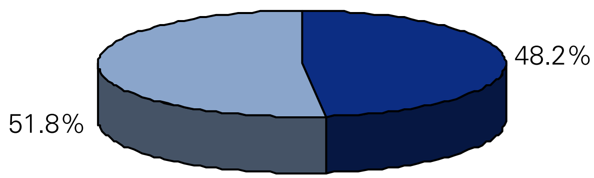
Sources: Observatoire Européen de l’audiovisuel (European Audiovisual Observatory), various professional bodies

Overview of Comparable Countries

Austria

- Number of productions in 2005: 24
- Investments – national productions, 2005 (in millions of US$): N.A.
- Local market share: 2.3%

Funding from public agencies (2002)



Total funding (in millions of EUR): 20

■ Government (+EU) ■ Communities/regions

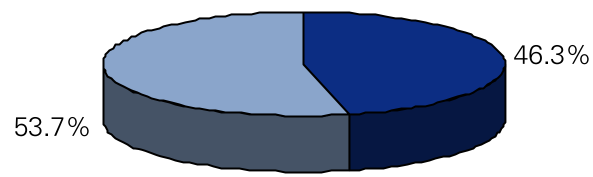
Main funding mechanisms used

- Direct assistance from government and communities

Belgium

- Number of productions in 2005: 28
- Investments – national productions, 2005 (in millions of US$): 128
- Local market share: 4%

Funding from public agencies (2002)



Total funding (in millions of EUR): 23

■ Communities/regions ■ Contribution by TV networks

Main funding mechanisms used

- Direct assistance from communities
- Direct contribution by TV networks
- Pre-sale of audiovisual works
- Tax incentives

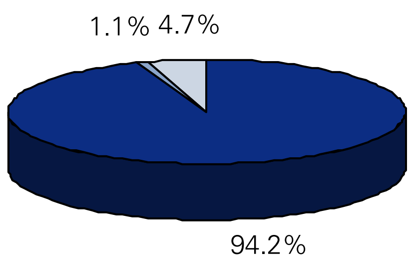
Sources: Observatoire Européen de l'audiovisuel, (European Audiovisual Observatory), various professional bodies

Overview of Comparable Countries

Denmark

- Number of productions in 2005: 31
- Investments – national productions, 2005 (in millions of US$): 134
- Local market share: 32%

Funding from public agencies (2002)



Total funding (in millions of EUR): 36.9

■ Govt (+EU) ■ Communities/regions ■ Contribution by TV networks

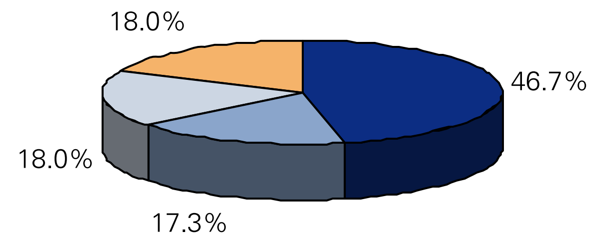
Main funding mechanisms used

- Direct assistance from government and communities
- Direct contribution by TV networks

Spain

- Number of productions in 2005: 142
- Investments – national productions, 2005 (in millions of US$): 433
- Local market share: 16%

Funding from public agencies (2002)



Total funding (in millions of EUR): 87.5

■ Govt (+EU) ■ Communities/regions
■ Other bodies ■ Recoveries and other revenues

Main funding mechanisms used

- Direct assistance from government and communities

Sources: Observatoire Européen de l'audiovisuel, (European Audiovisual Observatory), various professional bodies

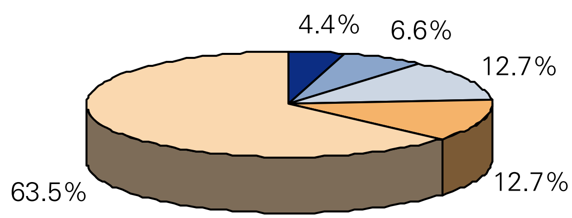
Phase I – International Benchmarking

Overview of Comparable Countries

Finland

- Number of productions in 2005: 13
- Investments – national productions, 2005 (in millions of US$): N.A.
- Local market share: 15%

Funding from public agencies (2002)



Total funding (in millions of EUR): 15.2

- Government (+EU)
- Communities/regions
- Video revenue taxes
- Contribution by TV networks
- Lottery

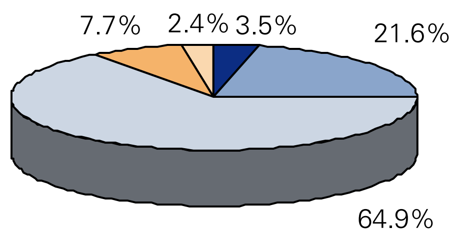
Main funding mechanisms

- Direct assistance from government and communities
- Direct contribution by TV networks

France

- Number of productions in 2005: 240
- Investments – national productions, 2005 (in millions of US$): 1,601
- Local market share: 38%

Funding from public agencies (2002)



Total funding (in millions of EUR): 493.8

- Government (+EU)
- Tax on cinema tickets
- Tax on TV network revenues
- Tax on video revenues
- Recoveries and other revenues

Main funding mechanisms used

- Selective and performance-based government support
- Direct contribution by TV networks
- SOFICA
- Tax incentives

Sources: Observatoire Européen de l'audiovisuel (European Audiovisual Observatory), various professional bodies

Overview of Comparable Countries

Iceland

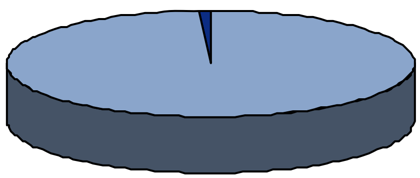
- Number of productions in 2005: 3
- Investments – national productions, 2005 (in millions of US$): N.A.
- Local market share: 3%

Italy

- Number of productions in 2005: 98
- Investments – national productions, 2005 (in millions of US) $: 267
- Local market share: 25%

Funding from public agencies (2002)

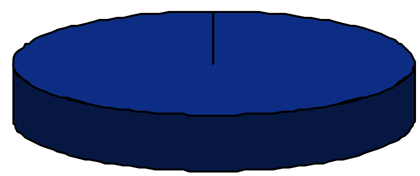
0.9%



99.1%

Government ■ Contribution by TV networks

Funding from public agencies (2002)



100%

Total funding (in millions of EUR): 41.4

Government (+EU)

Main funding mechanisms used

- Direct government assistance
- Tax incentives

Main funding mechanisms used

- Direct government assistance
- Tax incentives

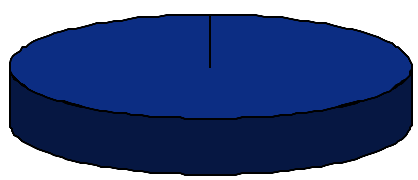
Sources: Observatoire Européen de l'audiovisuel (European Audiovisual Observatory), various professional bodies

Overview of Comparable Countries

Luxembourg

- Number of productions in 2005: 10
- Investments - national productions, 2005 (in millions of US$): N.A.
- Local market share: 0%

Funding from public agencies (2002)



Total funding (in millions of EUR): 3.9

Government (+EU)

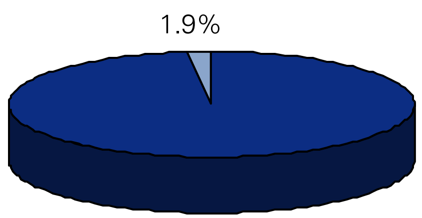
Main funding mechanisms used

- Direct government assistance

Norway

- Number of productions in 2005: 19
- Investments - national productions, 2005 (in millions of US$): N.A.
- Local market share: 14%

Funding from public agencies (2002))



Total funding (in millions of EUR): 30.2

Government Contribution by TV networks

Main funding mechanisms used

- Direct government assistance
- Direct contribution by TV networks
- Tax incentives

Sources: Observatoire Européen de l'audiovisuel (European Audiovisual Observatory), various professional bodies

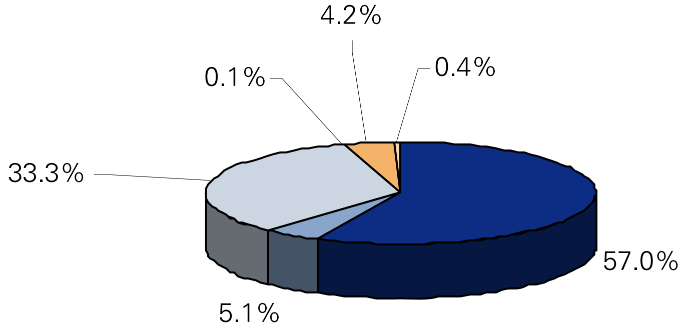
Phase I – International Benchmarking

Overview of Comparable Countries

Netherlands

- Number of productions in 2005: 24
- Investments – national productions, 2005 (in millions of US$): 80
- Local market share: 13%

Funding from public agencies (2002)



Total funding (in millions of EUR): 48.2

- Government (+EU)
- Communities/regions
- Tax on TV network revenues
- Contribution by TV networks
- Other bodies
- Recoveries and other revenues

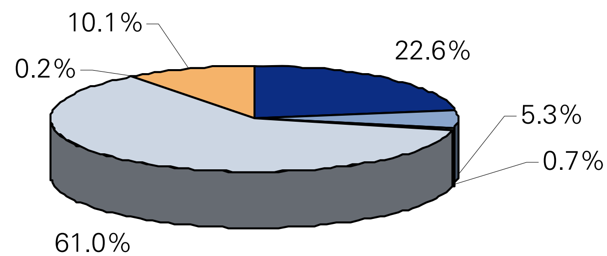
Main funding mechanisms used

- Direct assistance from government and communities
- Direct contribution by TV networks
- Tax incentives

United Kingdom

- Number of productions in 2005: 124
- Investments - national productions, 2005 (in millions of US$): 1,043
- Local market share: 34%

Funding from public agencies (2002))



Total funding (in millions of EUR): 90.5

- Government (+EU)
- Communities/regions
- Contribution by TV networks
- Lottery
- Other bodies
- Recoveries and other revenues

Main funding mechanisms used

- Direct assistance from government and communities
- Direct contribution by TV networks
- Tax incentives

Sources: Observatoire Européen de l'audiovisuel (European Audiovisual Observatory), various professional bodies

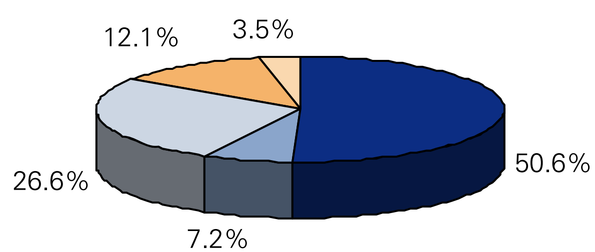
Phase I – International Benchmarking

Overview of Comparable Countries

Sweden

- Number of productions in 2005: 54
- Investments - national productions, 2005 (in millions of US$): 104
- Local market share: 22%

Funding from public agencies (2002)



Total funding (in millions of EUR): 49.7

- Government (+EU)
- Communities/regions
- Taxes on cinema tickets
- Contribution by TV networks
- Recoveries and other revenues

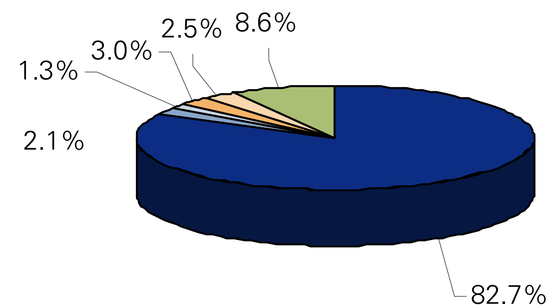
Main funding mechanisms used

- Direct assistance from government and communities
- Tax incentives

Switzerland

- Number of productions in 2005: 47
- Investments - national productions, 2005 (in millions of US$): 145
- Local market share: 6%

Funding from public agencies (2002)



Total funding (in millions of EUR): 16.3

- Government (+EU)
- Communities/regions
- Contribution by TV networks
- Lottery
- Other bodies
- Recoveries and other revenues

Main funding mechanisms used

- Selective and performance-based government support

Sources: Observatoire Européen de l'audiovisuel (European Audiovisual Observatory), various professional bodies

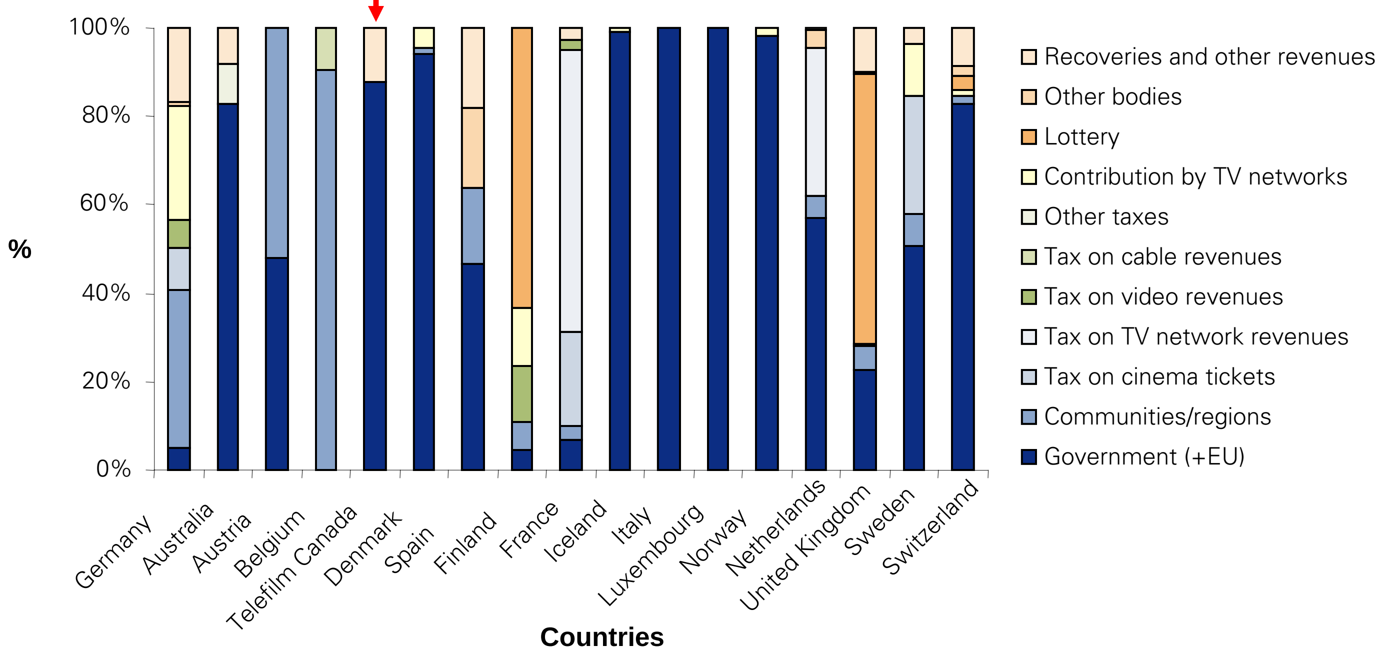
Phase I – International Benchmarking

Overview of Comparable Countries

Summary illustration

Funding by Telefilm Canada is similar to funding in Australia, Denmark, Iceland, Italy, Luxembourg, Norway, and Switzerland, where over 80% of public funding is dependent on government budgets.

