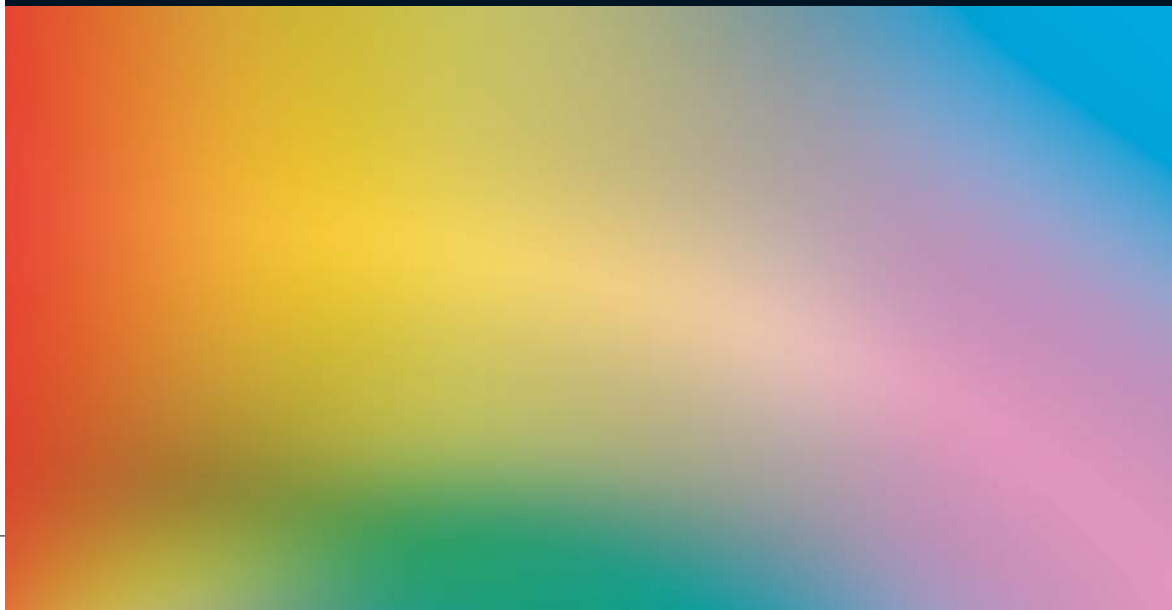


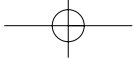
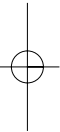
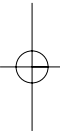
A conference organised by the British Screen Advisory Council

BSAC FILM CONFERENCE



MARCH 2008





FOREWORD

The British Screen Advisory Council is an independent advisory body to the government and policy makers at national and European level and to the audiovisual industry. It uniquely brings together the widest possible range of UK interests, experiences and contacts in the screen industries.

Members include senior management from television, telecommunications and new media companies, international film producers and distributors, cinema exhibitors, technical experts, business people with media interests, media lawyers, communications consultants, TV producers, trade unionists and the heads of training and trade organisations.

BSAC regularly commissions and oversees research on the audiovisual industry and uses its research to underpin its policy documents. In addition to regular meetings, BSAC organises informative events including seminars, conferences and industry briefings, all of which provide valuable networking opportunities.

BSAC relies on industry funding for its activities and we are therefore particularly grateful to Time Warner for sponsoring this event. BSAC also wishes to express its gratitude to all the speakers and panellists at the Conference for their interesting contributions. The Conference Chairman was John Howkins, Deputy Chairman, BSAC, and Director, HandMade plc.

Please note that the speakers' presentations and panel sessions in this report are edited transcripts.

TIME WARNER

Time Warner Inc. is a leading media and entertainment company, whose businesses include filmed entertainment, television channels, online interactive services and magazine publishing. In Europe, Time Warner's operating businesses include Warner Bros., Turner, HBO, Time Inc. & IPC and AOL.

Warner Bros. Entertainment

Warner Bros. Entertainment is a global leader in the creation, distribution, licensing and marketing of feature films, TV shows, DVDs, video games and consumer products. In 2007 it was named the UK's number one film distributor and is currently planning the releases of *Harry Potter & The Half Blood Prince*, *Lego Batman: The Video Game*, and JJ Abrams' new TV series, *Fringe*. Warner Bros. is also committed to producing and distributing local European productions. Films produced in the UK include the *Harry Potter* films, *Sweeney Todd* and *The Dark Knight*.

Turner Broadcasting System

Turner Broadcasting System is a major leader in news and entertainment around the world. In Europe, Turner delivers cable and satellite television channels and web sites, including *CNN International*, *Cartoon Network*, *Turner Classic Movies*, *Boomerang* and *Toonami*.

Home Box Office

HBO is America's most successful premium television network, whether measured by subscribers, profitability, viewers, awards or critical acclaim. HBO sells its original programming such as *The Sopranos*, *The Wire*, *Entourage* and *Sex and the City* to broadcasters throughout Europe. HBO Central European ventures offers basic and pay television channels throughout Central Europe.

Time Inc.

Time Inc. is the world's leading magazine publisher. Its more than 120 magazines reach total audiences of more than 300 million worldwide. In Europe, Time Inc. offers readers the best in serious journalism, including *Time* and *Fortune*, as well as popular consumer magazines. Time's IPC Media is the UK's largest consumer magazine publisher, with over 80 titles including *Country Life*, *Loaded* and *Marie Claire*.

AOL

AOL is a global web services company that operates some of the most popular Web destinations, offers a comprehensive suite of free software and services. AOL has recently expanded its full suite of advertising solutions, Platform-A, into Europe. Platform-A is made up of leading ad operations like Advertising.com, ADTECH and Buy.at and is powered by some of the web's most advanced advertising technologies, including TACODA, Quigo and Third Screen Media. A majority-owned subsidiary of Time Warner Inc., AOL LLC is based in Dulles, Virginia. AOL and its subsidiaries also have operations in Europe, Canada and Asia.

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CONFERENCE CHAIRMAN'S INTRODUCTION

John Howkins, Deputy Chairman, BSAC, and Director, HandMade plc

The Chairman welcomed guests to the fifth annual BSAC Film Conference and commented that where the 2007 Conference had looked at how the industry was responding to technological changes, the 2008 Conference would be devoted to working out ways to monetise content in the new digital environment.



John Howkins

He alerted delegates to BSAC's plans to convene a 'Blue Skies Thinking' Working Group, which would seek to identify and define the concepts that determine the conditions under which audiovisual content is created, made available and accessed. The group would develop a thorough understanding of these concepts, with a view to using them to inform approaches to policy interventions affecting the sector.

He announced that this year's Conference speakers had been asked to continue this future-looking approach by focusing on emerging business models, issues for rights and distribution and the all important issue of changing windows of exploitation. In the afternoon, the Minister would comment on the role of government going forward.

He thanked Time Warner for its ongoing support in sponsoring the event for the fifth year running, enabling BSAC to assemble a first-class programme.

FILM INDUSTRY PRESENTATION

Ben Keen, Chief Analyst and Director, Screen Digest

Ben Keen presented this written report for the Conference. Slides used during his presentation are available on request.



Ben Keen

UK MOVIE MARKET UPDATE 2008

Market overview

British consumers spent around £3.8bn on all forms of movie products and services in the UK last year. This included payments for cinema tickets, purchase and rental of DVDs, Blu-ray Discs and HD DVDs, premium movie pay TV channels, TV-based on-demand platforms and internet downloads. After two years of slight declines in overall market value, caused primarily by a softening of the DVD market, the 2007 total marks a return to the record level of market value achieved in 2004.

Cinema

Admissions to UK cinemas returned to growth (3.8 per cent) in 2007 after two years of decline. There were 162.5m tickets sold - down more than 13m from the modern high of nearly 176m in 2002. That peak was marked by average attendance per capita of close to three visits per person per year - a symbolic metric that has not been broken for decades.

Gross box office takings came to £821m in 2007, up 7.7%. This was driven by another rise in average ticket prices, estimated by Screen Digest to have broken the £5.00 barrier for the first time.

We estimate there were close to 3,600 cinema screens in the UK by end-2007. This means there have been very nearly 1,000 net screen additions over the last decade. However, we believe the number of cinema sites actually fell last year, underlying the increasing dominance of multiplex operations.

The march towards a digital future for the cinema industry continued in 2007, with the number of screens served by digital projectors doubling during the year to 296. Of these, 47 were equipped for displaying digital 3D content.

Home video

DVD continues to provide by far the highest value market for movies and remains the most important profit contributor to the industry. Total UK consumer spending (on a retail and rental basis) on video packaged media products was more or less flat last year at £2.65bn, down from a high of £2.95bn in 2004. However, not all of this is

derived from movies. A little over 70% of the value of purchased DVDs derives from feature films, the rest coming from TV content, music video, children's, special interest, etc. While the vast majority of rental transactions through physical stores are movie-based, the equivalent proportion for online rental services is typically around 75%.

There were 248m DVDs sold to British consumers in 2007 - an all-time record. Growth was driven by sales of titles from key film franchises including *Casino Royale*, *Harry Potter and the Order of the Phoenix* and *Pirates of the Caribbean at World's End* - each of which sold in excess of 2m units - and the performance of children's theatrical titles such as *Shrek the Third* and *Happy Feet*. Average prices charged for DVDs are estimated to have been down again, resulting in a lower market value rise of five per cent to £2.3bn.

Total spending on rental of DVDs fell for the second consecutive year to £297m. This was despite continued strong growth in the subscription-based online DVD rental sector, which now accounts for more than half of all rental spending (£155m).

Last year represented the first full year on the UK market for the new high definition disc formats - Blu-ray Disc and HD DVD. Although the format battle is now resolved in Blu-ray's favour, the commercial war between the two groups is likely one of the factors that led to disappointing consumer take-up of this category in 2007. Only about 30,000 British households had invested in a stand-alone player of either format by year-end. 940,000 households possessed a game console equipped to play one of the hi-def formats. The net result was that only just over 1m BD/HD DVD discs were sold last year, generating £2.1m at retail.

Pay TV

Within the pay TV sector, only one company - BSkyB - still offers premium pay movie services. The pay TV window generally starts 12 months after cinema release and lasts 12 to 18 months before the free-to-air window starts. BSkyB acquires and transmits library movies and first-run titles (about 2,500 movies per year in total).

Currently about two thirds of Sky Digital subscribers take the premium Sky Movies package. We estimate this generated consumer spending of around £886m (inc. VAT) in 2007.

TV platform on-demand

Today, the UK's TV platform on-demand market is dominated by BSkyB (Near Video-on-Demand, NVOD, and 'push video-on-demand', Sky Anytime, via satellite) and Virgin Media (true VOD via digital cable). These two currently hold around 98% of the nation's on-demand market, with Tiscali's and BT's IPTV platforms having a combined

market share of less than 2%. In terms of true VOD, Virgin Media holds a near monopoly, generating over 95% of the UK revenues.

This situation is likely to change over the next four years, with true VOD expected to allow BT and Tiscali to secure larger shares of the market.

In terms of enabled households, Screen Digest estimates there were 8m households equipped to receive NVOD services at the end of 2007, equivalent to 31% of all TV households. This compares to 3.6m able to receive true VOD, a penetration of 14%. Virgin Media has been actively transitioning its digital subscriber base from NVOD to true VOD because it is a key differentiator over the digital satellite proposition of arch rival Sky.

Total revenues from TV-based on-demand services in the UK in 2007 totalled £378m, according to Screen Digest estimates. Out of this total, movie transaction revenues (pay-per-view payments) from NVOD and VOD came to £118m. If NVOD and push VOD services are excluded, revenues from movie-based true VOD amounted to just £83m in 2007.

Unlike the US market, subscription-based on-demand services (SVOD) in the UK are mostly based around non-movie content categories. This is because movie rights in the subscription pay TV window that SVOD operates in are mainly controlled by BSkyB.