Breakdown of funding from public agencies (2002) and from Telefilm Canada (2005/2006)



Sources: Observatoire Européen de l'audiovisuel (European Audiovisual Observatory), various professional bodies

Public and Private Funding of National Feature Films

Objective

This section of the report aims to determine the share of public and private funding in the national productions of some reference countries. The benchmarking is designed to situate government contributions to the funding of feature films in Canada and other countries, and the contributions of the private sector.

Limitations

It should be noted that the information presented here is based on estimates of the funding of national feature films so as to take into account the large disparities that exist between data collected within the countries under study. The countries presented are those for which good quality information was available: Germany, Spain, France, Italy and the United Kingdom.

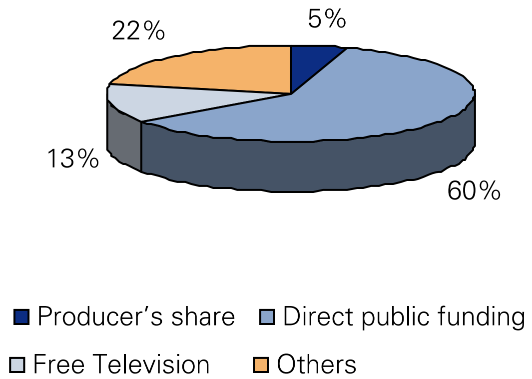
Data was collected from the firm International Media Consultants Associés ("IMCA"), which was mandated by the European Union in 2002 to conduct a study on the identification and evaluation of the flow of funds for cinema in Europe

Note that in the presentation:

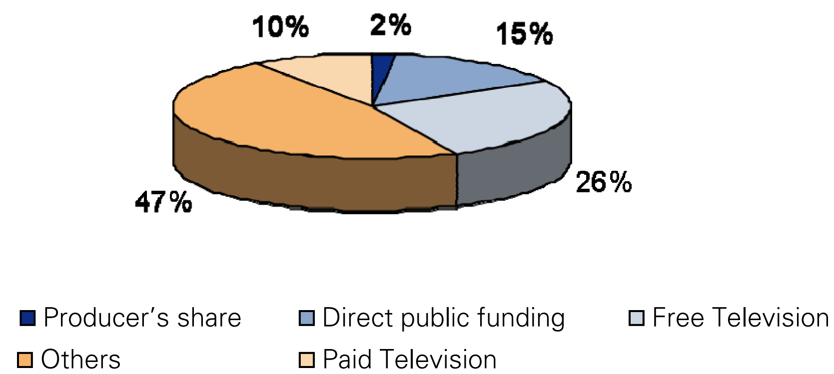
- Public funds represent direct government assistance, and do not include tax relief
- The "Others" segment includes minimum guarantees and private coproducers
- Contributions by broadcasters include public and private networks

Public and Private Funding of National Feature Films

Germany (2002)



Spain (2002)

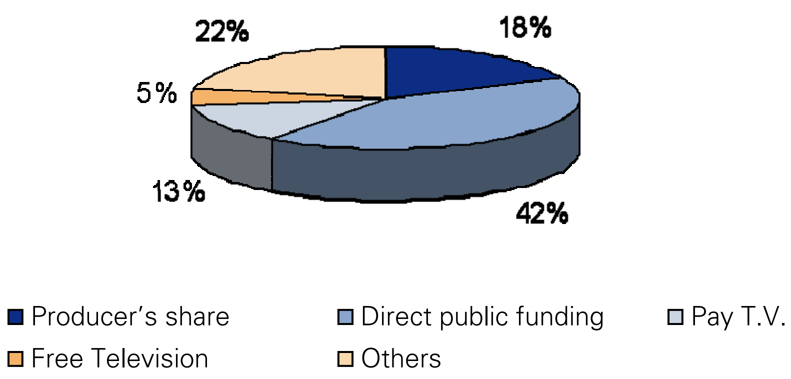


- Among the five countries analyzed, producers' shares in Germany and Spain are the lowest, representing 5% and 2%, respectively.
- For the reference year 2002, direct public funding reached 60% in Germany.
- The "Others" segment is composed mainly of minimum guarantees and private coproducer contributions.

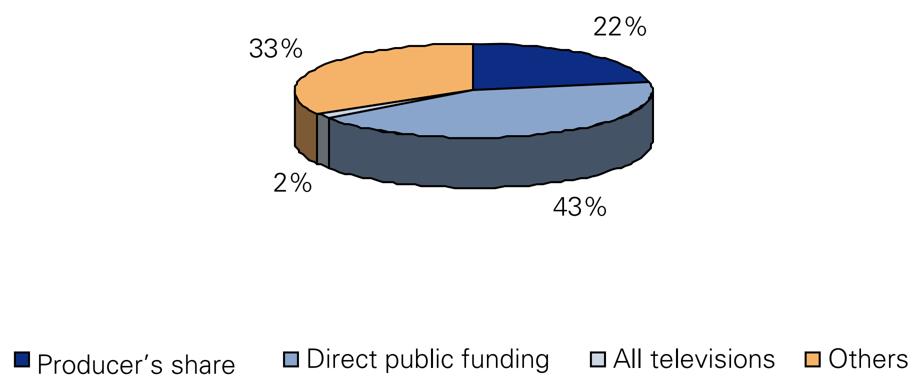
Source: IMCA For DG, Unit C1, Study number DG EAC/34/01, 2002

Public and Private Funding of National Feature Films

France (2002)



Italy (2002)

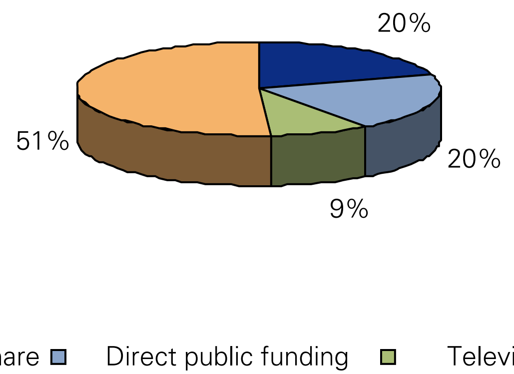


- In Italy, public funding stands at 43%, whereas producers' shares account for 22%
- In France, contributions by television broadcasters account for 35% of funding
- The "Others" segment is composed mainly of minimum guarantees and private coproducer contributions.

Source: IMCA for DG EAC, Unit C1, study number DG EAC/34/01, 2002

Public and Private Funding of National Feature Films

United Kingdom (2002)



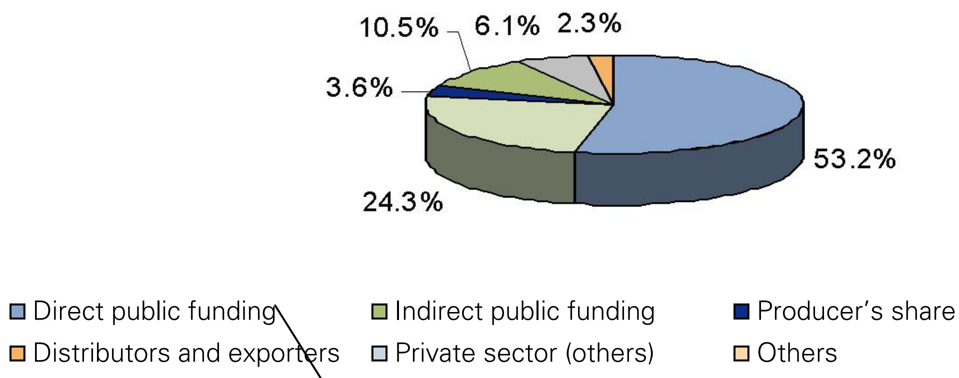
- Foreign coproductions classified under "Others" represent the main source of funding in the United Kingdom.
- The "Others" segment is composed mainly of minimum guarantees and private coproducer contributions.

Source: IMCA for DG EAC, Unit C1, study number DG EAC/34/01, 2002

Public and Private Funding of National Feature Films

Telefilm Canada, CFFF (2005-2006 fiscal year)

Including direct and indirect public funding



Direct public funding refers to support provided by the CFFF. All other forms of government support (including tax relief) are presented as indirect support.

- Direct and indirect public funding reached 77.5% for French-language Canadian feature films partly financed by the CFFF during the 2005-2006 Telefilm Canada fiscal year.
- The "Others" segment is composed mainly of minimum guarantees and private coproducer contributions.

Source : Téléfilm Canada

Main Funding Mechanisms and Sources Identified

This section presents the main private funding mechanisms identified in the film industry and the main sources of public funding.

This section is not an essay on the various funding sources and mechanisms. Therefore, it does not attempt to exhaustively define the mechanisms but sets out their main advantages and disadvantages, along with some comments.

Public funding mechanisms can take many different forms (tax incentives, grants, loans, etc.) and differ significantly from country to country. Therefore, we simply identify them in the list below, with no further comment. Readers seeking details of tax programs for the film industry in various countries are referred to the KPMG study "Film funding and Television Programming: A Taxation Guide."

The list below summarizes the main sources and mechanisms identified during this study. With the exception of the public funding mechanisms, they are presented in detail in the following pages.

Sources of public funding

- Tax on cinema tickets
- Tax on television network advertising revenues
- Tax on sales of video cassettes and DVD
- Contributions by cable operators
- Contribution of the national lottery
- Direct voluntary contributions by television networks
- Government budgets

Public Funding mechanisms

- Tax relief
- Grants
- Loans
- Others

Private funding mechanisms

- Production-finance-distribution
- Minimum guarantee
- Self-funding
- Pre-sale of distribution rights
- Loan financing (including consortia)
- TV pre-sale
- Financing by end-user

Main Public Funding Sources Identified

Tax on cinema tickets

The tax on cinema tickets is generally based on the admission price. In France, it is payable irrespective of the format and delivery system of the films or audiovisual documents projected in movie theatres.

Advantages

- Diversifies sources of financing for public funds
- Foreign films serve as financial levers for the local film industry
- Constitutes the basis of a support policy for exhibitors

Comparable countries with this funding mechanism

- Germany
- France
- Sweden

Disadvantages

- Likely to reduce the number of moviegoers in the short term
- Increases management effort and cost for exhibitors

Comments

- In Spain and the United Kingdom, this tax was abolished in the 1980s.
- In 2002, the tax on cinema tickets accounted for 22%, 27% and 29% of the respective budgets of the CNC in France, FFA in Germany and SFI in Sweden.
- As of January 1, 2007, in France, the tax on cinema tickets is collected directly by the CNC in line with its mandate to monitor exhibitor revenues. This reform is accompanied by simplified measures: the tax is set at the uniform rate of 10.72% of the admission price, and reports are made by theatre, not by screen (ticket categories and serial numbers have been eliminated).

Main Public Funding Sources Identified

Tax on television network advertising revenue

This tax is generally used to fund a body that supports the audiovisual industry. In France, more than two thirds of the CNC budget is derived from this tax, which amounted to 338 million EUR in 2005.

Advantages

- Diversifies sources of financing for public funds

Comparable countries with this mechanism

- France
- Netherlands

Disadvantages

- Likely to affect the financial performance of television networks in the short term
- Likely to make the televisual industry dependent.

Comments

- In the Netherlands, STER, the public agency in charge of selling advertising space on TV networks and public radios, pays in an amount equivalent to one-sixteenth of its revenue to STIFO, a national film industry funding agency.

Main Public Funding Sources Identified

Tax on video cassettes and DVD sales

The widening profit margins of the video market led to the institution of this tax in Germany and France. It is calculated on distributor turnover.

In Germany, this tax applies as follows:

- 1.8% for a turnover of less than 30 million EUR
- 2% for a turnover of between 30 and 60 million EUR
- 2.3% for a turnover of more than 60 million EUR

Advantages

- Diversifies sources of financing for public funds
- Involves multiple users in the funding of feature films
- Growth of this exploitation platform in recent years
- Foreign films serve as financial levers for the local film industry

Comparable countries with this mechanism

- Germany
- Finland
- France

Disadvantages

- Likely to affect the financial performance of retailers in the short term
- Increase in the prices of DVDs and video cassettes is likely to encourage piracy

Comments

- In France, since 2003, due to the rapid development of the DVD, the tax scope is no longer based on the turnover of publishers, but rather, on that of retailers. The share of this tax in the CNC budget in France tripled between 2002 and 2005, going from 12.6 million to 40 million EUR.

Main Public Funding Sources Identified

Contributions by cable operators

In 1995, the French Belgian Community signed a protocol agreement with all cable network operators in Wallonie. This agreement lays down the terms of their contribution to the development of audiovisual creation.

The amount of 1.86 EUR indexed per subscriber per year is paid to the Centre du cinéma et de l'audiovisuel.

Between 1995 and 2002, cable operator contributions amounted to nearly 30 million EUR, half of which was paid to the Centre du cinéma et de audiovisuel .

Advantages

- Diversifies sources of financing for public funds
- Involves multiple users in the funding of feature films

Comparable countries with this mechanism

- Belgium

Disadvantages

- Likely to affect the financial performance of cable operators in the short term
- Increases management effort and cost for cable operators

Comments

- In France, discussions are underway for the institution of a tax for cable operators, more specifically, Internet service providers.

Phase I – International Benchmarking

Main Public Funding Sources Identified

National lottery

A percentage of lottery revenues is distributed to national agencies that fund films. In the United Kingdom, the creation of a national lottery in 1993 served to restore direct support for the film industry.

Advantages

- Diversifies sources of financing for public funds

Comparable countries with mechanism

- Finland
- United Kingdom
- Switzerland

Disadvantages

- It could reasonably be asked why this mechanism should be used to fund the film industry at the expense of other economic sectors

Comments

- In 2002, two-thirds of the funds of the UK Film Council were generated from the national lottery, accounting for 55 million EUR

Main Public Funding Sources Identified

Voluntary contributions by television networks

Several types of contribution can be made by television networks:

- Programming provisions
- Direct investment obligations defined by a regulatory framework
- General cultural obligations defined by the statutes or mandates of public service broadcasters in the form of commissions or pre-buys from independent producers
- Compulsory or voluntary contributions to support funds
- Commitments signed with producers' associations or public authorities to invest specific sums in film production or to participate in a group investment fund.

Advantages

- Diversifies sources of financing for public funds
- Provides audiences with access to national cultural content
- Involves multiple users in the funding of feature films

Comparable countries with this mechanism

- Germany
- Australia
- Belgium
- Canada
- Denmark
- Spain
- Finland
- France
- Iceland
- Italy
- Luxembourg
- Norway
- Netherlands
- United Kingdom
- Sweden
- Switzerland

Disadvantages

- This form of funding could lead to reduced creativity among producers and a tendency to produce films designed to raise ratings

Comments

- A large majority of these laws were promulgated before the advent of the digital technology age and the multiplication by broadcasters of audiovisual and/or film content. New providers, and especially cable operators since then, have been operating beyond this law.

Main Public Funding Sources Identified

Government or community budget

Government budgets are generally generated through various taxes.

Advantages

- Easy set up and management of financial assistance
- Good way of preserving cultural identity

Comparable countries with this mechanism

- Germany
- Australia
- Belgium
- Canada
- Denmark
- Spain
- Finland
- France
- Iceland
- Italy
- Luxembourg
- Norway
- Netherlands
- United Kingdom
- Sweden
- Switzerland

Disadvantages

- Liable to be challenged, depending on government priorities
- Continuous government support in the form of grants may lead to an ever-increasing demand for this mode of funding
- Can promote the development of films designed chiefly to meet the eligibility criteria of support programs

Comments

- With the exception of the United States and India, the survival of film industries is closely linked to government support. The limited nature of markets coupled with stiff competition from American films makes the development of national industries very precarious.

Phase I – International Benchmarking

Main Private Funding Mechanisms Identified

It is not necessary here to identify the countries where the following mechanisms are used, since these are private initiatives that may or may not be put in place on an isolated basis, i.e., for a single film production.

Mechanism	Main Parties	Basic Structure	Advantages	Disadvantages
Production-finance-distribution	**Producer, studio and distributor**	The studio advances the production cost, manages its distribution and shares the net profits with the producer (and other parties)	Financing generated by studio, partly through pre-sale of distribution rights	Loss of producer's creative control
			Option of contract with the studio	Limited control over the studio's decision on distribution agreements.
Minimum guarantee	**Producer and studio/distributor**	Studio/distributors' commitment to buy all distribution rights at an agreed price before production starts in order to allow the producer to use this agreement as a guarantee to obtain funding	Possibility of negotiating better conditions with the distributor	Strong bargaining position for the distributor, especially if the budget is already fixed, making the producer responsible for all budget overruns
			Commitment serves to secure a bank loan	

Source: Observatoire Européen de l'audiovisuel (European audiovisual observatory)

Main Private Funding Mechanisms Identified

Mechanisms	Main Parties	Basic Structure	Advantages	Disadvantages
Self-funding	**Screenwriters, producers and studio**	The studio is responsible for developing the script, production, funding the film, marketing and distribution	Financing by the studio	Loss of producer's creative control
			Access to resources and know-how of the studio	Limited control over the studio's decision to produce or not produce a film
				Producer shares minimally in the profits of the film
Pre-sale of distribution rights	**Producer and distributor**	The distributor buys the distribution rights per territory and per window in exchange for funds. The producer cedes a share of the copyright in the project.	Minimum guarantee serves to secure a bank loan	Limited future markets
			More prudent in terms of risk sharing and co-guarantees	Distributors can challenge and demand control of costs
			Greater creative freedom	Limited potential for integration of distribution windows, reducing as a consequence the integration of advertising and promotion efforts.

Source: Observatoire Européen de l'audiovisuel (European audiovisual observatory)

Main Private Funding Mechanisms Identified

Mechanisms	Main Parties	Basic Structure	Advantages	Disadvantages
Loan funding	**Producer and lender**	The financier provides liquidity generally guaranteed by assets other than the film, with a fixed reimbursement date.	Profits are not shared with the lender Greater creative freedom	The producer assumes guarantee costs
TV pre-sale	**Producer and TV networks**	TV networks buy the broadcasting rights of the film against an immediate contribution of funds	Minimum guarantee serves to secure a bank loan Possibility of pre-sale when the TV network is coproducer Greater creative freedom	No control over the exploitation of film rights
Financing by the end-user	**Producer and end-user**	Cash investment by the end-user in exchange for sharing in the revenue of the film in some territories or some exploitation windows.	Producer retains financial and creative control Encourages maximum exploitation by the end-user	Available to producers with a solid reputation Cost of raising funds

Source: Observatoire Européen de l'audiovisuel (European audiovisual observatory)

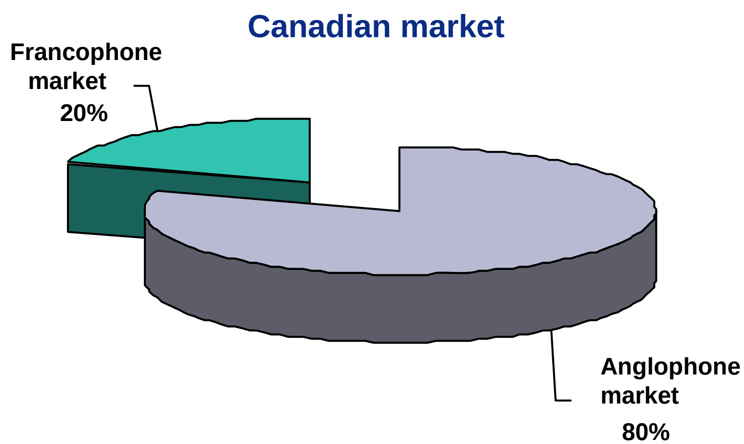
Main Observations

- Apart from direct financial contribution, governments may choose to intervene in various ways to support their national film industry. It is therefore important to take into consideration all protection and support mechanisms when comparing jurisdictions. Intervention mechanisms may take different forms, such as tax relief, protectionist legislative measures, marketing support programs or training programs for industry professionals. Furthermore, it is essential to adequately measure country-specific development parameters and to fully understand the government objectives, be they cultural or economic.
- That said, direct government assistance accounts for between 15% and 60% of feature film funding in the countries for which information was compared. Canada compares favourably, with direct and indirect public support amounting to 77.5% for French-language Canadian feature films partly financed by the CFFF during Telefilm Canada's 2005-2006 fiscal year.
- All film industries of countries comparable to Canada receive government support. However, the logic that favours government intervention is not unanimously accepted worldwide and is the subject of ongoing debate. Three main types of thinking cut across the different countries of Europe and North America: a purely economic approach, but with cultural references; a purely cultural approach, but with economic resources; and a mixed approach that combines economic and cultural logic.
- To some extent, the comparable countries identified face the same challenges as Canada: an unstructured industry, difficulty attracting private sector investment for productions, a limited local market, and difficulty penetrating international markets.
- Many European nations draw on diverse sources – national lotteries, taxes on cinema tickets, taxes on telecaster and cable operator revenues, etc. – to finance their support budget for the film industry, whereas the agencies that fund Canada's French-language feature film industry derive nearly all of their resources from government budgets.
- The financial assistance of almost all public European funding agencies goes largely to the production sector, as is the case in Canada.
- The proximity of the various European markets encourages coproductions, whereas Canada does not enjoy this advantage.
- Several European countries receive funding from supranational organisations (MEDIA, Eurimages, etc.) and their support programs, whereas there are no such bodies in the Americas.

A Few Facts and Figures

The growth of Canadian Cinema is moderated by two main factors:

1. **The fragmentation of the market into two segments: Anglophone and Francophone.** The Francophone segment, which is the subject of our study, represents a little over 20% of the entire Canadian market, and has about seven million inhabitants.
2. This has a direct effect on the limited nature of the market and the growth potential of French-language film products .



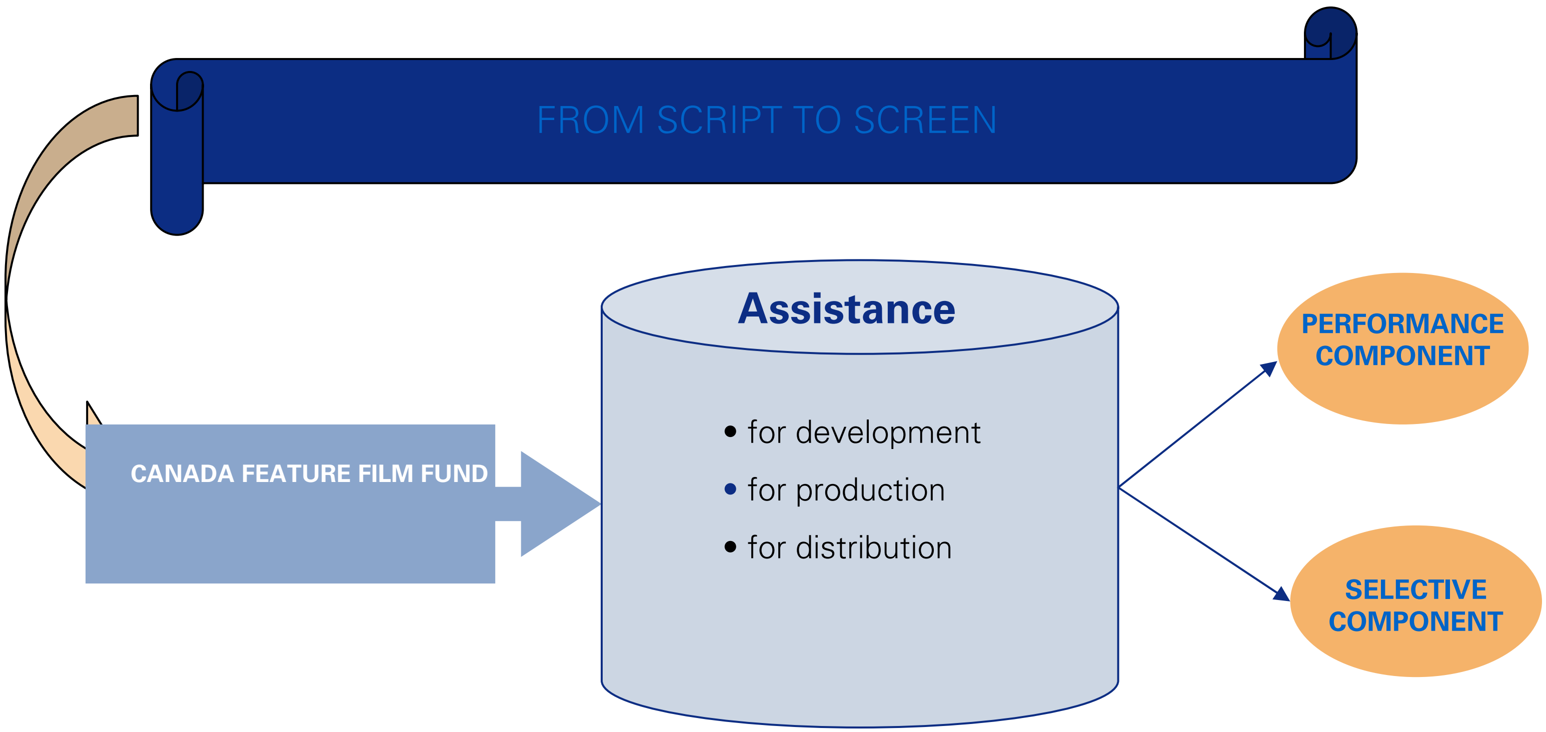
Source: Canada Statistics

2. **Proximity to the American world film industry giant.** Although this factor is relatively more pronounced for the Anglophone market, the French-language film market is also facing competition from American films.

To boost the film industry and enable it to occupy its place within the country and to fully play its cultural role, the government in 2000 adopted the policy "From Script to Screen," thereby creating the Canadian Feature Film Fund (CFFF) with the main objective to increase the Canadian audience for national films and capture 5% of box-office revenues by the end of 2006.

A Few Facts and Figures

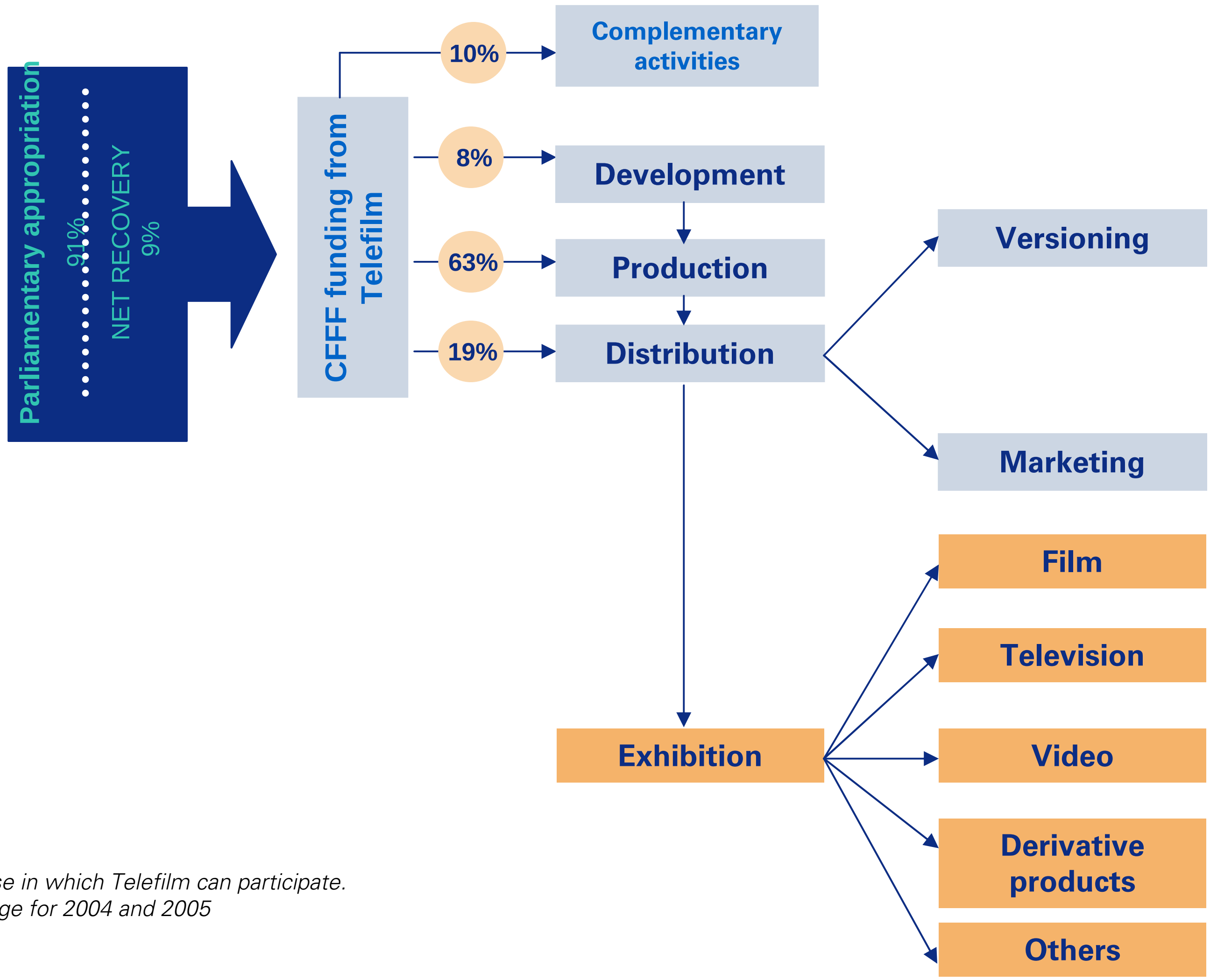
To stimulate Canada's French-language feature film industry, the CFFF set a goal to double the average production budget of films funded by Telefilm, bringing it to $5 million. A second goal was to increase the share of distribution costs included in production budgets. In pursuit of these goals, the CFFF provides funding at every stage of a feature film's life cycle, with the exception of exhibition. It supports the French-language industry by means of loans and/or grants through two components: performance-based and selective.



A Few Facts and Figures

The CFFF receives 91% of its funding from the federal government budget and an average of 9% from revenues recoupment. Most of its assistance (63%) is granted at the production stage. As will be shown later, this stage is considered the most risky of a film's life cycle.