Internet-based on-demand

Distribution of movies over the open internet can potentially replicate most of the business models offered in the physical world - i.e. retail ('download-to-own', DTO, or 'electronic sell-through', EST), rental, subscription and 'free' (ad-supported). To date, development of online movie distribution in the UK is at a nascent stage, and this is represented in the revenues being generated.

The two most successful open internet movie services in the world - Apple's iTunes and Microsoft's Xbox Live online service for the Xbox games console - are both device-based platforms. By contrast, web-only platforms that have no device strategy have gained little traction in the market.

Because Microsoft did not launch a UK movie service on Xbox Live until December 2007 (and then only with one major studio) and Apple has yet to launch a UK movie outlet on its iTunes store, the British digital movie market has yet to take off in the way that many hoped. There were only about 160,000 paid-for movie internet downloads in the UK last year, which generated less than £600,000.

KEYNOTE ADDRESS

EMBRACING THE DIGITAL AGE

**Josh Berger, President and Managing Director,
Warner Bros. Entertainment UK**



Josh Berger

Back in early 2006 I spoke at this conference about how Warner Bros. was responding to the challenges of the digital world. I hope there's no-one out there with too good a memory, because today, I've been asked to speak about how Warner Bros. is embracing the digital age...! Looking at my notes from back then, I talked about:

- the explosion in consumer choice
- the proliferation of TV channels across a mass of new platforms
- how broadband penetration meant exciting new services like IPTV and VOD
- how, with the incredible investment behind 3G, the mobile phone was looking like the platform that would bring everything together and transform the way we watched content
- the then relatively new phenomenon that was MySpace
- and some sobering numbers around piracy.

Well, it will come as no surprise to you that, two years later, practically all the numbers I quoted back then are a good deal bigger now.

As Ben Keen's impressive analysis underlines, we're seeing much greater penetration in the use of the internet and broadband. The number of digital devices is growing, as is the functionality and connectivity they offer. Change is still the word that best describes what's going on - and none of us knows for sure what will stick and what will disappear. And, over the last couple of weeks, there have been signs that some of the electrifying growth we've become accustomed to, may be settling down: witness recent reports of Google reporting flat growth in click-throughs, and Facebook showing declining rates of growth. That said, Facebook's numbers are still a massive 712% higher than a year ago, with 8.5m members in the UK, and over 30m worldwide. And when I last spoke here two years ago, none of us talked about the future pulling power of YouTube. Its statistics are quite staggering: in November its 16.2 million UK users spent a total of 500 million minutes online.

But while so much is changing, it is also worth reminding ourselves that, in spite of the scaremongers back in 2006, those 2.5 minute clips show no signs of destroying our business. Nor have the much hyped Mobisodes transformed mobile use or TV viewing habits. For us, these have provided another useful route to market for our entertainment lines. To paraphrase Ben Silverman when asked at last year's MIPCOM whether he feared for the future of episodic TV because of the internet, he said: 'I'm not sure what the second episode of cat pissing in a toilet is.'

At the same time, all the established studios and networks are massively affected by the move to digital. Every aspect of our business - from production through marketing and distribution - is changing. The nature of piracy is changing too. Whilst levels of physical DVD piracy appear to be stable, digital piracy levels are increasing year on year. In 2007, 32% of the population were engaged in some form of piracy, up from 29% in 2006, with those most likely to watch pirate films also the most likely to legally download. And although none of us can predict exactly the shape of the digital future, or even the next big digital thing, I am confident that Warner Bros. is well placed to leverage these technologies and trends as we have done throughout our history.

Some of the notable examples of this include our involvement in the development of the Vitaphone, one of the first music and picture synchronization systems, and our release of the first talkie *The Jazz Singer* in 1927. We were also the first film studio to produce for TV in the 1950s. And 20 or so years later, our parent company Time Warner created the first television network to 'continuously deliver its signal via Satellite' when it launched HBO. And in the 1990s Warner Bros. led the development and the launch of the revolutionary DVD format which changed forever the economics of the film industry. All of these examples point to the fact that as a company we are prepared to experiment and take risks. This is something we have done historically and will continue to do - and it is critical that we continue to do this as an industry as well. Significantly, these emerging technologies help us to be better at what we're all about: telling great stories and providing them in every possible way to consumers. As Peter Chernin puts it: 'Content is still king. The kingdom just got bigger.'

So in the time I have today, I want to share just some of the ways Warner Bros. is using digital technologies to:

- adapt our content and distribution strategies
- expand and engage our audiences
- better exploit the power of our brands across all platforms
- AND manage our digital rights more effectively.

Perhaps one of the most exciting aspects of the emerging digital tools is how they make us re-examine what is possible in creating entertainment content. Our 2007 film *300* is a great example of that. We used new ways of filming, resulting in a much edgier, stylized look and feel, geared to younger audiences. It was produced and shot in 60 days almost entirely on blue screen, with over 1500 digital effects - about 30 times more than a typical movie and about double or triple the number of effects for a heavy special effects tent-pole film like *Batman Begins*.

Thanks to the latest generation of digital projectors, screens and glasses, 3D is taking off in a big way. For our launch of *Beowulf* at the end of last year, 3D screens generated over a third of the film's total box office revenues, despite accounting for just over a tenth

of the screens. That's another good example of how consumer demand for new and innovative visual experiences is driving the market. In week 1 of release, *Beowulf* averaged £45K per screen on IMAX and over £13K per screen on 3D compared with almost £5K per screen on the 2D screens.

Digital enables us to create online destinations and new programming. In the US, Warner Bros. and AOL developed and launched TMZ.com, which fast grew into the leading celebrity news site, leading the category in monthly unique visitors. If you can't resist hearing the very latest about Britney or Brad, TMZ.com is the best place to go. And after the site gained sufficient momentum, in September, we launched TMZ, the daily syndicated TV show. In other words, we were able to use the web as a development tool and incubator, developing the format, creating awareness and popularity, before moving to television, and we're continuing to extend the TMZ brand with the launch, last week, of the TMZ MySpace channel.

Another example of a new online destination site is T Works. This is a site on which kids (of every age) will be able to create avatars, or virtual versions of themselves as a Warner Bros. cartoon character. Ad supported, and free to users, this site will provide the kind of immersive online experience that will create direct relationships with both our audience and our advertisers - something which digital, interactive technology enables. Now, instead of the one-way traffic of old - 'here's the movie, here's when it opens, now go and see it' - we can properly engage with the consumer in much more compelling ways and over a much longer period of time.

As you'd expect, we work with all the major ISPs in launching all of our major films, but now we're beginning to do much more online promotion than previously across the downstream windows. A great example is a recent promotion we did with MSN for the DVD launch of *Harry Potter and the Order of the Phoenix*. We built a dedicated Harry Potter hub on the site with bespoke content including behind-the-scenes clips, red carpet coverage and press conference highlights. We also offered up a prize of a lifetime, a walk-on part in the next Harry Potter film, helping feed the insatiable consumer demand for Harry Potter and really improving the life cycle marketing for our biggest brand. In the end, this money-can't-buy competition turned out to be MSN's biggest promotion of all time, generating over 75,000 entries for the coveted prize, a huge number by any media owner's standards.

For obvious reasons, there's been a lot of discussion over recent weeks about High Definition, as the Blu-ray/HD DVD battle has come to an end. We believe that this new generation of Blu-Ray DVDs will help spur the overall market, allow us to resell library product and renew the consumer's sense of the value of DVD. High Definition offers a completely new user experience and one that fits well with the needs of consumers to engage more fully with content. And in High Definition, the in-movie experience allows viewers to enjoy insights into the film and filmmakers without ever leaving the movie.

They can even host their own community screenings using the interactive features on the disc and watch the movie at the same time as chatting with their friends online.

As we seek to move Standard Definition to High Definition, we're also managing the transition to VOD. In 2007, VOD revenue worldwide stood at \$4.8 billion and is projected to grow to \$10 billion by 2012. The UK is projected to account for \$677 million of that. In this increasingly on-demand world, digital distribution represents a great opportunity for the consumer - more compelling products and services and greater choice and convenience. It is also great for Warner Bros. It means we're no longer constrained by the limits of physical shelf-space. Content that didn't meet the breakeven requirements for distribution in the physical world can now find an audience in the digital world. So, once we've digitised much more of our catalogue, we should begin to see evidence of the long tail in action, and all at a fraction of the manufacturing and distribution costs. We're also using our DVDs to show some of the more reluctant consumers how easy it is to move to digital. In the US in December, people who bought the Special Edition *Harry Potter and the Order of the Phoenix* DVD also got a digital copy of the film that they could download to use on their PC and other portable media players. And now, we're going to be providing digital copies downloadable from our DVD's onto Apple's iTunes and Microsoft's Xbox 360 Live Marketplace, to give even greater flexibility to our consumers. In the coming months, we'll be providing digital copies for the first time with some of our major DVD launches here in the UK.

Now, you can't have missed the hype around the recent deal we and most of the studios did to make movies available to rent on iTunes. In the last couple of weeks, we've also inked a UK-specific deal with iTunes, for some of our most popular television series, including the day-after-broadcast downloads for our newest series, like *The Big Bang Theory* and *Moonlight*. The evidence suggests that by having episodes easily available the next day, broadcasters are keeping viewers they may have lost - because previously they'd have missed an episode or two and drifted away from the rest of a series. This way, they keep up. And, of course, consumers get to try something new and, if they like it, get to go and find it on the network, for free.

The new digital environment is also allowing us to create new TV channels of our own. Just last November, we launched Warner TV with some of our best loved TV series available on a subscription video on demand basis. This new branded channel, available in the UK on BT Vision and Virgin Media, improves the service for our partners and gives us a closer relationship with the consumer, who benefits in kind from greater, more expansive viewing options, and on their own terms. And the ability to manage our rights digitally, gives us the option to make our content available in a wide range of ways and at a variety of different price points.

When I was asked to speak at this conference, my contribution was billed as the story of how a traditional entertainment company is moving into the digital world. So I want

to end by telling you about how this traditional company is moving into the fastest growing arm of the entertainment industry - interactive games. Warner Bros first set up our games operation in the US in 2004. Last summer, we expanded that operation into Europe with headquarters in London. In September we entered into a venture with Abu Dhabi based ALDAR to create a \$500m fund to develop and produce new games. In November, we acquired TT Games, the UK publisher of the huge family hit *Lego Star Wars* which has sold 12m copies worldwide. And we will be releasing *Lego Batman* in just a few months time. Thanks to new games consoles like the Wii, gaming is moving from a leisure activity for boys to a shared family activity. This gives us a fantastic platform to develop games from our own library of film and TV franchises. By way of example, the likes of *Batman*, *Speedracer*, and even *Dirty Harry* will soon be introduced to a whole new set of consumers.

To conclude, no one really knows for sure where these emerging technologies will go. The market, consumer tastes and expectations will continue to change and evolve. We will need more experimentation, investment and risk-taking. We will need to understand the end consumer much better than we do today. Of course, we know our consumers don't always understand or appreciate the need for distribution windows. They don't think films and television shows are the only forms of entertainment, and they don't always think about the nuances of copyright protection. But they do appreciate great brands and great entertainment. That works for us, because in the end, at the heart of what we do is not the technology or the platform, but a great story well told and distributed to the widest possible audience. What's coming in the digital age will only force us to keep getting better at that.

David Steele, Head of Research and Statistics, UK Film Council: What do you think the time scale would be for Warner's to finish digitising its whole movie catalogue and making it available in the UK, video-on-demand on a platform via iTunes, X-Box, cable or whatever?

Josh Berger: The whole catalogue is huge, so it's very difficult to say. I'm not sure we'll ever really see the whole catalogue any time soon, but I think the bulk of the catalogue will appear. Every studio is working around the clock on digitising the library because they all see it as that opportunity in a digital space. Hopefully the bulk of where there's a consumer demand should be digitised in the next few years.