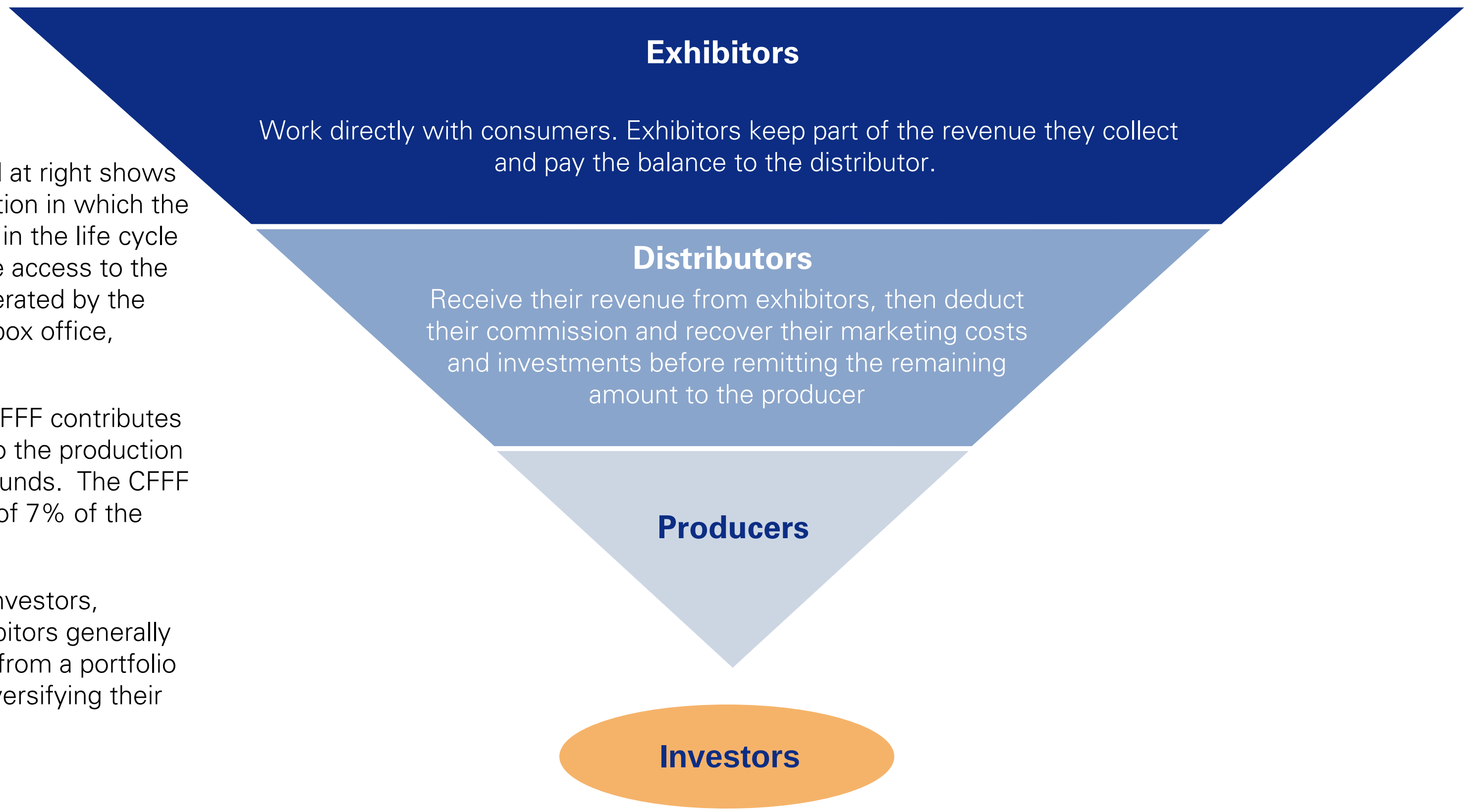
As shown in the table at right, the CFFF offers no assistance for the exhibition of works. According to the conceptual analysis of a feature film's life cycle and the inherent risks of each stage presented in the pages ahead, exhibition ranks among the stages with the lowest level of default risk.



Notes: *The stages in pale blue are those in which Telefilm can participate.*
The figures represent the average for 2004 and 2005
Source: Telefilm Canada

A Few Facts and Figures

Feature Film Revenue Flow



The inverted pyramid at right shows the order and proportion in which the various stakeholders in the life cycle of a feature film have access to the flow of revenue generated by the work's exploitation (box office, television, DVD, etc.)

As an investor, the CFFF contributes an average of 32% to the production cost of the works it funds. The CFFF receives an average of 7% of the revenues.

Like producers and investors, distributors and exhibitors generally derive their revenue from a portfolio of works, thereby diversifying their business risk.

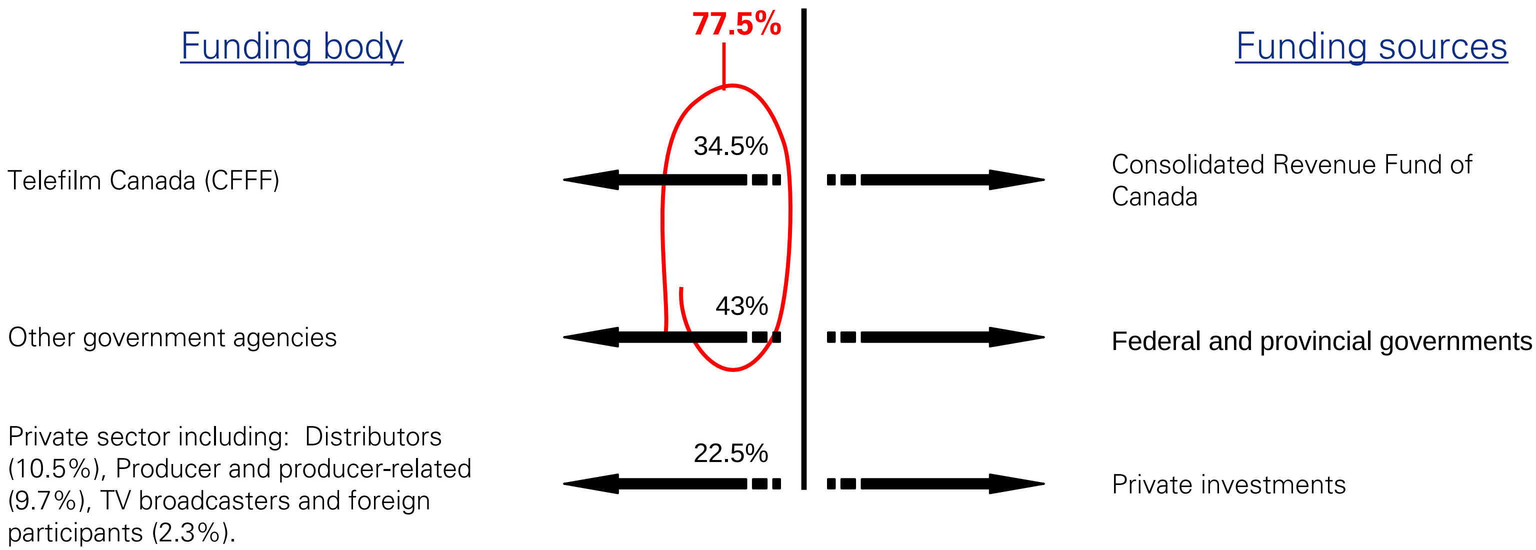
Source: Telefilm

A Few Facts and Figures

In 2005/2006, direct or indirect government[1] contributions funded an average of 77.5% of the production costs of French-language feature films in Canada. Television broadcasters and foreign participants contributed the least, preceded by producers and distributors.

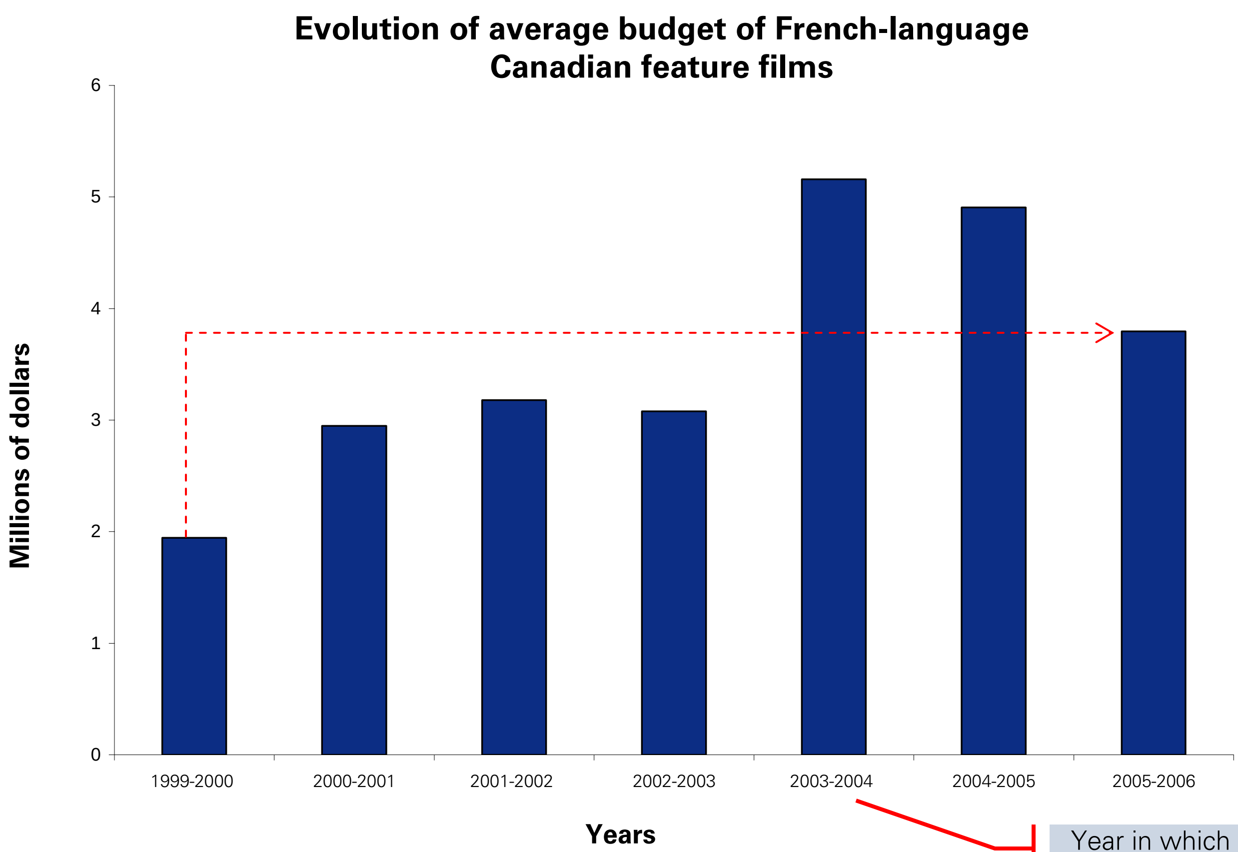
It should be noted that, because government support comes in a wide variety of forms and is provided by numerous funding bodies, it is not possible to precisely determine the proportion of feature film funding derived from public sources versus private sources for each of the comparable countries identified.

French-language feature film funding mechanisms



Source: Telefilm Canada
Note 1: *Including both provincial governments and the federal government*

A Few Facts and Figures



Year in which the feature film coproduction "Nouvelle France" was made with a budget of more than $30 million

Source: Telefilm Canada

Between 1999 and 2006, the CFFF achieved its goal of doubling the average budget of feature films in which it was involved, raising it from about $1.9 million to $3.8 million.

In 2005-2006, however, despite a $5 million per-project target, the average fell to slightly below $4 million.

The constant decline of the average budget over the last three years should be noted

Understanding the Issues

In order to fully grasp the issues surrounding the current situation regarding the funding of s, it is important to clearly define and understand how the film industry operates. To this end, the following pages outline several concepts useful to defining the challenges the industry presently faces.

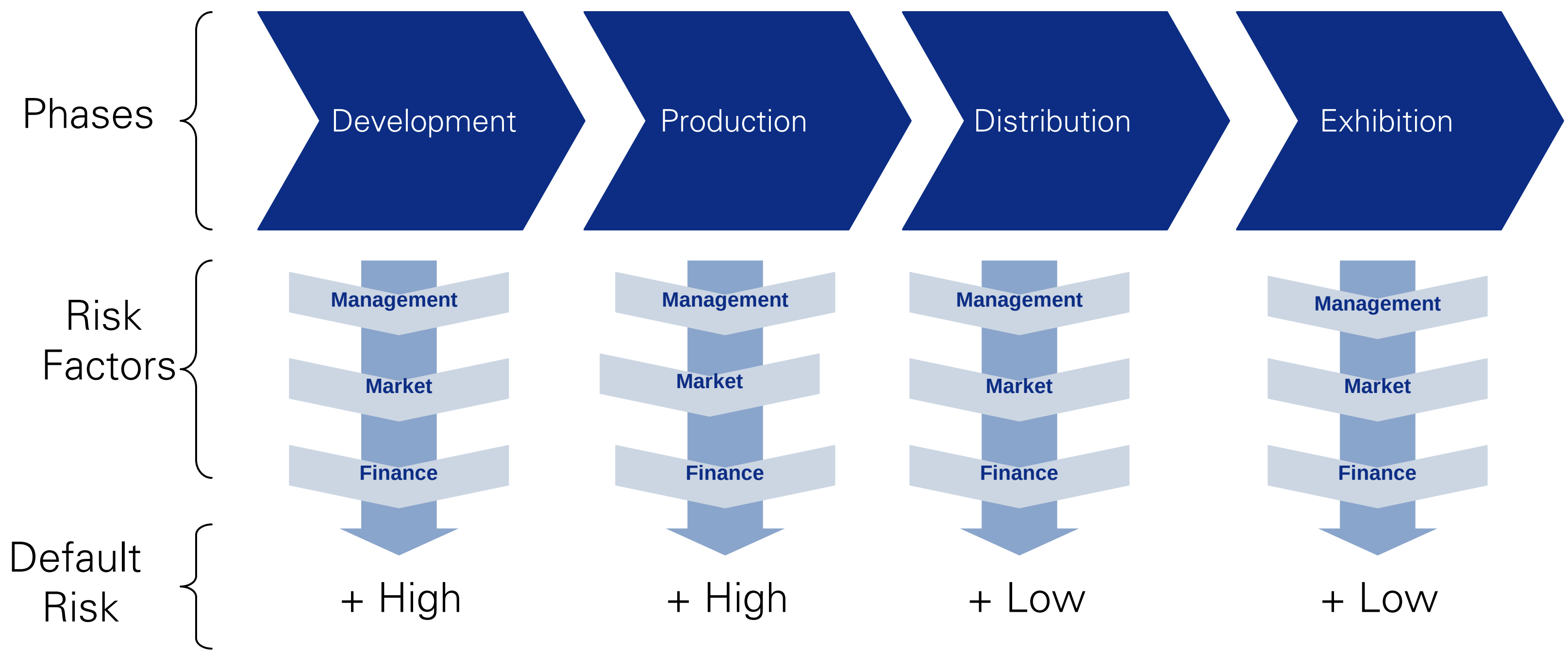
Readers should note that these concepts have not been validated by Canadian film industry stakeholders. As a result, certain factors, such as the risk analysis, may not apply to or accurately reflect the reality of some industry members. Nonetheless, based on our experience of the financial world and discussions with a number of stakeholders, we thought it wise to present the concepts as the observations are relevant to our analysis.

The conceptual illustration of the industry's workings is followed by our findings, which subsequently serve us in formulating recommendations for consideration by the CFFF Working Group set up by Telefilm.

Understanding the Issues

The life cycle of a feature film basically comprises four major phases: development, production, distribution and exhibition. Each of these phases has its particular dynamics. Though there are exceptions – not least of which concerning the American market – the level of risk differs depending on the phase (e.g. development or exhibition phase). There are many reasons for the risk disparities between the different phases of a film’s life cycle. Some are attributable to corporate size, expertise, financial situation and bargaining power, or to the availability and quality of financial information or simply to the level of industry consolidation.

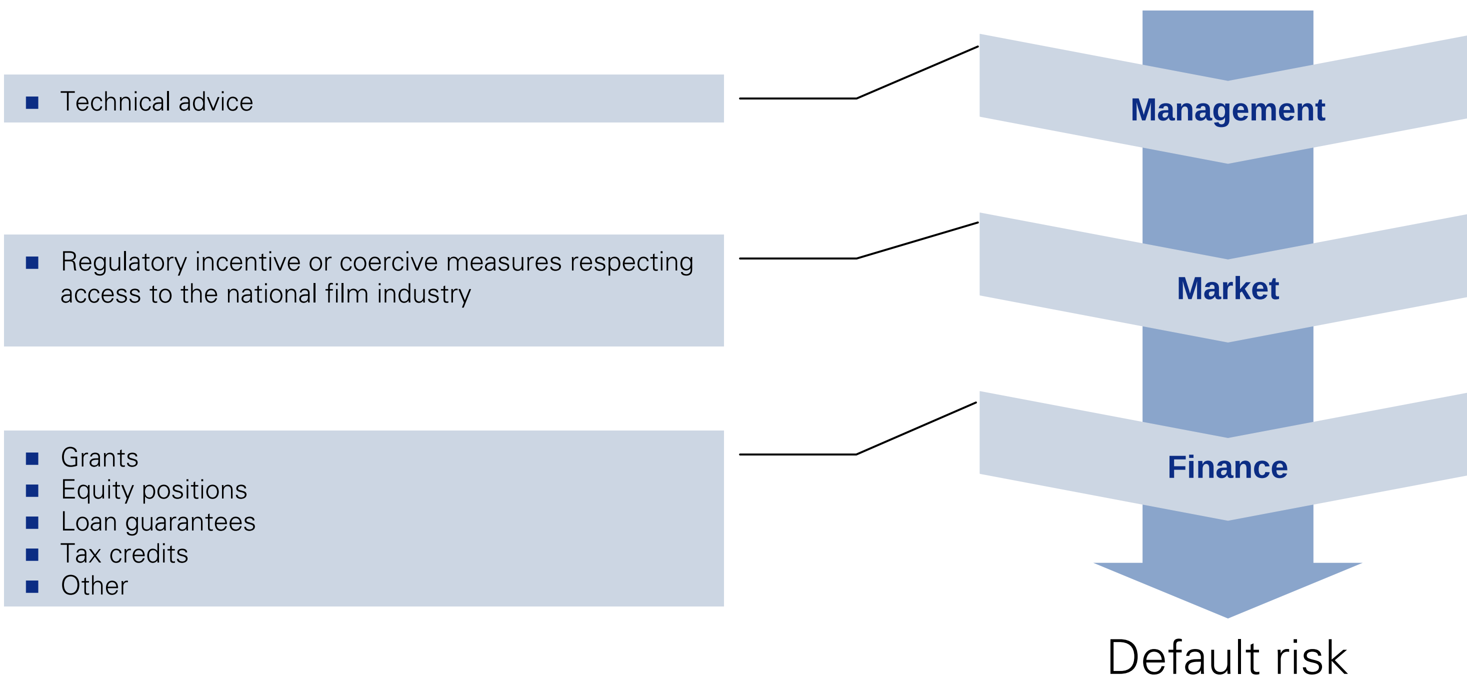
Over the years, financial communities have developed the notion of "default risk," that is, the probability that a project, borrower or business partner will not respect the given commitments or obligations within a specific time frame. Excluding the American market factor, we note that default risk is generally considered to be higher during the development and production phases and lower during the distribution and exhibition phases.



Understanding the Issues

Governments may want to develop an industry for a variety of reasons. In the case of French-language Canadian feature films, the underlying reasons are primarily cultural and economic. Either of these can independently justify the need to develop the industry. On the one hand, the film industry is of significant economic importance and provides jobs for many Canadians. On the other hand, the film industry has made an unquestionable contribution to the development of culture and, by implication, of national identity. Together, these two aspects form the basis of Canada's support policy for the industry. In this sense, the situation in Canada is similar to that in other countries.

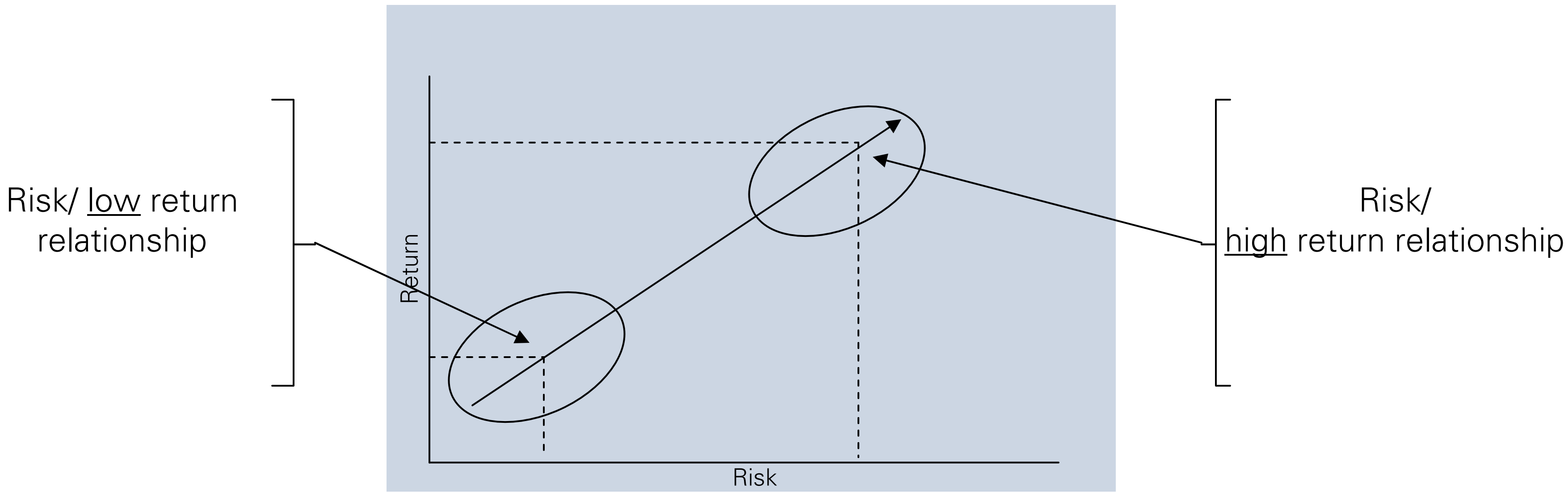
In order to mitigate an industry's perceived risk, a government can intervene in several ways. For example, it may opt for regulatory measures and influence market terms and conditions. It may also provide performance-based financial incentives or, in some cases, technical assistance for company managers. In most of the cases observed, the government measures consist of diverse initiatives that complement each other. In Canada, these measures involve various levels of government. For instance, the federal initiatives are complemented by those of the Quebec government.



Understanding the Issues

All partners in a feature film project, whether sponsors, investors, lenders or government bodies, begin by formally or informally, intuitively or rationally assessing their respective levels of risk. In addition, they all seek ways to reduce potential risk by taking different mitigation measures. One such measure is the use of government programs. Nonetheless, in all cases partners other than government seek a return that compensates for their risk exposure. The various financial tools reflect this close relationship between risk and return.

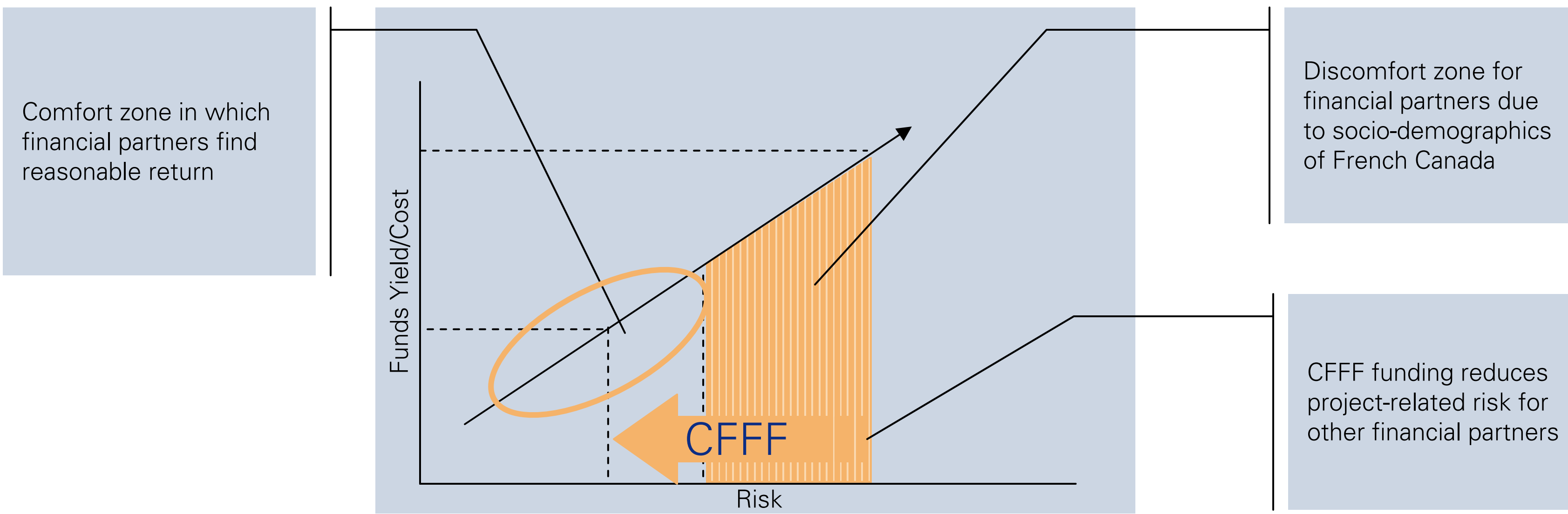
As mentioned earlier, government, for collective and strategic reasons, may opt for measures that are inconsistent with the risk/ profit logic, such as tax measures. These offer a negative financial return for a high risk (notwithstanding the economic impacts and income linked with taxation and incidental taxation). However, such government action lowers the risk for the other partners, making a project more attractive.



Phase II – Analysis of Canada's French-Language Feature Film Industry

Understanding the Issues

The CFFF and other government measures serve to reduce the risk borne by financial partners. It should be noted that such risk is to a large extent attributable to the nature of the industry itself, and more particularly to market structure. The challenges of socio-demographic realities are such that few nations can sustain a national film industry without substantial government support. In this sense, Canada is no exception, and the various levels of government intervene aggressively in order to maintain and develop the industry. The latest statistics reveal that French-language films in Canada benefit from assistance amounting to 77.5% of their production costs. In other countries, the level of support varies according to local realities and the political objectives of government. How does the existing support in Canada measure up? Would it be desirable to increase the level? Or to reduce it? As is the case with many government-sponsored funding programs, balance is achieved through the control of supply, by varying the access requirements and/or the available monies.



Phase II – Analysis of Canada's French-Language Feature Film Industry

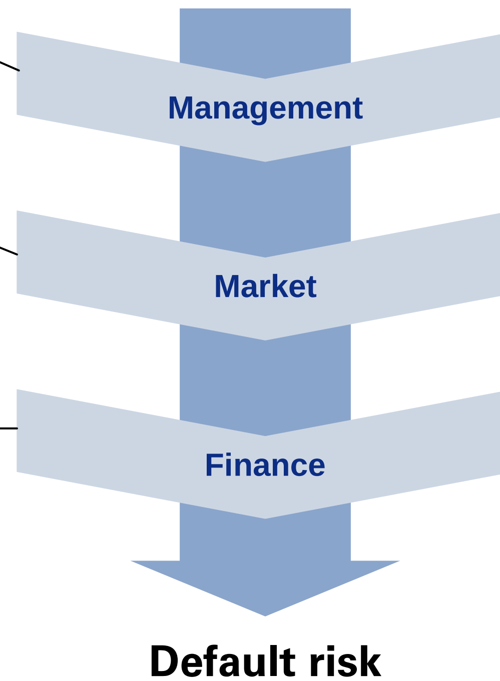
Understanding the Issues

The CFFF operates within the framework of the many different government support measures adopted in favour of French-language Canadian feature films. Specifically, the fund aims to reduce the overall risk borne by the various financial partners. The fund intervenes in two areas: financial factors and market factors**.** The positive impact of the financial factors is indisputable because, without this support, a significant proportion of films would likely never be produced. Similar to tax measures, the fund serves to reduce the financial contribution made by other financial partners. However, it must be said that the Canadian content requirements for accessing the fund may, in some cases, increase the financial partners' risk insofar as they can diminish a project's appeal in foreign markets. It should be noted, though, that some French-language Canadian works with strong national content have met with outstanding commercial success in foreign markets these past years.

Although the CFFF has introduced some training programs, its primary focus is not on developing the skills and qualifications of film industry professionals.

Rightly or wrongly, some financial partners feel that the national agency's Canadian content requirements may, to some extent, render the productions less attractive in foreign markets.

The CFFF acts primarily through financial measures aimed at stimulating the development, production and distribution of Canadian French-language feature films. Its financial support is clearly a powerful factor in reducing risk. Without this injection of capital, the perceived risk would be such that many productions would go unmade.



Main Findings

The performance of Canada's French-language feature film industry has been marked by:

- Positive elements:
  - The average budget doubled between 1999 and 2006, from $1.9 million to $3.8 million.
  - The market share of French-language Canadian films tripled between 1999 and 2006, rising from 10% to 27%.
- Negative elements:
  - Over the last 40 years, only 38 films have generated more than $1 million at the Quebec box office. The CFFF participated in the funding of 30 of the 38 films, and half of them were released during the past five years.
  - The number of coproductions was relatively low between 1999 and 2006, ranging from 3 to 6 a year (minority and majority included).
  - The chief provider of funding is government, accounting for 77.5% of French-language Canadian feature film budgets in 2005/2006. Without government support, the production of French-language Canadian features definitely would be compromised.

Main Findings

The business model of the Canadian industry is characterised by:

- Long and rigid production and distribution cycles.
- Public funding mechanisms that include national content requirements, namely in terms of culture and language, which may somewhat reduce a film's appeal in international markets.
- Difficulty in securing private investor and financial institution participation due to market specialisation, a largely SMB industry, the lack of available information and the perceived risks, especially in the development and production phases.
- Development and production phases considered risky for financial partners.
- Random, hard-to-predict factors such as product quality and audience reception, which increase the industry's risk level.
- Small production companies with limited financial resources.
- Significant government intervention in the funding of feature films. This could encourage a culture of dependency in the industry and to some extent create a false sense of security apt to impair the quality and possible potential of the works.

Main Findings

The business model of the Canadian industry is characterised by: (cont'd)

- The acquisition and further development of skills and qualifications by film industry professionals. This is essential to strengthening the competitiveness of Canada's French-language film industry within an open and competitive market.
- The use of diverse financial instruments chosen according to a company's stage of development and financial needs, and the risk connected with each market segment. The notion of risk is closely linked to the expected return and the capacity to generate the return.
- Difficulty in assessing the solvency of non-government partners, which limits private investment.
- The intangible nature of assets financed at the development and production stages, and the difficulty in assessing risk. These features are inherent to the film industry and represent serious funding obstacles.
- A lack of documentation on the French-language Canadian feature film industry. This further complicates risk/return analysis for private financial partners.