Audience Member: Having teenagers myself, I realise that one of the frustrations is that they can go onto Apple, for instance, and access all of their websites globally. When they see something they want to download from the US site and they can't, they try to source it illegally because they want to consume it now, not when you decide they can have it. Content management is not an issue teenagers understand and they see that as an artificial barrier put in the way by the studios and the content providers. They're willing to pay for it, but if they can't get it then they'll find the next best means to get it.

Josh Berger: Yes, consumers don't always understand distribution windows and it's a pretty tricky problem. All of us in this industry understand why we have the distribution windows. Rupert Gavin and Tim Richards are here, and when they speak, they'll give you a sense of their feelings about how important those windows are. It's a pretty intractable problem. We have distribution windows and the end is not in sight of those windows, so we're going to have to try to manage your teenagers' expectations for the moment.

When people know about a big global film that doesn't get release day and date, you get that huge appetite and people want to see it. It's not just teenagers, it's all of us. Everything is available online, within a day or within three days, of it being put in a cinema, that's the world we live in. But shortening the window by a week, making it four months, instead of four months and a week, is not going to change that. We're not going to satisfy people's desire to get it earlier by doing that. It's either a total step change or we're living in the world where we're not satisfying our consumer's desire to get it immediately.

KEYNOTE ADDRESS

Mark Cranwell, Director of Content Acquisition, Babelgum:

It's pretty daunting following Josh, not just because he's such a good speaker but also because he's got Warner Brothers sitting behind him with that rich history, the archive, the current franchise that they have and all the innovation that he spoke about. Babelgum doesn't have the history or the employee head count, but what we do have is an opportunity. The staggering growth that you're seeing on broadband take-up is the pond that we're going to be fishing in and it's growing at a very rapid rate. With respect to videos, 9 billion videos watched each month, more than three hours of video per person per month, and 68 videos watched per month, per person. That's more than two a day, and a lot of that is the small kind of snackable YouTube videos which is exactly what Babelgum is not going for.



Mark Cranwell

Yesterday we completely upgraded our technology, so we have a new graphic user interface, and the technology that underpins the website is pretty remarkable. It's pretty intuitive, it's very sexy looking, and it's a great starting point. We are in Beta testing and we're looking to do a gradual roll out of our services. So it's an interactive video portal and free-to-view ad-supported, so free to the consumer. I was encouraged by Ben Keen's stat that in the US, 99.9% of all revenue generated from video online last year was advertising-supported. I think that's the way to go, given our discussions about piracy. People don't want to pay for things, and so our service is going to be free-for-the-customer ad-supported. Full screen VOD at near TV resolution. We deliver at a very low bit rate, it takes 450 kilobits to deliver a video on our service which addresses one of the questions about services like ours being bandwidth-intensive. Actually we're not particularly bandwidth-intensive at 450 kilobits a second and it opens up a huge number of the population who maybe just have 1 Meg broadband service. It is personal and tailored to viewer preferences. It's all about customising and creating small communities and micro-sites for people who have very specific interests, and very strong networking tools. We're going to have a whole interactive component to the service where people will be able to chat to each other, create communities, invent videos and blogs and send email links.

So to get to the content. We did research in the US and UK which indicated that people are underserved, in both television and online. So we came up with four things that we call 'The Passions.' These are: film and film festivals; nature and conservation; travel and culture; sport and lifestyle. I propose to concentrate on the first one, but you can extrapolate the ethos and the philosophy behind what we're going to do with film and film festivals to the other three passions. Film and film festivals are going to be our first big marketing push starting in the next few weeks, with the Babelgum Online Film Festival. We are looking at creating a community, where Babelgum becomes *the*

destination for independent film, foreign film, and for people who have got a real passion about film. The research we've conducted asked a generic question 'do you like film?', and millions of people responded 'yes' and then 'do you like independent film?' and that dropped off. Then we started to drill down to see 'are you really actively involved in independent film? Do you really feel passionate about independent film?', and we asked questions like: 'Have you been to a film festival in the last 12 months?', 'Have you rented out a sub-titled film in the last 12 months?', 'Do you subscribe to a movie magazine?' 'Which websites do you visit for movie reviews?' We tried to get the nugget of people that are intensely interested in this area. I'm pleased to say that it's in the millions, and together with the first four passions that we're looking at rolling out, it's in the tens of millions. So we think that people out there are looking for this type of content, and what we're going for is a mixture of licensed and commissioned content.

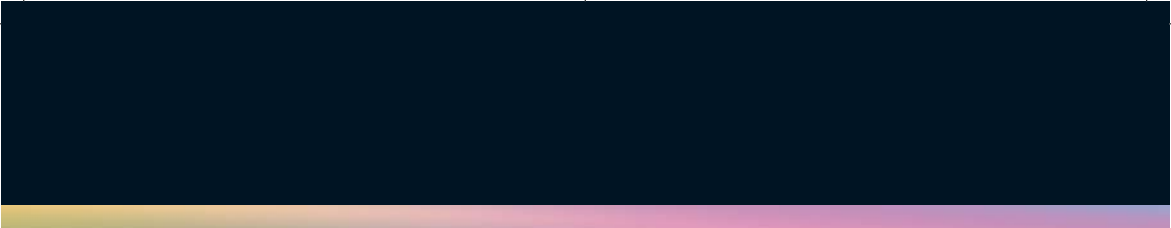
For licensed content, we're looking to the independent distributors to see how quickly we can unlock some of those free ad-supported rights. Obviously pretty tricky right now but we've got some good traction so far. We're looking to the studios as well to see what kind of innovative things we can do with their catalogue by freeing up the great classic films, black and white silent movies and the independent films that the studios have made over the years. Then commissioning content. We're certainly not going to become a studio, but in a couple of the other passions, and in particular nature and conservation, we think we need some kind of beacon programming to drive people to the Babelgum website. We're not looking at replicating a broadcast channel, or making things available that you can get on other websites. We're interested in having something that will be exclusive to Babelgum, that will interest people and take people to the website and keep them there. We will have a mixture of exclusive and non-exclusive programmes. Unlike YouTube, we're looking at an emphasis on long-form programming. All the current data indicates that fairly short viewing sessions are popular, and if you're going to be an advertising-supported business you really need people to come and stay.

We also have an uploading facility, and this is particularly relevant when it comes to the film festivals and the films. We are not taking user-generated content, but instead we're having the ability to upload professional content. That's quite a high technical hurdle to surmount, so it needs to be shot and encoded in a certain format. There's also the professional element as well. We're going to create a virtuous circle so that people come to the website to look at independent film and the things that surround independent film. And then we're encouraging film makers and distributors, who might not otherwise have a viable outlet for their film, to upload their film and participate in the advertising revenue generated from that film.

The experience is pretty rich. We're building and promoting specific channels and working very closely with a number of small film festivals. We'll be announcing some deals where we will take a well established film festival and enhance its profile, extend it out from just a one week or two week period, during which the festival takes place, to

across the entire year. We are going to be offering films or whatever the type of programming is underneath those branded channels, so you'll have a specific destination you can go to if you, as the content owner, have a sufficient amount of programming that could be housed under a brand name. We're not particularly concerned about having an established brand, but we are keen on helping people to try and build their brands. It's key to have a very powerful search engine and we have a proprietary search engine sitting underneath the service. Everything that is put onto the system is very heavily meta tagged as well, so you'll be able to put in very discreet terms and get very pinpointed results from your search. The customisation tools are strong. If you return once and have a specific interest in surfing, for example, you can create your own branded channels. So using the tagging procedure, you can go surfing and even identify a particular country, or place, that you want to go surfing in and create your own branded channels. As new content comes onto the surface, it automatically gets populated into your branded channel under the service, either through the upload facility or through it being licensed in. Every time you go back, you'll have more content without having to recreate your search all over again. We'll provide the ability for users of Babelgum to interact with other people who are equally passionate in the particular community that they are involved in. Ultimately the final component is a collaborative filtering system. It is a proprietary algorithm which will enable a component on the service to give you a 'most popular.' And it's not simply the most videos watched, it's a combination of how recent it is, the number of times people have embedded a link into a blog or emailed a particular video to a friend. This will be evolving every few minutes and the most popular content will be rising up to the service, and so there's another area for content owners to get some profile. The tag line is 'Personal, Social and Interactive.'

The Babelgum Online Film Festival is an initiative that we started last year at the Venice Film Festival. Spike Lee is the Babelgum ambassador, and for the past year, with very little to no marketing or promotional activity at all, we've received over 1100 applications from all over the world. At the Cannes Film Festival in May this year we are having an esteemed jury, headed by Spike Lee, with awards being given across seven categories. It will be the users who vote on the films that are up on the service, and the most popular ones will rise to the top. That layer will then be passed onto the jury, who will make decisions based upon those finalists. So we're pretty excited about the Online Film Festival. It will be an annual event and we're trying to encourage other film makers, who see the success of this, to upload their films throughout the course of the year. In a nutshell, the business model for us is 100% ad-supported and we're doing revenue share deals with all of the content owners. So we are looking right from the big studios down to the person who shot one documentary. There's recognition that it's a very nascent market. We take a pretty pragmatic approach, so that we're looking at giving minimum guarantees just on impressions to begin with, and so if your content proves to be quite popular we'll give you some money over impressions. Then depending on the programming itself, we'll look at a recoupable advance as well. So we do have a content budget. You saw the first four areas



or passions. Our intention is to just start very narrowly. We want to get the first four categories right and then we'll start building from there, adding in new categories that are all intertwined. The first four have a theme running through, pitched a little bit higher than the likes of YouTube and MySpace. It's a little bit more sophisticated and has this thread of passion or activity running through it. Music is the next possible genre. If you like independent film, there's a very good chance that you will like the soundtracks that accompany those films and other types of independent music. The Babelgum Online Film Festival will be heavily marketed and promoted in the lead up to the Cannes Film Festival in May. We're going to continue to build the independent film and film festivals - partnering with as many film festivals as possible.

David Steele, Head of Research and Statistics, UK Film Council: Going back to Ben's description of the digital ghetto and how i-Tunes and X-Box are dominating the emerging market, what's your strategy for getting from the computer to the television screen?

Mark Cranwell: It's a longer term plan actually and mobile can be included as well. Any legitimate global internet provider has got to be looking to not just the PC but to mobile and television as well. The difficulty that you have migrating from the PC to the television is one of resolution, and that's the big challenge.

DISTRIBUTION RIGHTS AND ISSUES IN AN ONLINE WORLD

Panel Chairman: James Kay, Partner, Media Communications and Technology Group, Olswang

Michael Maxtone-Smith, Partner, Reed Smith Richards Butler

Phil Rymer, General Manager, Icon UK Group

Peter Watson, Chief Executive, Recorded Picture Company

Panel Chairman: There are two things that set the scene: monetisation and convergence. In terms of convergence, everyone is familiar with what the impact is for this business. It's important we understand what consumers are after in order to position producers appropriately. The most popular device that people have in their home, after the cell phone, is PVR. 70% of people in most convergence surveys have a computer in their living room, which indicates that they want to be able to watch content in the comfort of their own home. Three important messages emerge from such surveys: first that people are after the 'lean back' experience via streaming devices, such as X-Box and i-Tunes - what these devices really do is provide a 'lean-back' experience that makes it very easy to watch the content; second, although most people say that they don't want to pay for movies, full length features would be the most popular form of content, if they were free, so that's a very positive message; third, certainly in the Olswang Convergence Survey (www.olswang.com/convergence), consumers were asked whether or not they would spend more money on content if they had to pay for it digitally - in other words, would they reduce their physical DVD spend? And the answer was, sadly, 'yes.' I'm not sure that's terribly surprising, but nonetheless it does lead us into the first topic which is monetisation.



James Kay

I'd like to start by asking Michael to give us a brief overview of what we mean by monetisation so we can see how to apply it to the digital world.

Michael Maxtone-Smith, Partner, Reed Smith Richards Butler:

I'm a lawyer and most of my career I've been acting for the money, mainly for banks financing productions. In terms of monetisation, I thought I'd start furthest point from my home territory, which is the consumer. For digital distribution you're looking at three possible options for the consumer: a pay-per-view system, a subscription system, or it can be free, with the whole thing is funded by advertising. In terms of monetisation, you get money coming into the website from those sources. Obviously it's going to be advertising in every case. The website, having obtained the rights to show productions, will have a payment obligation



Michael Maxtone-Smith

to the rights holder. Under the present model it will probably have obtained those rights from a distributor, probably a distributor that has acquired territorial rights itself from the producer of the film; so it might, for example, be a French distributor. Under the current model, and it will be interesting to see the extent to which this gets adapted or ripped up, the territorial distributor will have paid a minimum guarantee or advance to the producer, which it will then recoup from the various sources of revenue that it gets. So DVD deals, theatrical, television deals, and of course now digital deals, will be another source of revenue coming into the distributor. At the moment, when a distributor is deciding what minimum guarantee it is going to pay, it is making a projection of what it thinks it can get back from various sources and fixing its minimum guarantee on that basis. Digital has been around for a long time, and there are already many deals in place exactly like this, where distributors have made that assessment. I suspect that in the past they haven't really looked too closely at what they think the digital revenue is likely to be, because they've acquired at a time when DVD has still been dominant. Often they've acquired digital rights on a blocked basis that then can't be exploited until exploitation can be territorially discreet and everyone can be happy with how the money goes in. I think in the future, when fixing levels of minimum guarantee, they're going to be much more concerned with what they think they're going to get back from websites, and that will depend on what the deals are with websites. If you are talking about subscription, what price is it going to be sold for? What's going to come off the top - VAT obviously, but what expenses will come off? Is there going to be a floor price? So if you track that back, the distributor is paying a minimum guarantee to the producer. That's something that the producer can use as a financing tool. If you look at the way the risk therefore goes, the producer and the financier are far removed from the risk of how much money is going to come in from digital distribution. The person who's actually taking that risk, on the present model, is the distributor in deciding to fix what their minimum guarantee is. Now, it is possible that this system will continue. What will be interesting will be whether distributors in assessing that income will decide that their minimum guarantee should come down, or go up. That is going to depend on what happens in the next few years, in terms of looking at historical performance and that is a great unknown at the moment.

Panel Chairman: That leads on to other questions. The first is whether or not we think that the revenues are likely to be incremental or whether new forms of distribution are going to erode existing value chains. Peter, perhaps you'd like to tell us a little bit about what you think about the incremental nature of these revenues?

Peter Watson, Managing Director, Recorded Picture Company: I'm Managing Director of Recorded Picture Company, which is a production company. I'm also wearing a distributor hat, as a Director of Hanway Films, which is a sales company that licences rights on behalf of producers worldwide. Do we think that there is any additional value to be added by digital distribution to the global pot?

First of all, let's look at popular or mainstream films. We have to accept that there are some natural limitations to the size of the marketplace which will always apply, and they relate to the number of people, the number of hours they're prepared to spend watching films as opposed to doing other things, and the amount of disposable income that they're prepared to spend on watching films. We can all agree that those are necessarily finite markets, and that we've probably maxed-out under the current model. I don't think many of us believe we'll be able to secure more pounds or more hours from audiences.



Peter Watson

The question is how the pie is carved up, and I think that's where the opportunity comes. The traditional distribution, which Michael has described, very much limits the amount of the VOD pie and the amount of the total pie that will ever filter back to the producer, because the economics of that distribution model will, to a certain extent, gobble up those revenues. After the theatrical distribution, we have the exhibitor and the terms of trade that exist between the distributor and the exhibitor, or the terms of trade that exist between the distributor and the pay TV operator, which have to reflect the fact that the massive capital expenditure has been made in digging up the roads, laying the cables and acquiring expensive packages from the studios. With VOD, on the proviso that we'll continue to licence all rights to distributors, the recoupment will be across all media. And so we won't necessarily be able to enjoy the benefit of there being a much more direct relationship with our audience through the VOD platform. The only way to begin to subvert that old model is not requiring MGs from distributors, which equates to setting up our films without MGs, by which I also mean any release commitments, theatrical release commitments, de facto investments - essentially, money out the door. As long as we continue to need MGs to set up our films - and we do at the moment - we just won't be able to suppress the old economy.

Panel Chairman: Do you think that, given some of the stats Ben showed us this morning, which seem to indicate that the value of digital distribution was extremely low, there is any chance of reserving those rights to the producer since they don't appear to be of great value?

Peter Watson: The answer is absolutely categorically no, because it's not really their value today, it's the speculative value. If you're asking for an MG from a distributor in any given territory and they're giving a release commitment to release the film theatrically, you will not be able to either carve out the VOD rights or limit the grant to a non-exclusive grant, or whatever. It will be a conventional grant of rights, I'm pretty certain of that. So you've got to look at how films are financed, first as a producer, or as a sales agent, before you can start subverting the old economy.

Panel Chairman: Phil, what is your view on that?

Phil Rymer, General Manager, Icon UK Group: I'm the General Manager of the Icon UK Group of companies. Unlike Peter I have a dual role in that the group comprises a UK and Australian distributor. It also comprises a worldwide sales agent as well as a home entertainment company. So I have to look in terms both of purchasing these rights, when we are putting up an MG, but also selling them on behalf of rights owners into foreign countries. As long as we are putting up an MG for our territory, and providing what is usually the second largest piece of collateral of any film financing for the value of the UK, then



Phil Rymer

We take a very robust view about protecting every source of revenue from within our own territory. I'm not sure it is very speculative as these technologies seem to be developing unbelievably quickly. We are approached by lots of telecoms and internet service providers on an almost weekly basis to provide some kind of content for them to use on their service. So things are growing very rapidly.

I agree with Peter that there is a finite value to the UK and it's just the blocks of revenue spent on different media that are changing. We might see a decrease in a sell through video, we might see a decrease in rental video, and an increase in VOD by cable, a sort of VOD. It's fair to say right now that VOD via the internet, such as the LOVEFiLM model, is very nascent and we're not seeing a vast amount of value, despite the sophistication of the technology. I suspect that's more to do with public mores rather than failings in that particular style of service. We don't just buy and say: 'that's it, the UK is ours, have done with it.' We have lots of in-depth discussions with the sales agent or licensor selling us that particular territory. We find them to be increasingly sophisticated. American licensors, in particular, have moved from a simple block ban on exploiting online rights to accepting pre-approved DRM standards and pre-approved business models. We are finding more and more that we are in output situations with VOD providers and pay-per-view providers. We need to ensure that when we are putting up an MG for a film from Focus or Miramax, that we can automatically assume that we can put that film out through our output arrangements and that we're not losing that particular slice of revenue. Frankly the licensor does not care if we say: 'if you block this particular window we'll have to reduce our MG'. They'll go to someone who will meet the ask price for the territory. So we have to reason with them constructively to make sure these can be fed through our existing deals. The level of sophistication, understanding, security and reassurance has improved. Apart from the hacking of the Windows Media Centre Version 10, 18 months ago, when Sky and others stopped their VOD service, and licensors withdrew their consent for films using that DRM, there have been very few security scares on regular cable VOD and internet VOD. Licensors are becoming more reassured by that. This helps us when we are purchasing films and exploiting these rights. I love the idea that there would be no MGs, that would be a great step forward. Exploring revenue sharing off rights versus the cost of releasing would be a very interesting and productive experience. In terms of how we account to rights owners to

producers and licensors for revenues from digital rights, it is a very amateur model right now. Most deals are done on a 50/50 net revenue basis with all costs being absorbed by the distributor.

Panel Chairman: Do we think that as those revenue share models become more prevalent that will have an impact on the level of the MG?

Phil Rymer: No, I think that over the last two years, we have accurately assessed the impact of certain regular cable VOD and the value of pay-per-view. Right now we pretty much discount the value of a web-based distribution. But even if we've got it colossally wrong and we've got a bargain and make a lot of money out of that MG, we would say that the revenue share on it is one which is equitable and just the same as a successful DVD release or a successful sale on pay television, and will lead to those overages flowing down the line as they're intended to.

Panel Chairman: I just wanted to come back to Peter and explore the concept of the ability of producers retaining rights. If there were an alternative source of financing, somebody that was prepared to pay some money for those rights separate from your territorial deals, would that be positive? In other words what are the barriers?

Peter Watson: We have traditionally built our finance plans and financed films on what we call distribution-led finance plans which require at least 20-30% of the territorial value of the film for it being pre-sold. Now that was the old way and on the back of that were all the other bits that you leveraged to finance a film. That, alas, seems to be changing as a model.

Most sales agents will tell you that pre-selling in cornerstone territories is becoming incredibly difficult. We're all looking to the myriad financiers out there prepared to take a view on the value of a completed film. So to finance a film, you don't need necessarily to have locked up the film and have the rights bound up in territorial bundles as per the orthodox model, provided the financier is prepared to accept that the subsequent distribution that's put in place by the sales agent doesn't necessarily conform to the orthodox model. So as long as the financier is able to take a view that they'll be able to responsibly attach VOD deals that generate revenue streams and start to take bigger risks over time, you might be able to start to overcome the orthodoxies. I think it's up to the financiers to take those views. Alas, I don't think it's the producer. The producer is going to need to put a safe pair of hands in the mix any which way, so my sales agency will move into that space.

Phil Rymer: Although you may not need an MG, the rights still all vest in one single distributor per territory. If you stopped the current traditional model right now, you would still find the current windows of exploitation through video, electronic sell-through, pay-per-view, VOD, pay and free, will hold true. Either because that's the way in which consumers expect to see the product, or because there are output arrangements which

have some years to run. Even if the financial model made sense to the distributor, the logistics of arranging with the prior and post windows that a third party were to exploit on an exclusive arrangement, even just the normal three month window, would be extremely complex to overcome. It would be better to still maintain one commonality of ownership of the rights and allow that one distributor to start unpicking certain arrangements, even in terms of length of windows.

Peter Watson: That's probably going to happen. Even if distributors have got complete control over how rights are sequenced and how windows operate, they're not going to have any reason to break the old sequence of theatrically-driven distribution. Until you can deliver online the same sort of marketing bang that you can get through theatrical release, nothing apart from the theatrical release delivers the sort of PR and general awareness for the film in society. Building campaigns virally on the internet is not going to serve a big film. Yes, a specialist film, but for mainstream films nothing, so far, online is able to top theatrical.

Phil Rymer: I take issue with that slightly. We've had two recent releases, one was a low budget comedy horror from Film New Zealand called *Black Sheep* and the other was a film from Universal called *Alphadog* with Justin Timberlake. The viral campaigns on both drove them to far higher degrees of success, both theatrically and in home entertainment. You're right in that it is specialist in the sense of perhaps films targeted at more youthful audiences.

Panel Chairman: You've heard people say this morning that online revenues from exploitation are almost exclusively advertising-generated. Mark Cranwell talked about the possibility of MGs being paid, presumably as advances against the shares of those advertising revenues. Michael, can you tell us a little about the possibilities?

Michael Maxtone-Smith: The crucial thing for a financier is, who is going to pay me the money? This will obviously favour the more established, well funded websites. The other important things are, how much is going to be paid, and is it quantifiable? So it is going to depend very much on how you split the advertising revenue and how you can give assurances as to what that advertising revenue will be. Clearly a minimum guarantee is going to be very helpful in that way. There's a timing issue in terms of whether it's an advance that's paid upfront or whether it's a minimum guarantee that's paid over a longer period of time. Obviously, if it's the latter, there are two consequences. One is that you're taking a longer credit risk on the person who's paying, which is not very attractive. The other is you've got extra interest costs because you're going to get paid later. But the crucial thing is how it will be quantified, and that depends on what deal the producer, the distributor, or whoever is dealing with the website in terms of advertising, has done. Either you can solve it by certainty or you can't. In terms of lending against forecasts, it's going to be very difficult until this has been around for a long time and one can look at historical data. We're a long way off that.