Main Findings

The government:

- Must take into consideration cultural and economic factors in formulating policy to sustain Canada's French-language feature film industry. Accommodating this duality poses a challenge in view of the possible disparity between cultural and economic objectives.
- Wants to leverage other financial partners by means of industry support programs. Generally, the goal is not to have public funding replace private monies when the latter is available; rather, the role of public funds should ideally be to bring financial partners aboard.
- Wants its programs to have a structuring effect on the industry; to that end, it must remodel the industry by targeting very specific activities, partners and financial risks.
- Must take into account the desired complementarity of government-sponsored industry support measures, irrespective of program or level of government.
- Must act to reduce the level of perceived risk within the industry. To this end, it should opt for diverse mechanisms that affect the risk analysis factors relating to management, market conditions and corporate finance.

Key Success Factors

- Improve the circulation of French-Canadian works nationally (outside Quebec) and internationally.
- Stimulate private capital investment.
- Strengthen the weak links in the production of feature films, i.e., the development and production phases.
- Make the various players in the value chain more accountable for the product's financial results.
- Structure the industry:
  - Create a database for the financial performance of Canada's French-language feature film industry (e.g. by participant, by production type, by budget, etc.).
  - Require transparent, uniform accounting procedures.
  - Support the development and improvement of skills and competence by film industry professionals.

Phase II – Analysis of Canada's French-Language Feature Film Industry

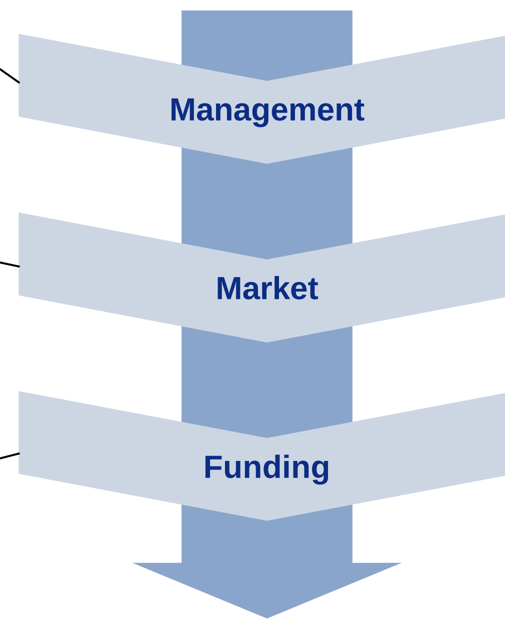
Recommendations

The above findings suggest that any new measures be aimed at reducing the overall default risk, not only at the financial level but at all levels of analysis. This means improving corporate management and market conditions. New measures advanced by Telefilm should be designed to reduce risk by means such as these:

1. Provide technical assistance to company managers
2. Improve the quality and quantity of information available on the Canadian film industry

1. Provide technical assistance on script development
2. Make possible the production of films likely to attract more interest in foreign markets

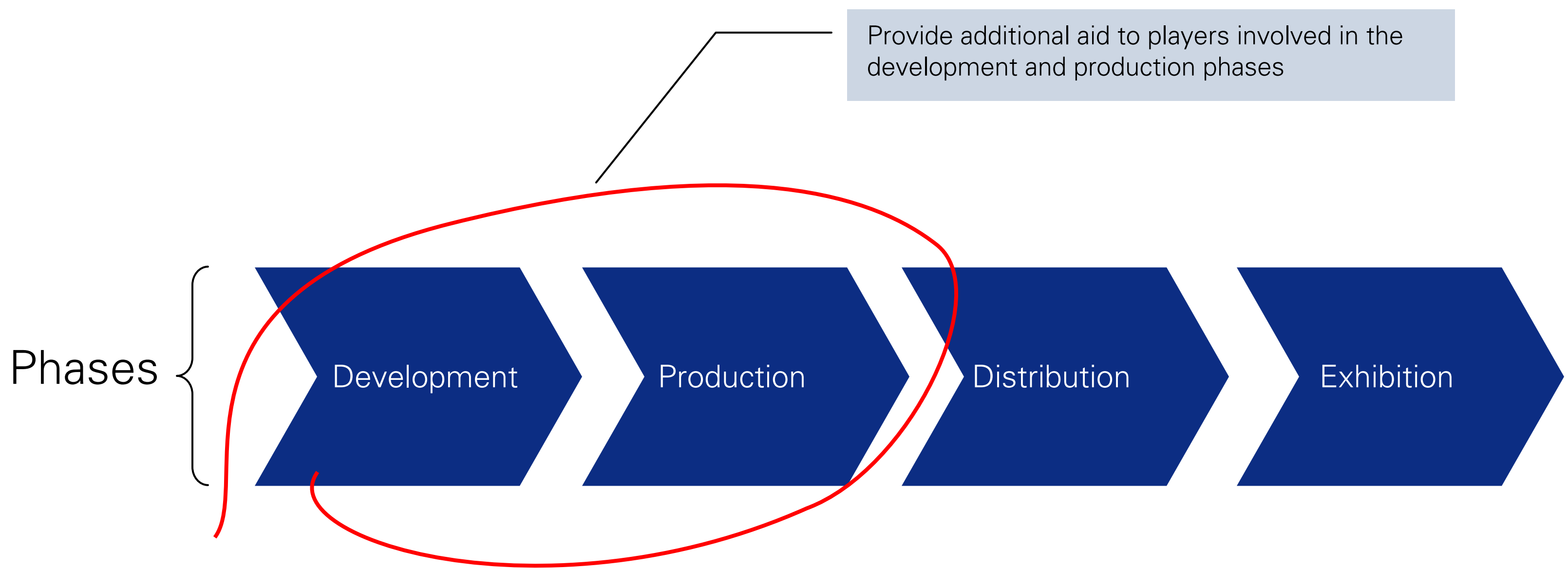
1. Provide additional funding subject to conventional (risk/return) financing conditions



Reduction of default risk

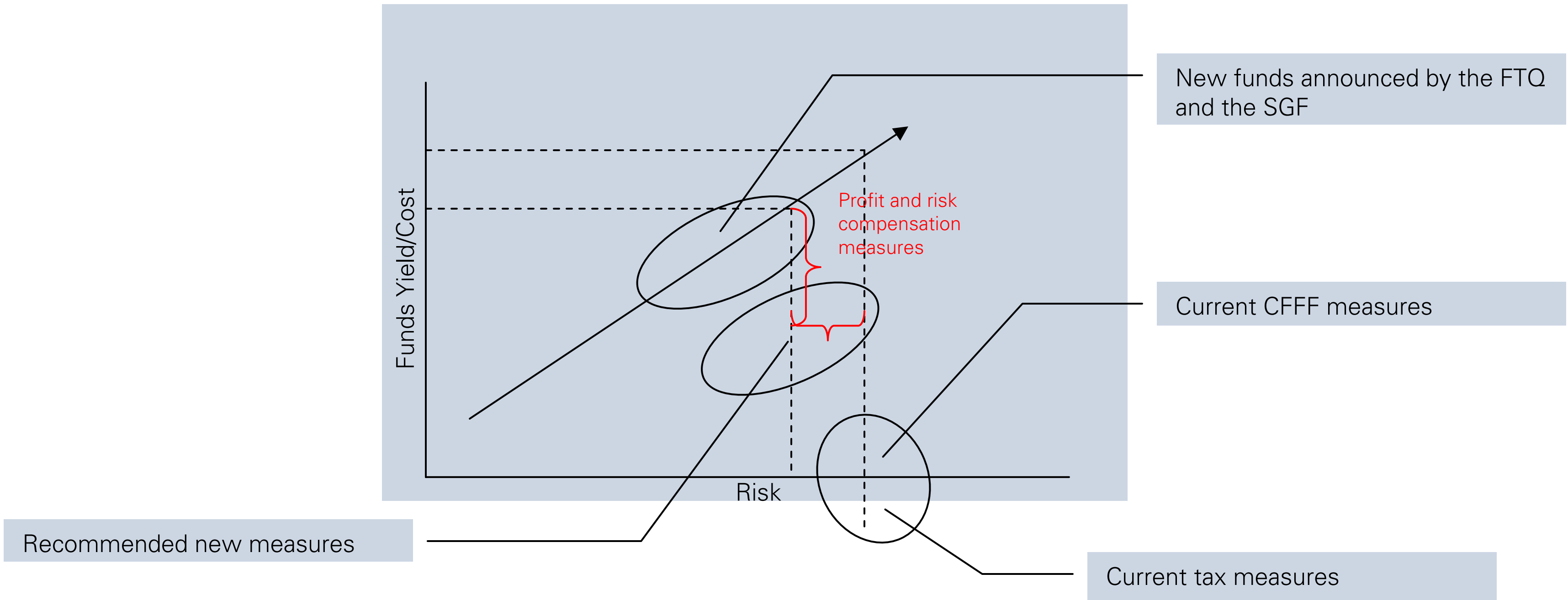
Recommendations

Telefilm's action through the CFFF is chiefly aimed at the development and production phases. We believe this emphasis should be maintained in view of the level of structural risk associated with these two phases. Because of the size of the companies, the nature of the activities, the production cycle and the inability to mitigate risk with a portfolio of film projects, it is imperative that these phases be supported by government. However, preference should be given to a form of support different from the currently available measures, including those of the CFFF. In other words, any new measure should be primarily designed to have a structuring effect on industry players. This could be achieved by giving a few production houses access to funding over and above the existing programs. These monies would support the companies' growth and make them more independent of financing from distributors.



Recommendations

Funding tools coexist in different forms and can be analysed on the basis of the risk/profit relationship. For private partners, the desired return will be directly proportional to the assumed risk. The funds recently announced by the SGF and the FTQ are good examples in this regard. Through various risk mitigation measures (portfolio of films, well-established producer, films targeted to the American market), these funds call for financial performance proportional to the perceived risk. Owing to government objectives in supporting the industry, the various public financial support and risk reduction programs rarely meet this criterion. The best example is the tax credit program for the film industry, where high risk results in negative returns (local economic benefits notwithstanding). Similarly, the CFFF measures provide low to no yield, which is disproportionate to the risk assumed and ultimately makes them grants. The new measures envisaged should, in our opinion, fit between the FTQ and SGF funds and the current CFFF programs. In this way, they would complement the array of existing financial tools.



Recommendations

Striking a balance between existing support, industry needs and government objectives

The recent performance of the Canadian industry could be seen to suggest that the current level of public financial support is acceptable. Statistics on box-office receipts, the average production budget and the number of productions are, to a certain extent, performance indicators for measuring the achievement of government objectives. But this exercise remains difficult and very subjective. Should government be more or less involved? That's hard to say. In fact, we can only answer by first answering the following question: In view of its set objectives, is government doing enough for culture and to support Canada's French-language feature film industry?

That said, it is obvious that the industry is seeking more support. The scarcity of funding was front and centre this past year, and many productions could not be made for lack of funds.

This situation may be partly attributable to the funding mechanisms currently in place. Without wishing to criticise them or to suggest that they be replaced, we note that they are generous (77.5% of funding for French-language feature films in 2005/2006 came from public sources) and hardly demanding in terms of financial return. This approach is not unique to Canada; it is found in many comparable countries.

It bears noting that most of the existing financing mechanisms can be controlled only by managing supply, since analysis shows that these mechanisms have a risk/return relationship that is particularly attractive to private partners. Given the nature of this type of funding, the larger the amounts available, the larger the needs of partners will be. We believe that increasing CFFF funding or government funding in general will only cause the needs of the industry to increase.

In view of this, we feel that Telefilm would be well advised to envisage additional funding through a consortium of investors that could include both private and public partners. However, it must be emphasised that the involvement of external partners would result in funding based on a risk/profit relationship, which differs from Telefilm usual practice and would increasingly reflect that of more conventional funding bodies.

Recommendations

Risk/return compensation measures

Direct or indirect intervention

There are two main approaches used by governments to compensate for a certain degree of risk associated with the funding of films, and thereby reduce the return demanded by private financial partners

The first approach is "direct" and involves participating in the investment consortium as an investor. However, the government contribution is positioned behind those of the other financial partners and commands a lower return.

The second approach is "indirect" and may be in the form of tax incentives or letters of guarantee. Tax incentive programs vary widely and include very diverse features. In the Justification for Recommendations section below, we present two new tax incentive programs.

Areas of intervention

In addition to financial compensation mechanisms, the government can influence the risk level of a film portfolio funding project by intervening on the Canadian content requirements, the quality of the technical and management teams and access to information.

Areas of intervention (cont'd)

With regard to Canadian content requirements, in order to reduce the perceived risk for financial partners it is important to ensure that the eligibility criteria for tax relief and/or direct public funding do not reduce a film's potential appeal in the international market.

Regarding the quality of management and technical teams, the government could, for instance, fund the hiring of highly qualified managers and/or the costs associated with the revision of scripts by various experts.

Finally, with regard to access to information, the government might consider creating and managing a database giving investors access to information key to assessing the risk associated with a film financing project. This could include such things as the profitability of French-language Canadian feature films by genre, by budget, by target audience, etc.

This last initiative is apt to be the most difficult to achieve, since it requires the cooperation of all industry stakeholders (producers, distributors, exhibitors, funding bodies, etc.), including private organizations likely to resist sharing information of this sort.

Justification for Recommendations

Objective

This last section of the report briefly presents and describes a few existing applications of investment consortia aimed at funding national film industries.

Methodology

We first describe what a consortium of investors is all about, and present the main characteristics underlying its operation.

Next, we present and describe investment consortia operating in various parts of the world.

Readers will note that the two consortia selected owe their existence to the tax incentives in effect in their respective countries. Without these tax relief measures, it is obvious that these ventures would never have seen the light of day.

Given the importance of government involvement in investment funds (via direct or indirect funding mechanisms) in order to artificially mitigate the local film industry's lack of certain key success factors and thereby attract private investors, we also present the advantages of two foreign revenue programs that caught our attention**.**

Lastly, we describe several foreign public funding sources that have seen some degree of success. Although they involve government money and are not intervention tools, they are interesting as models that could serve to partially or wholly support current government funding and/or additional funding for the Canadian film industry.

Funding Mechanisms

Investment funds

- The SOFICAs in France
- German film funds

Tax incentives

The Belgian tax shelter

- The enhanced tax deduction in the UK

Funding Sources

Taxes

- Tax on cinema tickets
- Tax on TV network revenues
- Tax on cable operator revenues

Justification for Recommendations

Funding mechanisms

Principal investor consortia that caught our attention

- The recent alliance of the SGF, CIT and Dark Castle Entertainment
- The SOFICAs in France
- Film investment funds in Germany

Objectives

- Attract private investors
- Reduce the extent of government intervention
- Encourage performance in the industry
- Create a viable long-term funding mechanism

Comment

- In a sector considered unprofitable, private funding depends on reducing the risk borne by private investors

Justification for Recommendations

Funding mechanisms

- Consortium of investors

Key success factors

- Revisit the business model to encourage producers to invest in their films and to speed up recoupment of their investments
- Access to a film portfolio well defined in terms of genre, targeted age group, etc.
- Access to experienced producers with some past success
- Access to financial information on producers

Advantages

- Adds new funds to support French-language feature film industry
- Frees up funds for productions of a chiefly cultural nature
- Reduces producers' financial dependence on distributors and other current sources
- Available funding for such projects abounds in the North American market

Disadvantages

- The predominance of an economic logic
- Requires returns that might be difficult to realize
- Few private investors have the necessary expertise to assess opportunities in this niche area
- Likely to favour a particular group of producers
- Requires a change in paradigm for producers

Justification for Recommendations

Application

A consortium is an alliance of several private and/or public, local and/or foreign partners. A Canadian consortium might include organizations such as the SGF, the FTQ, Telefilm Canada, SODEC and private funds (e.g. Harold Greenberg, Cogeco). A consortium usually seeks to be involved with one or more producers in financing a portfolio of features, not just a single film. Spreading the business risk across a range of titles considerably reduces the level of risk for the overall project.