Panel Chairman: Phil, you mentioned earlier that you get approached by online distribution all the time, what sort of deals are they offering?

Phil Rymer: Initially approaches by the likes of BT, Orange or internet service providers were for content to attract subscribers to their internet service. Most of the approaches were fairly unformed and turned out in essence to be merely loss leaders for the service. They usually offer a simple revenue share, based on hits and downloads to their websites. Almost without exception, these are pay-per-view and VOD deals. Whether cable or online, they work on a very simple basis of a price per download, a fee taken off that subscriber price and a division of the net receipts, between us and the licensor. Most of the subscribers are very flexible because of the nature of their delivery system in terms of price pointing. They can accurately register the number of hits they're receiving per film, and maintain a much higher price level, instead of automatically after three months dropping it to a certain level and a certain level lower until it becomes a very low library title. They are able to respond much more speedily. In fact in a recent example, we received a very low offer from a major pay TV broadcaster for one of our premium films, and we had already taken it off a pay-per-view service. After rejecting the pay TV offer we were able to re-licence and have it reinstalled the same day on that pay-per-view service and the revenue flow was almost unbroken. Most people will be familiar with the concept of a black period, a dark period between windows where the market refreshes itself, because the film is unavailable, so we'd suffered the loss of revenue through that dark period, but the film was up again. In fact, because of the revenues generated before, that pay-per-view provider was willing to spend a certain amount of advertising to trumpet the fact that it was not available on pay TV and only available once again through its pay-per-view service. So the flexibility and response time we're finding is very good from service providers.

Panel Chairman: Peter, are there any marketing tools that you as a sales agent can use online?

Peter Watson: Sales agents are business to business, so we're not in the business of creating advertising campaigns. The section we're most engaged in, in this area, is in library. Here we've got rights and we're free to deal in those rights, so we can take views that we couldn't take using films in the first cycle. They can be broken up traditionally. You licence by territory, but you can licence the DVD rights to one party and then broadcast rights to another party. So you've got a little bit more freedom in that domain.

The free proposition is a problem unless the free operator, and normally that's going to be an advertising-supported operation, is prepared to pay a hefty MG to get an exclusive grant. But even if they don't have an exclusive grant contractually, they are de facto exclusive: if they are the only free operator providing that film in that territory, they are effectively the only reasonable port of call for anybody who wanted to watch that

film. It's the place you go where you can see the film for nothing. Until those free operators have major market share, or are able to pay MGs of a sufficient size, I don't think you'll see many bundles of the independent films and classic films that we're representing being licensed to a free operator, because there's too much uncertainty in the marketplace. You don't want to find that you've somehow inadvertently damaged a more potent area - which might be the download pay-per-view side of the business.

Panel Chairman: Michael, what impact on monetisation does the potential piracy explosion have? Is that changing financiers' views of securitising these particular rights?

Michael Maxtone-Smith: Piracy is a big concern. From a financiers' point of view, if you're keeping the traditional model, piracy isn't their problem. It's actually the distributor's problem because they're still having to pay their minimum guarantee whether there has been piracy or not.

Panel Chairman: Are there any questions from the floor?

Ron Fogelman, Consultant: Given the fact that the consumer has stormed the gates already, is DRM antiquated and serving no purpose in restraining the relationship between content providers and the consumer?

Phil Rymer: We took our lead from the MPAA major studios. It's often a test for us when we're selling internationally and when we're buying as to whether a service provider has product which is licensed from at least two MPAA studios. We take the view that the type of individual who is concerned with cracking DRMs tends to be from a relatively narrow special interest group. Although they then tell each other where to find that particular piece of software, how to download and install it, it is not being taken up by any large proportion of the population, who have far better things to do than trying to download software to crack DRMs. People are more or less happy to pay £2.99 rather than become a computer expert overnight. The far greater danger is the websites that service the DVD pirates. For our film *Apocalypto*, it was on well known 'wholesaler' websites within the first few days of testing in the US. Now once it's on those websites, pirates have access to those websites, whatever their commercial arrangements. I don't know what their revenue share is. It was available worldwide. After that, it's shifting deckchairs on the Titanic. There's not that much point worrying about it. Plus there still is a certain cachet of owning the product, the DVD in its presentation case, rather than having it as a file on your hard drive. This will change with the demographics of people using and accessing the product. But right now we're not concerned about that aspect.

Panel Chairman: In terms of DRM and the failure of a DRM system, what sanctions are you seeing imposed? Is it something that you have to be responsible for? Is it something you pass on to the provider?

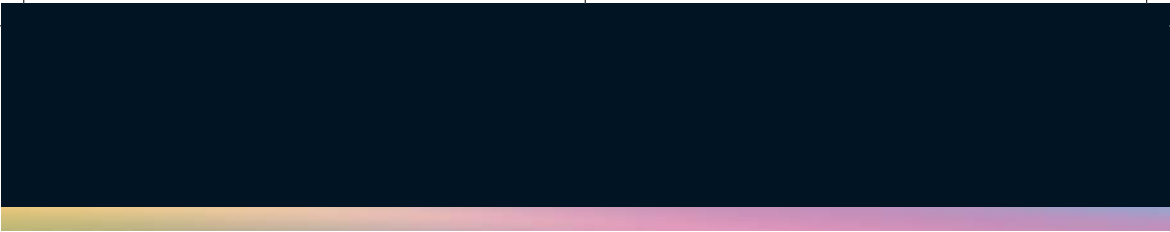
Phil Rymer: When we are acting as a licensor for the UK territory, we have decided as a company that we will enter into warranties with the providers of this product, with the licensors, with the producers. That does make us liable if there is an instance of piracy resulting from a breach of these DRMs. It is up to us, therefore, to ensure that our warranties extend down the line with FilmFlex, LOVEFiLM, Sky VOD, whoever we're providing the product to, that we can pass on that liability. We have tried limiting that liability. Sooner or later you've got to step up and say to the producers, to the licensors 'if you trust us to be the distributor in the UK we acknowledge there is a responsibility that goes with that'. Traditionally, there's been a responsibility to target video piracy, we see no difference with responsibility to try and crack down on internet piracy.

Jane Wright, General Manager, BBC Films: One of the ideas that came up in an earlier presentation is that a real growth area will be in mobile devices like iPods for movies. I realise that movies is still one of the most popular forms of content, but TV programmes and sales of TV programmes on iPods, for example through iTunes, is already well established. Television is the first mover. So for independent films, not necessarily the big studio fare, do you see television as a real competitor for this world of new revenues?

Peter Watson: There's a battle going on between distributors in the UK market and broadcasters. I think probably the battle for mainstream films will be won by the broadcasters. They are moving into the VOD space, it's a natural evolution for them and for the consumers who've developed habits or know what a set-top box is. We'll find that broadcasters will start competing with distributors for rights in territories, all rights in territories. That's probably going to create a little bit more competition in the indie marketplace. Broadcasters realise that what used to be the lion's share of DVD revenues can potentially move into their domain, although I believe it will be free-to-air. I think broadcasters will be successful in that free-to-air space, and it seems to me that's the strategy that Channel 4 is pursuing.

Terry Illott, Director, Film Business Academy, Cass Business School: I run the Film Business Academy at Cass Business School and we have some M.Sc., students, these are 24 year olds. Very bright, very enthusiastic, very committed, and they see the digital opportunity as giving the producer direct access to a relationship with the consumer. That excites them very much and drives a lot of what they intend to do in terms of their dissertations and career plans. Peter and Phil, wearing your producer hats, is that of interest to you also?

Peter Watson: Yes, but I think it's for very specialist programmes. For example: top documentaries, music films, or films that exist in the art house or specialist areas. There are niches that will become very valuable for the indie. There is opportunity for the online VOD space, but that will still represent a pretty small slice of the overall pie, although a very valuable slice for the rights owner or the rights creator.



Phil Rymer: It is an interesting area which will grow. The distribution world is very flexible and responds quickly to changing trends. We've seen lots of freestanding video retailers go out of business in the last year and the traditional model is changing rapidly. This is not a five year span, this is a one year span. Deals that Blockbuster is now doing with us to help promote their stores reflect an amazing turnaround in the power of the video retail chains. As technology changes we'll find ourselves responding to the way in which people want to see these films. I can't tell you how quickly that's going to happen, but we'll have to change our thinking as it does.

THE CINEMA BUSINESS IN A DIGITAL WORLD

Panel Chairman: Arvind Ethan David, CEO, Slingshot

Chris Auty, Producer/Distributor
Ross Fitzsimons, COO, Curzon Artificial .
Rupert Gavin, CEO, Odeon and UCI Cinemas
Tim Richards, CEO, Vue Entertainment



Arvind Ethan David

Panel Chairman: The topic of the panel is exhibition in a digital age. The contention, or perhaps the assumption, is that digital will bring huge change, both wanted and unwanted, to the exhibition area, and that change runs throughout the business. It's about the reinvention of content, the types of programming, alternative programming, non-film material, different ways of presenting films, 3D and so on. It's about the value proposition itself, when exhibition is not just exhibition and at least two of these businesses are not only exhibitors but also now distributors. It's about the business model, about going from a rental business to extending the way you charge your customers, and the way you split with the distributors. The big question underlying all of this is: how fast is it all happening, what's happening today? Tim I'm going to start with you. I'm the digital evangelist but my sense is you beat me, because whilst I think this is transformative, you are on record as saying it's life transforming, which makes it sound rather personal. What are the bets you are taking with your business?

Tim Richards, CEO, Vue Entertainment: For the last 15 years digital has been on the horizon, but it's always been two years off. Now it's here. Currently, film does not allow you to screen that many films in any given period, just because of the physical size of the product. Last December, we opened up the very first purpose-built digital multiplex in Europe with no 35 millimetre backup at all. We were the first in the world to do anything like this. We did have some teething problems, but these are now solved. In our manager's office, we have a little 19" monitor with 10 different rows on it, which controls trailers, advertising, features and the air conditioning and heating. It is absolutely the future. We currently have a 10 terabyte server that can hold 100 movies at one time. So you have the ability for the very first time to cater to a market absolutely perfectly. If there is somebody who wants to see a small arthouse production we can now cater to them. We didn't have that kind of flexibility in the past. So our programming ability is phenomenal, it's unlimited, and the picture quality in digital has clearly surpassed analogue. It is phenomenal and every single screening is an absolutely perfect rendition of what the director produced. I wish the consumer would pay more for it, but they are starting to appreciate that it's a cutting edge technology of the industry.



Tim Richards

Panel Chairman: Rupert, at about the same time that Vue announced the world's first all digital multiplex, Odeon also announced the world's first all digital multiplex. I won't ask

you guys to arm wrestle, but who got there first?

Rupert Gavin, CEO, Odeon and UCI Cinemas: We started a year ago with all digital multiplexes, but what Tim has done recently is different as it's the first one that has been purpose built. We took two existing nine screen multiplexes, Surrey Quays and Hatfield, and a year ago we started with digital projection in every single screen, so our experiences are very comparable. The customer likes it; it gives us far greater flexibility around programming. For example, last May on the first weekend of *Spiderman* in Surrey Quays we were able to offer a show start for the film every 15 minutes: the performance of the cinema that weekend was phenomenal. You couldn't have done that in an analogue world. Obviously Monday's programming was different from Sunday's programming in terms of number of screens, digital gave us transformational flexibility in terms of programming and screen utilisation.



Rupert Gavin

Panel Chairman: So there's clearly shared excitement, but amidst this excitement there are also issues. Josh Berger talked about the intractable problem, the disconnection between consumer expectation of being able to get anything they want whenever they want. Some distributors and studios think that's how they will maximise their revenues with the status quo. Chris, you and I have started an interesting conversation about the cultural and political aspects of this.

Chris Auty, Producer/Distributor: Well I'm obviously a creature of the old age, but I've been moving into the digital space because I'm about to launch a web-based business. It's been absolutely fascinating to me to experience first hand in encounter sessions with groups of young users and witness some cultural differences that lie behind all of this. The speed with which digital is rolling out in cinemas in the UK is fantastic, and we should all be proud of that. The speed with which broadband is rolled out generally in the UK is obviously incredibly important. The speed with which the broadcasters have jumped into the space, look at 4oD, over 100 million downloads and streams in the first 14 months of operation, that's incredible. So there is a huge momentum within this historically rather traditional and staid territory. As a Brit I feel kind of proud about that.



Chris Auty

What I notice, however, is that there are two hugely different communities at play here. At one level, traditional exhibition is about bricks and mortar programming and it has a fairly clear business model which has evolved. But when I'm in the encounter session with kids in South London, what's fascinating to me is their absolute resistance to the concept of payment for digital services. They have an antipathy to that culture. The

'digital natives,' to quote Ben Keen, are not just saying: 'we don't want it because we can have it for free,' they're actually saying: 'we don't want to pay as a matter of principle.' So the gap is culturally between expectation of freedom, almost as a political statement, and the needs of commerce to extract value, maintain windows and sequencing. This is the dynamic. I don't know where it's going to go, but it is fascinating. The previous panel suggested it is serious about not providing content into the IPTV space, and allowing that to become the colony and an outreach place for broadcasters. I suspect you might end up with a space where, from a movie point of view, a whole generation of kids will stay in the 'it's free and will always be free' and 'it'll be pirate if it has to be' space. They will never get recruited into a pricing point, subscription or paying model, and that's what interests me and that's the big challenge.

Panel Chairman: Ross, in the UK, Curzon Artificial Eye has been one of the first to experiment with 'let's change the business model a little bit, let's experiment with a simultaneous pay-per-view cinema release.' Channel 4's been doing it as well but you've done it very recently. Talk a bit about why.

Ross Fitzsimons, COO, Curzon Artificial Eye: The way in which we did it was unusual and if I admit to a slight nervousness, I am sitting among panellists who publicly commented extremely negatively on this experiment. It's important for us to make the distinction that the reason we did it is to engage with the customer. It's not really about the technology. The technology is only there for us to engage with the customer and to bring our films to customers. Artificial Eye is a tiny distributor in comparison with the studios. But what we do have is the highest possible quality of film and that's been proven conclusively over the last three decades. As a consequence, the media reception for our films is very often outstanding, and we usually have either the film of the week, or the second film of the week in all the broadsheets and in the parallel media. So it's fair to say that several million people will read about our releases every few weeks as we release each film.



Ross Fitzsimons

We cannot reach all the potential customers because we have no access to them geographically. So it was very simple for us to engage in a discussion with the main broadcaster or main provider, that would enable us to reach customers, wherever they might be. To say: 'if you read about this film and you want to see it, you can at the same time as those people who happen to live close to the few bricks and mortar sites referred to.' We have 5 of our own cinemas, and four of those are playing the film. We've got some backing from a couple of other exhibitors, for which we were very grateful. The main exhibitors who opposed us rarely screen our films anyway, and I've no criticism of them for that, because we are providers of high quality, but quite specialist film. It's always what's referred to as independent: it's foreign language, it's arthouse. You've got to read it as well as watch it very often. It might be in Romanian or Mandarin so it's not

going to appeal to the broad mass of customers. But there are millions of people in this territory who do want to access these films and, with the current business model, they can't. So for that content, this is a totally valid approach. I wouldn't dream of suggesting that *Spiderman* should go this route at the moment. Although teenagers might disagree. What people want, where possible, is to come together and enjoy the value proposition that cinema offers. This is something quite primal. We're all gathered here today to discuss these things. We wouldn't do this from our desktops. You know, we come together to enjoy experiences, that's what people do, that's why we have tribes, that's why we have villages, towns and cities, and we do the same thing with our culture, our art, our entertainment, our sport. Cinema does have to improve its value proposition constantly and both Odeon and Vue are doing that very fast. We're doing it in a slightly different way.

Panel Chairman: Can you just give us a bit more sense of the economics of releasing a film with a pay-per-view immediate window? What changed? Was it more efficient from a marketing perspective?

Ross Fitzsimons: No, because what's very simple for us is we release films that normally on anything from about 5 to 25 screens. This particular film went out on 10 screens. *The Edge of Heaven* is a very fine German/Turkish film, which won major awards at Cannes and the European Film Awards in 2007. It's got a small audience, so for us to release on 10 prints we probably would have hoped to get about 12 to 15. We didn't get as much exhibitor support as we'd hoped for, but there's not a huge degree of difference in that. The P&A is small, only in 5 figures. This is tiny compared to the kind of thing that Warner Bros. does every day. But by engaging with Sky, and saying we will go pay-per-view the same day that you can see it on the cinema screen, for a very limited period of 17 days, we reached nearly 9 million homes in the UK. That is 9 million screens, potentially. All those homes had this film advertised to them, so acting in this way doesn't just change the release pattern, it changes the opportunity. It was pay-per-view by the way at £9.99, not the normal Sky £3.99, and the price point was obviously the subject of much discussion before we did it. But what's also interesting is that it goes back to pay-per-view in six months time again after this 17 day window, so there is that dark period of five and a half months. My feeling is that the marketing we've done now will really see its benefit in that pay-per-view, and in the DVD sales and on other VOD channels and in the TV exposure that the film gains. This is going to be a much better known film than it otherwise would have been for a tiny Turkish/German film. The majority of the population would never even get to hear of it, and we are getting it to them.

Panel Chairman: In the States, IFC have been running this sort of experiment for a little over two years. Last time I counted about 36 pictures to date, and when they started there was the same scepticism, the same fear. But the sky doesn't seem to have fallen, or has it? The fear here is precedent. It's not that this doesn't make sense, it clearly does, but if one sets the precedent then the studios may demand it as well. I'll ask everybody

the same question, if you were starting again, is there a way you could design this so that some of these experiments could start to work?

Tim Richards: This is a model that has been in place for a long time, but Windows have been eroding over the past 10 years. Cinema Exhibition is not a declining industry: 7.7% year on year growth, 20 year straight line growth since 1984. This is an industry which continues to grow from strength to strength. You can point to a few declining years, because there were a couple of exceptional years in 2002 and 2004, but the future particularly with digital is uncertain. It's a very vibrant market and it's not something that anybody really wants to jeopardise. One of the exciting things about digital is that we get crossover productions, arthouse, European films, whatever they might be. Currently, there are some fantastic movies that we get really excited about, and then we hear they're going out on 20 prints, or even 50 or 60 prints, but we don't get any, or very few. With digital because of the significantly reduced print costs, a good cross over, art house or foreign production can go country-wide. So you're going to see a very material change in the near future.

Panel Chairman: In theory, you are right. But what you're talking about is losing the print cost, the advertising cost will remain. The point that Ross is making is that for these very small films with 5 figure or lower P&A spends, even if you lose the P&A, they cannot support that scale of release. So one solution is to do things like premium pay-per-view. Now, admitting the political and precedent issues of that when you're dealing with bigger films, is there a model that you can see evolving?

Tim Richards: It's taking a step back and looking at the total revenue stream. The windows have been tested and proven. Most of the arguments take place in terms of the actual size of the window. There is no discussion on complete abolition of windows, but it's now at 17 weeks or 4 months in the UK. Would distribution like it shorter? Absolutely. Would we like it longer? Yes. But the current length seems to give everyone a comfort level and that seems to work. We don't share in any ancillary revenue streams, so for us as exhibitors, as a sector and as a business, it is our life blood. You would see a lack of growth and investment in the future, were it to change. In a worst case scenario, you could end up the way we did 40 years ago where we went from 1 billion attendances spiralling down to 50 million attendances over a 20 year period, due to lack of investment.

Panel Chairman: The key phrase there is we don't share in any ancillary revenue streams, but the world knows that exhibition is the shop window, it's where the value is created for the ancillary revenue streams. Is there a deal that can be done?

Rupert Gavin: It's quite interesting. This is the model we have at the moment. You have to put to one side the plethora of content created for TV, which there has always been, but now is created for the web, as well as TV etc. It just so happens that there is content that is created specifically for the cinema. That has been one of the things that has emerged from the debate on windows. Ever since Bob Iger announced that: 'There will

be no windows,' there has been a creative community reaction. There is a significant volume of work that they wish to see the audience enjoy with the pleasure of sitting in a cinema. That is quite important. Is that all content? Absolutely not, it's a small proportion. However, by and large it tends to be content that is relatively expensive to produce; you have to have an economic model that supports that expense. A lot of studios have experimented with different attempts to squeeze out revenues at different places. And, while it's never a perfect system, the window system that we have at the moment seems to have maximising revenue ability for this type of content alone. Cinemas do not participate in downstream revenues; there may be a model which does that. In fact, a couple of distributors are now talking to us about a different model. They have put on the table propositions about participation in worldwide revenue through all the windows. It's interesting that some forward-thinking minds are starting to think about it. I don't know what our response is. At the moment we're showing very expensive content that the creative community wishes to have experienced in the cinema. There are significant economics in terms of running our buildings. Do we stand still? Absolutely not. We have to improve the value equation. We have to increase the different types of content we offer. We have to improve the environment. Remember that we are in the 'going out' market, as well as the content market. That's the real difference between us and the music industry. People try and create parallels, but actually a piece of music is something that people want to have and enjoy in a vast variety of settings and situations, whether it's on their iPod on the tube or whatever. In cinema, the place and the content come together in a specific experience.

Ross Fitzsimons: What we have seen in music over the last few decades is that the live concert side of the business used to be where people promoted their record releases and the money was made in album sales, but that's entirely reversed. The Led Zeppelin gig showed us just how much the live experience means. I'm going to see Neil Young on Saturday and paying £150 for the privilege for two tickets at Hammersmith Apollo. The parallel for us in the cinema business is that we have extraordinary business possibilities when we engage directly with the talent. We find that when directors and actors accompany the releases to our cinemas, the results are outstanding. Odeon has really blazed a trail in that respect and done a number of different events including a Robbie Williams gig. Where we can take not just the film, but the person who made it or is the lead participant in it, we can really leverage the content itself.

Panel Chairman: Let's look at this plethora of alternative content and some of the cultural implications. In an age of media fragmentation, and, to borrow the awful phrase of the current debate, a less socially cohesive era, what cultural role do cinemas have to play?

Chris Auty: There isn't anything particularly antithetical between where Rupert stands and the different viewpoints. There are differences of scale in the economics of the various propositions that are on offer here, and its horses for courses. One of the most exciting things about the roll out of digital screens in the UK is that, assuming the

business carries on growing in the way that it has and the roll out gets down to a very local level, then cinemas which are fully digital will become as available to use as most community experiences. They'll be both the theatrical shop window for things that can then be sold offline on DVD or online on the web, but they'll also become community operations in themselves, gathering together communities in a way that might eventually mimic behaviour on the web.

Rupert Gavin: The atmosphere in our cinemas is absolutely phenomenal at screenings such as the World Cup or some of the concerts. We've been experimenting a lot with interactivity and getting audiences of 200 to 300 people interactively using the screen to compete against each other. Once again it's a use of community but with advanced technology.

Turning to 3D, this is yet another transformation. The UK now has about 100 screens. 3D involves a new audience and moves the ticket price on. We talk about people not wanting to pay for content. Our experience is that people are actually willing to pay currently around £2 extra on top of the normal ticket price for the 3D experience. If you deliver a good value proposition, then there is no inherent reason why, by managing the markets sensibly and putting value into the market, people should not be willing to pay.

Ross Fitzsimons: They will also pay £25 to see Quentin Tarantino talk about his film. I think that there are opportunities that we should be aware of.