Financial participation by producers and distributors is generally required in order to make all players in the value chain accountable for a feature film's financial performance. However, the financial participation required of producers may be limited since their key contribution is expertise, the capacity to evaluate screenplays, revise scripts, etc.

A management committee of people chosen by the financial partners is usually formed to manage the project. The committee may or may not include a government representative, depending on whether or not a government agency is involved in the consortium.

In view of the generally low level of audiovisual industry expertise of private investors, several consortia additionally employ audiovisual industry experts whose principal responsibility is to assess the eligibility and potential of the submitted projects to determine which ones will be financed. These experts serve as intermediaries between financiers and artists, and enable the two groups to cooperate, ensuring the success of the project.

In view of the high level of risk associated with motion picture production, the creation of such a consortium is primarily aimed at generating a return on investment that should be high enough to attract the interest of financial partners. To that end, the possible participation of public agencies such as Telefilm Canada and SODEC would make it possible to reduce the level of risk associated with the funding project for the other financial partners, and to raise their level of interest. Government intervention would, in effect, serve to compensate for certain key success factors that are insufficient or lacking. On the other hand, it is essential that the consortium operate based on a financial logic, with the potential to make a profit, and that it distance itself from the current government funding model, which is basically in the form of grants and subsidies.

The participation of private investors definitely results in a predominantly economic logic. On the other hand, it is evident that any production is likely to attract financial partners, regardless of cultural content, provided its international marketing potential is sufficiently strong to offset the narrow French Canadian market.

Contrary to public support agencies, which are primarily compensated through participation in box-office receipts, consortia are compensated through the payment of interest, if the project involves funding via a senior and/or mezzanine debt ,and also shares in residual profits through participation in the company's share capital.

Justification for Recommendations

The Sociétés pour le financement de l'industrie cinématographique et audiovisuelle ("SOFICA") in France

The objective of SOFICAs is to compensate for the lagging resources available to fund film production (including stagnant government aid). They are designed to channel private capital towards independent production financing entities in order to support the central concerns of cultural diversity and cultural employment.

Specifically, SOFICAs are investment corporations that raise funds through public offerings. They act as intermediaries to invest in the funding of film or television productions approved by the Centre national de la cinématographie (CNC), and they are taxed as venture capital companies.

The main advantage of SOFICAs is tax relief. Individual subscribers are allowed to deduct their investments from their total net household income, to a maximum of 25% of such income (or up to €18,000), provided they hold their shares for at least five years. Companies are allowed to write off 50% of the invested capital in Year 1. The amount that can be raised each year is capped by the Finance Ministry at FF300 million. SOFICA subscription is restricted, with each investor limited to 25% of the total capital during the corporation's first five years of operation. After ten years, the SOFICA is liquidated, and the net assets, after redemption of the purchased shares, are distributed among the shareholders pro rata to their investments.

SOFICA financing generally takes the form of an equity position in the production company or a cash contribution as a contractual partner in the production. The funds initially or subsequently raised by a SOFICA must be invested almost in full (at least 90%) within the 12 months following approval of the corporation's establishment by the General directorate of taxes (DGI). The monies must go to finance works certified by the CNC, originally produced in French, and having the nationality of a European Union member State.

SOFICAs are neither distributors, broadcasters, nor coproducers (and thus do not qualify for automatic support from the CNC). They are co-financiers whose contribution is remunerated through rights to future exploitation revenues (French and foreign theatrical distribution, telecast, video). Returns on investment generally flow between the second and fifth years of a SOFICA's operation, and there is no obligation to reinvest the returns.

Advantages

- According to the Inspection générale des finances (IGF), SOFICAs have helped reduce production financing costs.
- Contribution of new funds to support local film production

Disadvantages

- This mechanism has substantially helped large productions but provided little benefit for low-budget films in France
- It would require additional government funding that cannot be easily quantified at this stage
- According to the IGF, SOFICAs have not had a significant impact on production volume and quantity

KPMG

Justification for Recommendations

The Sociétés pour le financement de l'industrie cinématographique et audiovisuelle ("SOFICA") en France

SOFICAs exist in two forms, the first of which does not guarantee the resale value of any share capital that may be acquired following Year 5. These SOFICAs are not guaranteed by cash outflows. Since 1993, guaranteed SOFICAs have appeared on the scene. The reimbursement value for subscribed shares held for eight years is guaranteed (by a bank or by an audiovisual group). This value is often set at 85% of the nominal value. The shares may also be repurchased in exchange for shares of the guarantor group.

A 2005 study by the Association Cinéma au Soleil indicates that non-guaranteed SOFICAs provided a rate of return of about 7% for individuals and of 2 to 3% for companies. The same study indicates that the rate of returns of guaranteed SOFICAs was around 5 to 6%, including tax benefits.

The choice of one or other form of SOFICA depends on the investors' risk tolerance and on when they will need their cash back. On the one hand, investors who play it safe and invest in a guaranteed SOFICA have their money immobilized for a longer period. On the other hand, more risk-tolerant investors who choose a non-guaranteed SOFICA can cash their shares after five years.

According to the CNC, SOFICAs contributed €31.6 million in 2005, funding 78 films and an average of 6.9% of their budgets. It is the film industry that benefits the most from the SOFICA system, garnering €27.5 million in 2004, compared to €4.7 million for the television sector.

According to France's Senate Finance Committee, there were 69 SOFICA initial or subsequent public offerings between 1985 and 1996, for a total of FF2.59 billion. The average subscription was FF112,000, while total tax expenditure stood at FF1.15 billion over the same period.

This mechanism is periodically called into question. The debate essentially concerns the proper balance between the cost of the mechanism for the population, the benefits derived by private individuals and the value added by the SOFICAs to the funding of French cinema production.

Advantages

- IGF estimates that four or five films per year would not have been produced without contributions from SOFICAs

Disadvantages

- According to IGF, the appeal of the system as it exists in France declines rapidly when the tax rate is below 56.8% and is nil for anyone taxed at 20%

Justification for Recommendations

German film funds

According to German law, **a film producer may write off in full the production costs for a film, even before production of same has begun, provided the film qualifies as a tangible asset.** To gain such qualification, the owner of the film (the fund) must actively employ the asset in the normal conduct of its activities. To qualify as a producer, the fund must hold the copyright in the work.

Investors purchase units of the fund, which is constituted as a partnership. The fund itself does not produce the film but instead hires a production company under a production service contract. However, the contract must show that the fund controls the production and is responsible for decisions such as hiring the director, cast, etc.

Unlike most tax programs elsewhere in the world, the tax breaks offered by the German authorities are not restricted by German content requirements (location, actors, etc.). Thus, even though this mechanism has served to raise hundreds of million dollars for film production, it is foreign investors (mainly the US majors) that have benefited, using a sale-and-leaseback scheme on the film rights.

Pursuant to two decisions rendered by the German Federal Court in 2001, the tax authorities are striving to deny publicly traded investment funds the right to claim producer status and thus benefit from a tax shelter. The main argument they advance is that the investor cannot influence the production process and does not face greater financial risk than the acquirer of a finished film.

Given this situation, German film funds are currently sold only through private placement. Funds may not be sold on the public market unless originally offered before September 1, 2002.

Beyond the importance of how a film fund should be structured, the greatest challenge lies in attracting private investors. Some past funds failed mainly due to lack of private participation.

Advantages

- Has served to raise hundreds of millions of dollars from private sources to fund film and television productions

Disadvantages

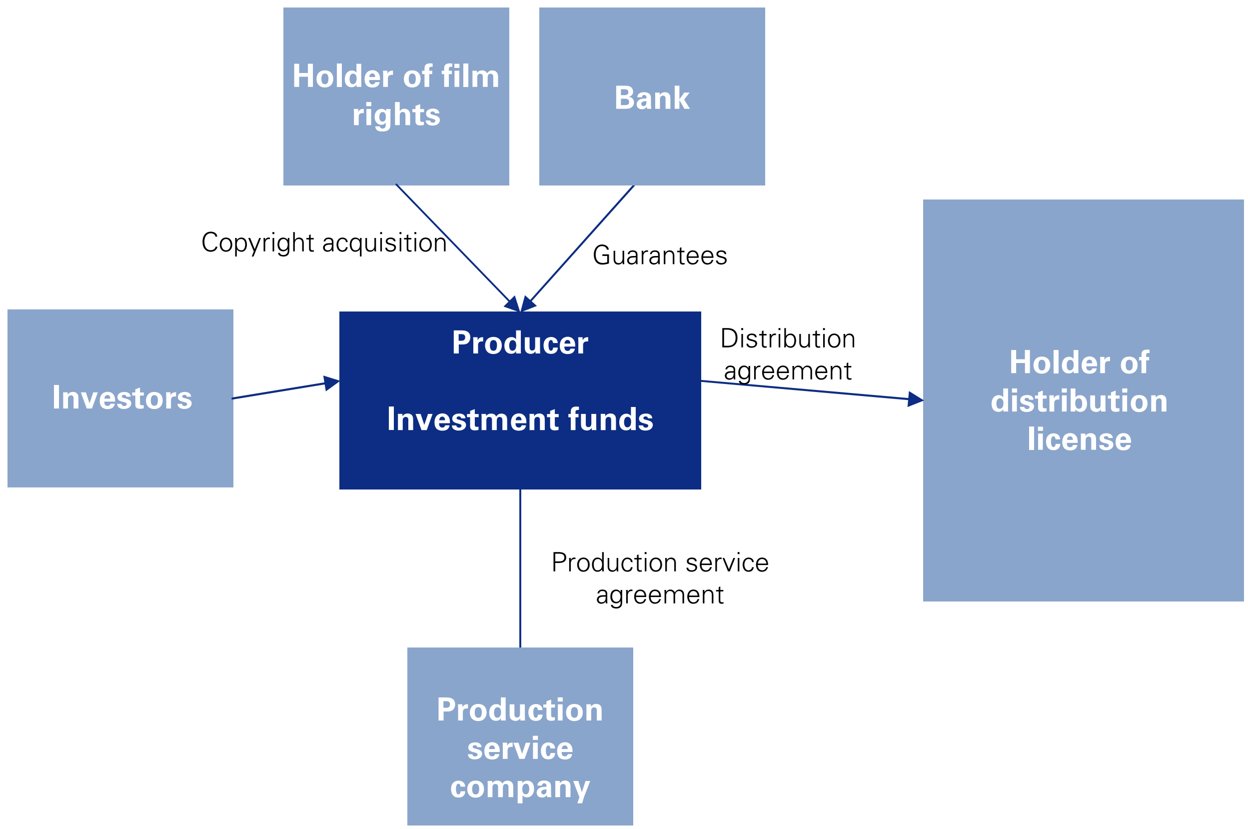
- Lack of requirements respecting national content and local economic benefits
- Mainly benefits foreign production studios at the expense of the local industry
- High cost (several hundred million dollars) for the German government through lost taxes
- Such funds require a complex structure

Justification for Recommendations

Some private capital investment funds in Germany:

- Apollo
- Cinerenta
- IWP
- VIP
- MPB

Typical Structure of a German Capital Investment Fund



Justification for Recommendations

Funding mechanisms

Tax relief systems that caught our attention

- The Belgian tax shelter
- The enhanced tax deduction in the U.K

Objectives

- Attract private local and foreign investors through tax incentives
- Stimulate the local film industry and generate economic benefits for the country

Comment

- In a sector considered unprofitable, raising private national and international capital is dependent on tax incentives in many countries

Justification for Recommendations

The Belgian tax shelter

This system is partly based on the SOFICA model used in France. However, it is more flexible and contractual in nature in order to allow the financial players involved to merge their respective interests within a legal and tax framework.

The goal of this incentive is to encourage companies that are not in film production to fund this type of activity by mitigating their risk through a tax credit.

Tax credits are reserved for companies, and individuals may not benefit from them. The production company must be a "resident" corporation, i.e., has its head office, main office or main place of management in Belgium and pays corporate tax in Belgium. Belgian television companies and resident television production companies may not benefit from tax credits. While lending institutions qualify for the tax benefits in principle, only funds serving to acquire rights in the production or exploitation of a film can derive a tax advantage, and therefore loans are not considered in the calculation.

The total amount invested must be spent within 18 months of the signing of a framework agreement between the production company and the investing company. The company's investment may not be more than 50% of its taxable profit, with a maximum of €500,000 per annum. Up to 40% of the investment may be provided in the form of a loan repayable within 18 months of the signing of the framework agreement . The investment may not exceed 50% of the film's total financing. Investors are entitled to a 150% deduction. The monies must spent in Belgium or to the benefit of Belgians at a rate of at least 150% of the amount invested in the production via the acquisition of rights.

The loans cannot be repaid and the rights must remain wholly held and owned by the investing company until such time as the production is completed. However, the law does not prohibit options allowing investors to cede their rights to a third party or to the production company subject to the payment of a price agreed to in advance.

Loan repayments do not generate taxable income for the investing company; however, the interest on loans is taxable. The rights are intangible assets, and the royalties they generate are fully taxable.

Advantages

- Brings in new funds to support local film production
- Involves the private sector in supporting the local film industry
- Lending institutions can access the tax benefit is accessible to some extent, thus becoming familiar with the workings of the industry

Disadvantages

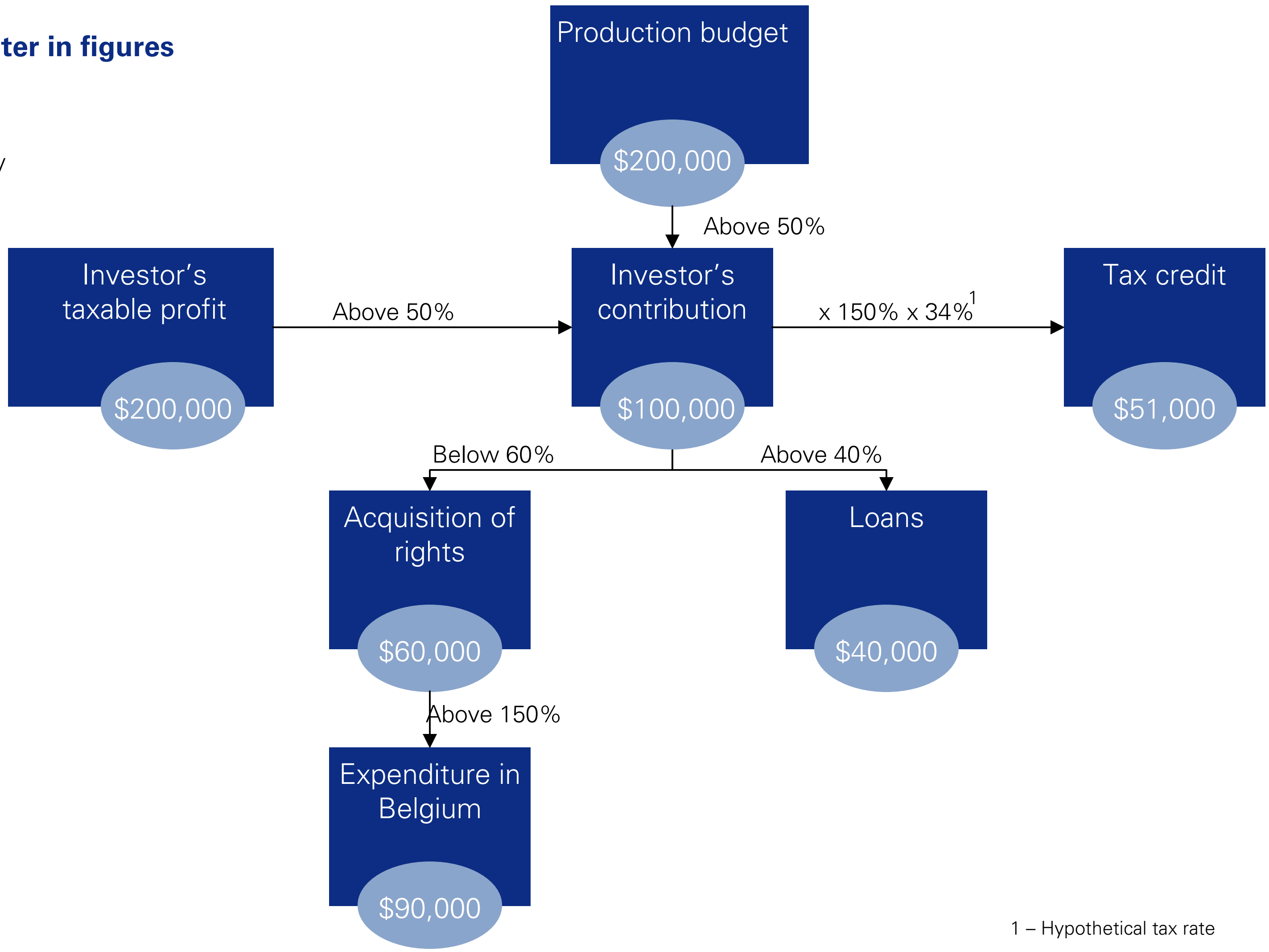
- Would require additional funding from the federal government that is hard to quantify at this stage
- Is aimed only at businesses, and thus limits potential investments

Justification for Recommendations

The Belgian tax shelter in figures

Nothing prevents the inclusion of the mandatory provisions of the tax shelter in a broader agreement that also deals with the financing not eligible for tax credits.

The law does not prohibit a production company from coproducing with foreign companies.



1 – Hypothetical tax rate

Justification for Recommendations

The enhanced tax deduction in the United Kingdom

The United Kingdom has eliminated the sale-and-leaseback scheme that provided tax relief for local and foreign investors and replaced it with measures designed to favour smaller producers and British culture.

The new measures, approved by the European Commission in November 2006, include an "enhanced tax deduction" and a "payable film tax credit."

The enhanced tax deduction allows a film production company to benefit from a higher deduction for certain production costs than the normal UK tax rules would allow. The payable film tax credit allows the film production company to receive a cash payment of up to 25% of any tax loss (after applying the enhanced tax deduction). This form of assistance applied to preproduction, shooting and post-production expenses incurred by the beneficiary on goods or services used or consumed in the United Kingdom.

Like other European support systems for cinema, the UK measures are subject to local spend requirements, meaning that a portion of the production costs must be incurred within the country. Briefly, the scheme works as follows.

For films that cost up to £20 million, the production company will be able to claim an enhanced deduction of 100% with a payable cash element of 25% of UK qualifying film production expenditure (where qualifying expenditure is capped at a maximum of 80% of the core expenditure). For films that cost over £20 million, the production company will be able to claim an enhanced deduction of 80% with a payable cash element of 20% of UK qualifying film production expenditure.

In order to benefit from this tax relief, a film must pass the cultural test or qualify as an official coproduction. Moreover, to qualify as a British production, films, including those to be produced under the terms of coproduction treaties, must spend a minimum of 25% of the production costs in the United Kingdom.

Advantages

- The eligibility test is transparent
- Encourages culture and benefits the local economy

Disadvantages

- The cultural factor can restrict a film's international circulation to some degree

Justification for Recommendations

Funding sources

Principal taxes that caught our attention

- Tax on box-office receipts
- Tax on TV advertising revenues
- Tax on cable operator revenues

Objective

- Secure financial support for the industry from sources other than box-office receipts

Comment

- Inasmuch as the government wishes to continue supporting the growth of Canada's French-language feature film industry, it is imperative that it seek new sources of funding

Note: *Because this initiative involves provincial jurisdictions, the analysis of this funding mechanism is limited to the presentation of the objectives and the advantages and disadvantages*

Justification for Recommendations

Funding mechanisms

- Tax on box-office receipts
- Tax on TV advertising revenues
- Tax on cable operator revenues

Objectives

- Increase the revenues of all local film industry stakeholders
- Make it possible to generate new (private) funds to support the Canadian film industry
- Support the film industry's growth with revenues other than box-office receipts

Advantages

- Contributes new funds to support the French-language feature film industry
- Foreign films can serve as financial leverage for the local film industry
- Serves to establish a direct connection between the performance of the film industry in general and funding of the local industry
- Enables film exhibitors to benefit from government financial support

Disadvantages

- In the short run, a rise in ticket prices is likely to lead to a drop in the number of moviegoers
- Results in additional management costs for both taxed companies and government
- Likely to have a negative impact on the financial performance of taxed companies in the short run
- The adoption of this tool is dependent on political will
- Dependence on the targeted companies' commercial success

Appendices

Appendix I

Identification of Reference Countries – Data by Country

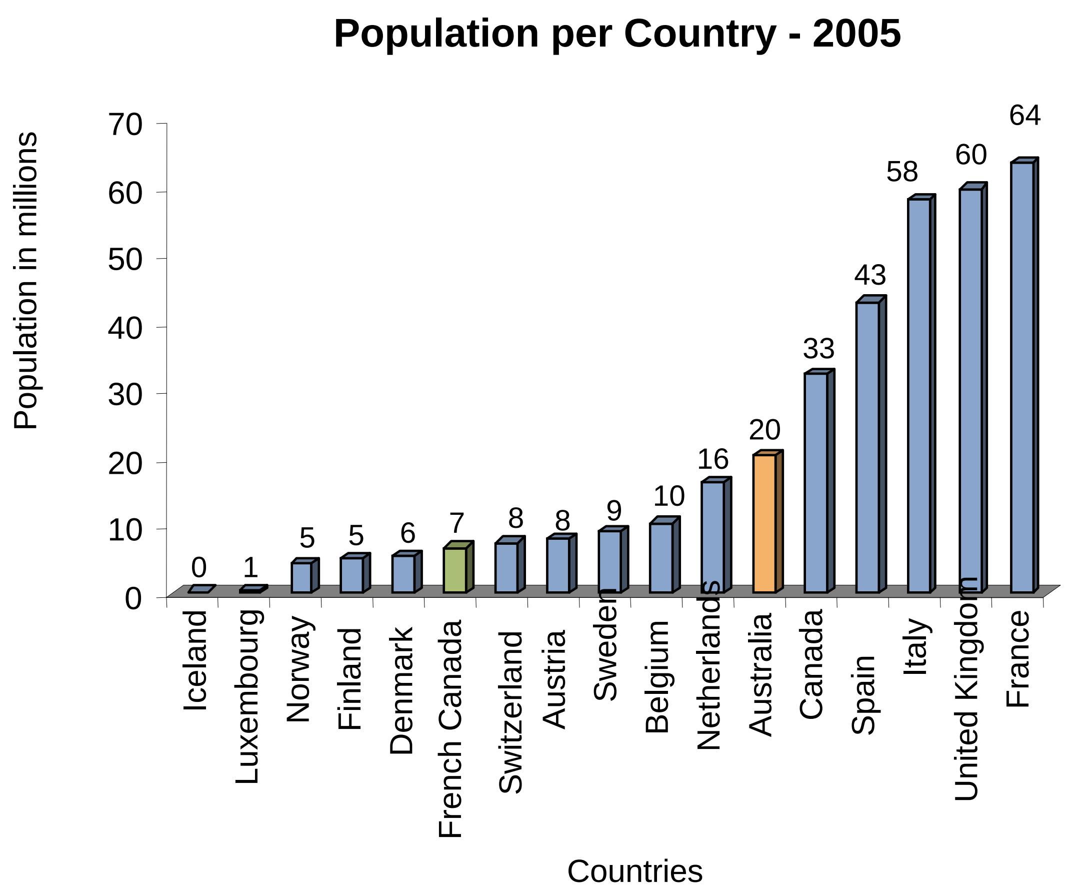
	Country	Population[1] 2005 (in millions)	HDI[2] 2002
1	**Australia**	20.5	0.946
2	**Austria**	8.2	0.934
3	**Belgium**	10.5	0.942
4	**Canada**	32.5	0.943
5	**French Canada**	6.8	N.A.
6	**Denmark**	5.5	0.932
7	**Spain**	43.2	0.922
8	**Finland**	5.2	0.935
9	**France**	63.6	0.932
10	**Iceland**	0.3	0.941
11	**Italy**	58.1	0.920
12	**Luxembourg**	0.5	0.933
13	**Norway**	4.6	0.956
14	**Netherlands**	16.3	0.942
15	**United Kingdom**	59.9	0.936
16	**Sweden**	9.0	0.946
17	**Switzerland**	7.5	0.936

Sources: Populationdata.net, 2002 United Nations World Report on Human Development

Appendix I
Identification of Reference Countries – Data by Country

Canada has the 6th largest population among the identified comparable countries.

The extremes are Iceland and France, with 300,000 and 64 million inhabitants, respectively.



Source: Populationdata.net

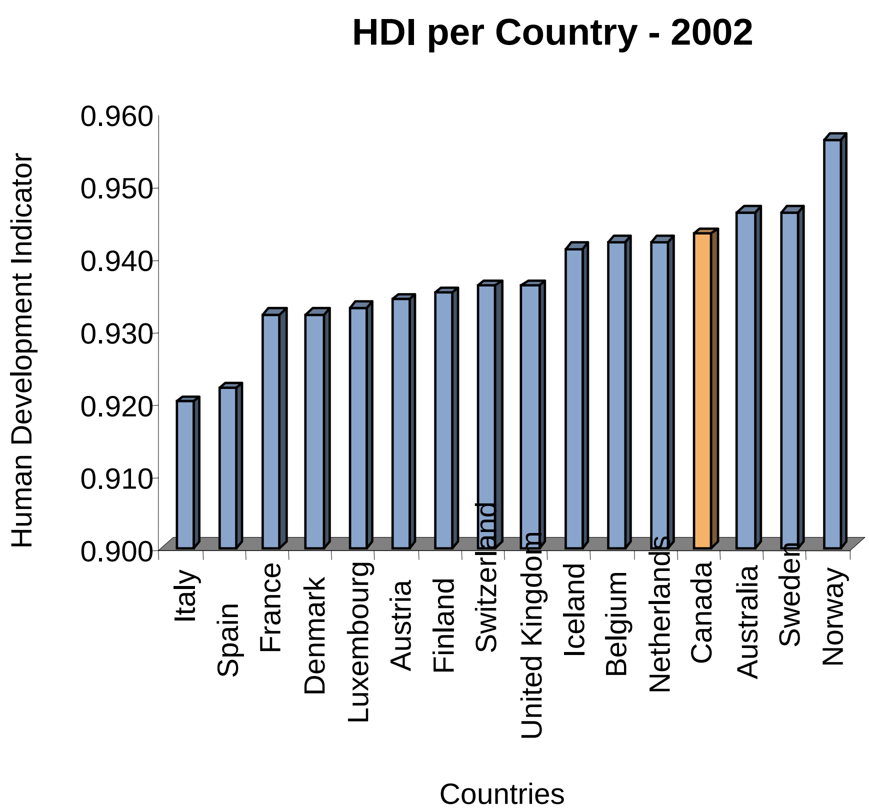
Appendix I

Identification of Reference Countries – Data by Country

Canada has the 4th highest HDI rate among identified comparable countries.

Italy and Norway occupy the extreme positions with 0.920 and 0.956, respectively.

Although no information is available on French Canada, it is reasonable to believe that its IDH is similar to that of Canada as a whole.



Source: 2002 United Nations World Report on Human Development

Appendix II

Number of Productions by Country

	Country	2001	2002	2003	2004	2005
1	France	204	200	212	203	240
2	Spain	106	137	110	133	142
3	Italy	103	130	117	138	86
4	United Kingdom	82	77	82	62	74
5	Sweden	25	21	27	40	54
6	Canada	61	65	75	77	53
7	Switzerland	33	37	35	44	47
8	Denmark	19	19	24	26	41
9	Belgium	16	11	12	23	28
10	Austria	12	16	17	24	24
11	Netherlands	27	28	29	24	24
12	Australia	25	26	18	17	22
13	Norway	7	14	18	22	19
14	French Canada	16	17	18	21	17
15	Finland	12	11	10	15	13
16	Iceland	6	4	9	4	6
17	Luxembourg	0	1	1	2	3

Sources: Telefilm Canada, Australian Film Commission (AFC), Focus 2006, World Film Market Trends, European Audiovisual Observatory

Appendix III

Investments (Total Budgets) in National Productions

	Country	2001	2002	2003	2004	2005
1	France	810	813	1.305	1.304	1.602
2	United Kingdom	859	852	1.96	1.79	1.43
3	Spain	216	304	287	392	433
4	Italy	188	262	341	354	267
5	Canada	59	145	151	210	212
6	Switzerland	64	84	100	135	145
7	Denmark	N.A.	N.A.	76	80	134
8	Belgium	N.A.	N.A.	34	75	128
9	Sweden	N.A.	N.A.	48	78	104
10	Australia	84	92	46	104	81
11	Netherlands	82	50	91	85	80
12	French Canada	23	43	51	81	53
13	Austria	N.A.	N.A.	N.A.	N.A.	N.A.
14	Finland	N.A.	N.A.	N.A.	N.A.	N.A.
15	Iceland	N.A.	N.A.	N.A.	N.A.	N.A.
16	Luxembourg	N.A.	N.A.	N.A.	N.A.	N.A.
17	Norway	12	36	N.A.	N.A.	N.A.

Sources: Telefilm Canada, Australian Film Commission (AFC)

Appendix IV

National Production Market Shares

	Country	2001	2002	2003	2004	2005
1	France	42	35	35	39	38
2	United Kingdom	24	24	16	22	34
3	Denmark	28	25	23	22	30
4	French Canada	10	13	19	21	27
5	Italy	19	22	22	20	25
6	Sweden	23	16	20	22	22
7	Spain	18	14	16	13	16
8	Finland	10	17	22	17	15
9	Norway	15	7	19	17	14
10	Netherlands	9	10	14	9	13
11	Canada	2	3	4	5	5
12	Belgium	2	1	2	1	4
13	Australia	8	5	4	1	3
14	Iceland	2	10	4	N.A.	3
15	Austria	N.A.	N.A.	N.A.	N.A.	N.A.
16	Luxembourg	N.A.	N.A.	N.A.	N.A.	N.A.
17	Switzerland	N.A.	N.A.	N.A.	N.A.	N.A.

Sources: Quebec Institute of Statistics, Telefilm Canada, Australian Film Commission (AFC), Focus 2006, World Film Market Trends, European audiovisual Observatory

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