Panel Chairman: A community has to provide a shared experience, but it also has to show individual knowledge of its community members, which is why traditionally it's been the smaller cinemas, the arthouses, who have been better at knowing their local audience. Digital allows another thing, less talked about, in that it allows CRM, in a meaningful way. It allows huge data mining off your communities. How much of that are you doing, and how sophisticated is it getting?

Tim Richards: We spent 18 months doing a detailed mosaic profiling of our customer base. We can tell you by post code, by street, ethnic background, anything you want to know about people who are either going, or not going, to the cinema. We are independent too and not tied to anybody, as we own the company. It's all about knowing your customers.

Panel Chairman: And the more information you have about the customer the more power you have, the more ability you have to market. Now, you've set up a distribution joint venture, presumably in part because you know you can reach customers more effectively?

Rupert Gavin: We now have 3 million cinema-going households on our database. We're in communication with them on a regular basis. Last year, for example, we asked 1 million of them: 'what sort of movies do you want? Which are the movies you like? What do you want to see in the future? What are the hot buttons for you?' To be able to

talk to 1 million cinema goers in one go is hugely powerful. What's important to us about digital is the web by which we connect with our customers. Currently, in any week, up to about 30% of our tickets are sold over the internet. Last year we served 22 million trailers in broadband to our customers and this year it will double. The Odeon website is the 36th highest ranking retailer in the UK. It's attractive because it's a good experience. You choose your seat, you get it guaranteed, you know when to come, you can see the trailer and you can be communicated to. That connection with the customer, enabled by digital, allows us a way of understanding what consumers want and transacting with them in a way that's seamless, smooth and high value.

Panel Chairman: Are there any questions from the floor?

Marc Gareton, SVP, Int. - Europe, Warner Bros. Digital Distribution: You have very trusted brands where consumers go to enjoy quality entertainment. What's stopping you having a VOD offer in the current window in the VOD window?

Tim Richards: It's not a business that we're in. We learnt a long time ago to stick to what you know, and what we know is building and operating great cinemas. We have looked at it and spent a lot of time on our website. As Rupert said, the goal is to use the website to get out and reach our customers across the country, so it's a model that we haven't pursued.

Rupert Gavin: We're in a slightly different space because we have a different strategy. We now retail DVDs quite successfully, we have a DVD rental business as well. I suspect we will get to the VOD offering by the end of this year, when it's become a little bit more substantial as a VOD in electronic download model. At the moment, it's a comparatively small market, so we've not been racing to get there. Our proposition is 'Fanatical About Film' and we think we have to be fanatical about that through the course of the lifecycle of a film.

Audience Member: A big part of the conversation today has been about convergence and Warner Bros. HBO have got things like *Band of Brothers* which has been shot at significant quality and could be shown at cinemas. What about some of the TV programming? Could penultimate episodes be shown at the cinema before they get shown on the TV, which would expand some of the broadcasters' material into the cinema not just on the TV?

Tim Richards: Our cinemas right now are generally not used 75% of the time. The goal within the exhibition community is to try and use them a lot more efficiently. That's why we are experimenting with alternative content like live music, live comedy, and sporting events. But it is a very small proportion of our overall business and I believe it will remain so. I do not ever see that impacting on film. Our business is movies and film going forward. But, if we can supplement by using the cinemas, even for conferencing it would all help. Getting people to change their way of thinking takes a long time, and both Vue and Odeon have invested heavily in our cinemas to provide the best kind of environment.

Rupert Gavin: You're absolutely right, TV is a real opportunity. Our 24 hour *Sex and the City* session was sold out; people will happily come along for that type of event, which can be based on TV programming.

Ross Fitzsimons: I think it's also a matter of educating the broadcasters. Curzon Mayfair is an outstanding venue where most of the broadcasters hire us to present their really highest quality programmes, for example, BBC showed *Planet Earth*. The broadcasters need to play ball too.

Carolyn Dailey, Managing Director, Public Policy, Europe, Time Warner International: You mentioned all the information that you have on your customers. How do you get that information and how do you know which of those customers who walk through your doors are the ones you have information on?

Tim Richards: It was a time consuming process to get an accurate snapshot. It was a combination of government census data together with mosaic profiling. We supplemented that through our internet and through market surveys with customers coming in. But it was literally an 18 month project. We had two people working on it full time to build the database. We do share. We have sat down with distribution and others within the community, because we all benefit. To give you a little sampling of it, we found that there was a small Turkish community around our cinema in Islington, so we bought in the Turkish Premier. We found there was a very small Bollywood or Asian community up in Inverness and we took them some Bollywood movies. That kind of fine tuning is possible when you've done sampling.

Panel Chairman: On the community gains side, you're all pushing and developing your websites with ever increasing sophistication. But would the UK not be better served by a unified film ticketing service as America has and why don't we have one?

Tim Richards: I think we had more sophisticated systems initially on our own, and that it is almost too late. Customers now know we have a very large successful website, as do Odeon, as do Cine, and it would be difficult for someone else to come in and try and take that. Also, it is a smaller market than the US.

Rupert Gavin: Our customers have their local cinema identified: they get the show times, they get an automatic connection through the website. When they receive an email they receive a trailer, can click on the trailer and can buy tickets. To suddenly try and build some sort of national system would be hugely expensive and time-consuming, and it would not add any value to the customer who knows they are either close to an Odeon or Vue.

Andy Paterson, Independent Producer: Obviously one of our hopes is that there is a way of reaching much more specific audiences for the kind of films we make. I'm interested in the million people that you have information on. Does that give you a sense that there is a huge growth potential for independent films if you can reach them

properly? Is that a market that we could dream is going to grow because of the information that you have on the audience?

Rupert Gavin: Yes. One of the strongest findings that came out of our 3 million database, is a really strong wish for the story-led film. Not the star, not necessarily the production effects, all of those things are nice. But the real wish from our audience is for producers to get back to narrative strength. As often as not, that can be met by relatively small independent producers and with small budgets. So since the research, that's been the sort of film that we've been particularly looking out for. We know there's an audience there that we can go back to and say: 'I think we've got something that you're really going to like.'

Cavan Ash, COO, Slingshot: One of the great hopes for digital is presenting more independent films to more people. How does that actually compete with the desire to show *Spiderman* on seven screens at the same time? Are we seeing an increase in opportunities on screens for new content, or are we seeing a reduction, because suddenly there's no incremental cost to show the big blockbusters on more screens?

Rupert Gavin: *Spiderman* was just Saturday/Sunday. We are in a slightly archaic model where we will have exactly the same film selection available on the Monday as we have on the Sunday. Yet we know the audience is entirely different. Now, for a weekend audience on the opening weekend of a big blockbuster, it is important to have the film available every 15 minutes. On the Monday, there is an entirely different type of audience and digital potentially allows us to free up screens to enable flexibility of programming.

Panel Chairman: Is this one of the areas where it's the studios that are impeding because they don't like you messing with their 27 shows a week?

Tim Richards: Yes and no, because the studios were also frequently distributing the movies as well. So everybody who has their hit of the week doesn't want it tampered with. But everybody also recognises that if you are able to play over and under and show other movies, you grow the business. In the future, you will see a lot more product in screen and, as I have said, 75% of the time our cinemas are dark, so that has to be an opportunity for all of us.

Chris Auty: The economics and the diversification of the programming, and the rollout of digital, are all actually leading to a much more varied mix, and interactive feeling to exhibition. When I look at the difference between where we stand today and where we'll be in five years time in exhibition, it is mind bending. It's huge, so there are grounds for a huge amount of optimism. I find the data mining in one way quite sinister. But the flip side is that there's an increasing orientation towards niche marketing, and that fits exactly with the context of the web. It's both a tool and sometimes a shop window in its own right, so this will happen simply for commercial reasons. The big issue is to unlock some of the content and see what the market will do with it.

MINISTERIAL ADDRESS

Margaret Hodge, Minister for Culture, Creative Industries and Tourism

The following is an edited version of the Minister's remarks:

I am delighted to be with you. Your programme for today reflects very much the issues we're tackling in government. Two weeks ago we published a Strategy Document on the creative industries - 'Creative Britain.' I want to focus on the issues we raise there and how they are going to impact on the film industry. But I am going to start by reflecting on where we are with the film industry today. Undoubtedly, we face difficult challenges in the future, but on the whole the UK film industry is prospering. The UK filmed-entertainment centre is the third largest in the world. Last year £723 million was spent on film production in the UK, the fourth highest year in film production since 1992. And it was a tough year for exchange rates and the introduction of the new tax relief. More UK films are being produced than ever before - both indigenous UK films and inward investments and co-productions. We do consistently well in Oscar nominations and other awards and box-office takings are up - £904 million in box office (6% higher than the previous year). British film's share of the cinema ticket sales was 28%, up from 19% in 2006 and finally, there were 7 UK titles in the top 20, up from just 3 in 2006.



Margaret Hodge

Running in parallel with this, the new tax relief is bedding down. Broadly speaking, the response to its introduction has been positive. What is needed now is a period of stability. There is no doubt that without the relief the UK film industry would be smaller. I am aware of an issue around co-production which is currently being examined by the UK Film Council. Government needs to see the case made in order to judge whether, should we decide to open this up, the European Commission would re-open the issues around 'state aid.' We are very keen indeed to ensure that this does not happen. There are key issues for you around new challenges. This is where we come to the Strategy Document, which indicates 7.3% GVA / 6% Growth. These issues are:

- Globalisation.
- Digitalisation.
- Challenges and opportunities in the fast changing digital environment.
- The difficulty of assessing consumer demand e.g. nobody foresaw the popularity of text messaging.

The worst thing government can do is try to second guess the outcomes in this new environment. This is why allocation spectrum in technology neutral auctions is the right thing. We welcome Ofcom proposals to rearrange DTT capacity to allow for the introduction of new services. If these go ahead, then from 2010 onwards, UK consumers will have access to even more digital services than at present. Hopefully, there's a

resolution to HDTV issues without having to allocate the extra spectrum. And the proposals around the Programme Making and Special Events sector should resolve some serious concerns raised by stakeholders.

I take a similar view about the dangers of second guessing on the issues raised by the European Commission in its Communication, and Content Online programme. It is very dangerous for government to try to intervene in how you can best deliver and exploit content online as the material develops. We are more than likely to get it wrong and cause unintended consequences as a result of our actions.

So what is the role of government? Let's look at our document 'Creative Britain' and how our proposals would impact on the Film Industry? One of the most important issues is protecting the intellectual property rights of those involved in the production of copyrights. We cannot turn the clock back and we must embrace the opportunities that the democratization of content brings.

Film needs to develop new business models. The music industry is already showing the way. But we do have proposals to strengthen the framework to protect content. We are currently taking forward the conclusions of the Gowers review and consulting on a range of copyright exceptions. We are toughening up on the enforcement regime and have made additional funds available and raised this up the list of priorities. We have also increased financial penalties. We are supporting the 'Fake Free London' initiative in preparation for the Olympic Games. We have also set a timetable for a voluntary agreement with ISPs regarding the unauthorized use of content over their networks. If a voluntary agreement, which we would much prefer, is not reached, we will bring forward legislation. We are also supportive of education around IP and delighted that industry has been so proactive in this regard.

Finally, innovation. We are developing a better understanding of the R&D and innovation that goes into copyrights and how it equates to innovation for patents. DIUS is undertaking a review of innovation, but in the meantime work on knowledge transfer networks is underway and we have recently seen the creation of the Technology Strategy Board for Creative Industries.

I have provided a quick summary of government's role here, but would prefer to use the remainder of the time for Q&A.

Conference Chairman: Thank you Minister for raising a very wide range of issues and initiatives. Who would like to comment or ask a question?

Timothy Burrill, Independent Producer: I am planning to film in the Antarctic and even now with global warming I won't find that location in the United Kingdom. Even though I'm taking a British crew, with British actors, technicians and equipment, I will not benefit from the tax credit. This seems to be a slight anomaly for what you are intending.

Margaret Hodge: When we get the report from the UKFC this is one of the issues we need to look at. I say that with one proviso. I feel really nervous about going back to the Commission to re-negotiate the package. The Commission has just agreed a package of tax reliefs around the games industry and I'm interested to see what comes out of that to give us a hint of their attitudes and approaches. I need to wait until we get UKFC reporting in the round, and then take a judgement in relation to Europe and of course the Treasury. And there's not much money around as we all know.

Conference Chairman: Could you tell us a bit more about the plans for funding or supporting research and development? You said it's primarily to support R&D towards innovation and science based technology. As you know, development is a hugely important part of making a film, and it's a very expensive and risky part. It's often said that we don't spend enough time on it because we can't afford to. Can you give us a bit of more detail on that?

Margaret Hodge, Minister for Culture, Creative Industries and Tourism: The positive news is the Knowledge Transfer Network that we're going to establish. This is a big investment programme in R&D, which has not previously been open to the creative industries. I'm keeping a really firm eye on that. I think that government understands that past thinking has been too narrowly focussed and doesn't really reflect those sectors of the economy that are going to grow in the future. We need to simplify R&D tax credits and the Treasury is up for that. So if there are people who are finding it just horrendous to work their way through all the bureaucracy, let us know so that we can take that up with the Treasury. I want to see whether we're getting all that we can out of the existing definition for the creative sector. This is something I want to explore over the coming period.

Conference Chairman: Will you be using the same definition?

Margaret Hodge: I think it's going to be really difficult to change the definition so we've got to see how it fits in.

David Sleight, Head of Media Production, University of Lincoln: I wonder whether we could redefine knowledge transfer into a useful mechanism for describing creativity transfer? We invite industry producers in on our assessment panels and a lot of undergraduate ideas could easily be picked up on and taken on into the industry with some further support.

Margaret Hodge: I will take that away.

Martin Spence, Assistant General Secretary, BECTU: The key test to qualify for the tax credit is that the services are used or consumed in the UK. But we're finding that increasing numbers of technicians are coming in from outside Europe or the UK for qualifying British films. Producers are getting a tax credit for their labour when there are

skilled freelance UK technicians available. Our concern is that under the new arrangements it's very easy for that to be the case. We believe that to protect the British film industry and culture, we need to protect and nurture our skills base in the UK and the current rules are causing us concern in the medium and long term.

Margaret Hodge: I think your view may be contentious in this room. What government can do is improve the skills base in the UK and we've commissioned ourselves to 5,000 apprenticeships. We want to make Britain a hub of creativity, to bring people here as much as we can, because of the knock-on cumulative effect that that can have, and that can only be good for your members and the UK economy.

Conference Chairman: Thank you very much. You spoke at the beginning about the reasons to be proud and there's one other reason which I think we have to feel proud. There was actually a British film that won an Oscar for Best Animated Short this year. But I would guess that few people in this room know what it is. How many have seen *Peter and the Wolf*? Four people. An Academy Award Winner, but it is virtually impossible to see it. That is one of the problems we have. Minister, thank you very much indeed.

MONETISING CONTENT

Conference Chairman: John Howkins, Deputy Chairman, BSAC, and Director, HandMade plc
Simon Oakes, Chairman and CEO, Hammer Film Productions
Patrick Walker, Director of Video Partnerships, YouTube/Google

Conference Chairman: Simon, I want to talk about the deal with MySpace. But before that I want to ask you about the assets that you bought when you bought Hammer. We're talking about monetising content, so what are the assets that you acquired and how do you value those assets?

Simon Oakes, Chairman and CEO, Hammer Film Productions:

It was a difficult asset because I think people were approaching it the wrong way. They were looking to see if they could monetise the back catalogue in terms of re-makes. The problem is that these were films made over 30 or 40 years with complex ownership which is difficult to unlock. We are doing that now, because we have the right financing that the previous owners unfortunately didn't. But that was never part of our plan or evaluation. Hammer, for me, was about what to do with the brand, how to reinvest in it, and also how to get the brand known to the demographic that are going to watch. The core business for Hammer will still be making feature films. But the gestation period can be a minimum of 18 months, often as long as that. So what was important was to take a view about how we could get the name, the brand, the history known to the MySpace generation, the social networking generation. We restricted the amount of money we spent and shot in four weeks, I think it looks like more money has been spent than it really has, and it's designed for the MySpace platform.



Simon Oakes

Conference Chairman: If you're going to have a brand in the media business you've got to have an online strategy and the need for that didn't exist 10 years ago. Do you find yourself needing different management skills to run your sort of operation and are they available to you?

Simon Oakes: I think some of the basic skills are the same. We used an English crew, English actors and writers. They're people who want to make movies and we'll make movies with them. The difference is that we're interfacing with a group of people in a different industry who have a different skill set. The people in MySpace understand social networking, seeding and the different ways of marketing to their consumers, and our relationship with them. They're not going to invest in film but we want their screen time, and that's where the relationship works between a content provider and producer and financier like us and MySpace. We have something they want, they have something that we want. But we're learning off them how they disseminate content on their platform in a way that's different from cinemas or television.

Conference Chairman: We talked this morning about distribution deals and minimum guarantees and revenue sharing, can you just describe how the deal with MySpace has been structured?

Simon Oakes: I'll be honest, we literally made it up as we went along. We didn't have a great master plan. The simple structure is we design a film that can be broadcast in five minute increments, but actually can be held together as a 100 minute movie, that it is premiered on MySpace in five minute increments, which have a hit at the end of each five minutes, three times a week. The 100 minute film is available as one piece on DVD and then televised afterwards.

Conference Chairman: And theatrical?

Simon Oakes: No, I made a promise to the director that it would not be released theatrically. I've got issues about low budget films and that's why I'm interested in the internet. I think the market's flooded with low budget films that don't get theatrical release, go straight to DVD and I'm not sure what the real business model for those films is. How you monetise is, basically, by sharing the advertising and sponsorship revenue around the MySpace broadcast and hopefully you break even, or near to break even, and then the revenues come on a shared basis. I can't divulge what that share is, on DVD, and on television.

Conference Chairman: Patrick Walker from YouTube/Google what are the assets that you regard as most important to you as a business?

Patrick Walker, Director of Video Partnerships, YouTube/Google: It's about know-how. Our assets are largely tied to our technology platform. The world was moving in a direction with new hand-held devices, very inexpensive production, technology for users and individuals around the world participating in the creation of content. So we developed a technology platform, which is our main asset to help people distribute globally, instantaneously taking advantage of broadband and other technologies that existed already. The other asset of course, once it became popular, is traffic. It's an enormous asset. That is the main reason why we have so many major partners, young people, individuals, independent and amateur film makers utilising YouTube as a distribution platform. Going forward, one of the most important assets is our advertiser and content network. The network consists of individuals, websites and advertisers that are familiar with YouTube and Google. This acts as a means of reaching people with messages that can be very targeted and associated with content that is appropriate for that message. Those are the key assets. The videos themselves are not our assets, those always remain in the hands of those who produced them. We're just working with them in collaboration to make them available. If people can search and find it, we're happy



Patrick Walker

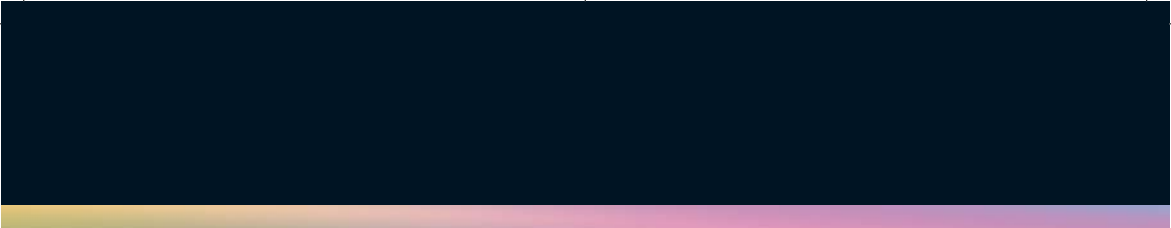
if users are happy, ultimately we think the marketers and advertisers will be happy with that platform.

Experimentation is still very much something that people should continue doing with any platform, where you feel your content will be well represented and your brand can be respected. We began our monetisation process in the UK only a few weeks ago. We've established new ad formats such as the in-video ad which is a very unobtrusive user-initiated ad that appears within a video, if the user feels like that message is appropriate to them. We've begun the process of extending that across into new markets in Europe. The revenue is still very incremental from a content creator's perspective, unless your production cost is very low. Any individual who creates content can actually join in the ad rev share there, and some of the most successful videos on YouTube are actually produced by 18, 19 year olds in their homes. But the actual income can be incremental. The big impact we're finding now is visibility and discoverability which can lead people to enjoy more cinema, more television, because they've come across it on YouTube. A lot of people are beginning their journey for content on YouTube. Hundreds of millions of videos are watched every single day and that number continues to go up. Ten hours of content are submitted every single minute of every single day. So a lot of people are beginning their journey of looking for a trailer they have heard about, looking for an outtake from a TV programme they might have heard about, leading them to a show they have never heard about. So the impact on your offline business can be substantial to support your traditional businesses, if you approach it in a really creative way.

Terry Ilott, former shareholder of Hammer, and Director, Film Business Academy: Congratulations Simon for getting so far so quickly. You describe the film for MySpace as a way of connecting the Hammer brand with a new audience, which I completely understand. But is it also your expectation that this kind of form of production and distribution might be a business model that works?

Simon Oakes: Yes absolutely, I really do think so. It was about marketing spend to start with, but I believe there's a model there. So far it's looking good. We've got a good profile of sponsors, or MySpace have for the first five weeks of broadcast. We have closed our deal with Fox Home Video, so I think it's a decent model, but it's much more. It has less upside but it's much more controllable. It's more like a TV model than it is a movie model, and I come from that background of cable and television so it's something that I understand. In six months time I'll really know if it's worked.

Unless the content in itself is good, unless the story telling is good, it will fail. There are hundreds of examples of things that had no press but naturally, through the network, through people sharing and talking about it and sending it to their friends, have become major hits with no press whatsoever, so there is sustainability. It's really about the creativity and then being a bit smart in terms of being open to positioning that video at its outset. Good content will find its way up and through and will become popular. What



needs to happen now is for the advertisers to get more comfortable with advertising on these platforms. But they're keen, they just need to be guided a bit in terms of the new ad formats and how that works.

Ben Keen, Chief Analyst and Director, Screen Digest: I wonder if you could say a few words about your thinking of YouTube beyond the PC?

Patrick Walker: We've invested in a lot of talent and engineering, predominantly with regard to advertising technologies and discoverability of content. We have a relationship in the US with the satellite network for collaboration and discoverability through the EPG. We're working with Sky to explore new ways of discovering content through a television interface, that's the Google site. For YouTube, Apple TV has launched a new technology which allows people to access the web via the television and a whole slew of different sort of content services. Within that you can access YouTube as a web-based service. The television just happens to be your interface. Similarly YouTube is accessible on the mobile if you have the right sort of handset such as iPhone. Apple makes it easy, and the usage on those platforms is very high, the potential is there. People keen on watching and creating videos for the YouTube platform want to access it wherever they happen to be and to the extent the technology allows it to happen, we hope to be there. We work with over 1000 partners, 350 or so in Europe alone, major media brands. They can help to determine, through a tick of a box and the meta data, whether or not they want their content to appear on those new platforms. So we've made sure to include technologies that maintain protection in terms of rights based on the platform.

INVESTORS, FILM AND THE DIGITAL ECONOMY

Martin Smith, Adviser to the Chief Executive, Ingenious

Introduction

I hardly need to make the case to this audience that the film industry is both an important contributor to our cultural output as a nation and a vital driver of the creative economy. It directly employs more than 40,000 people, and indirectly tens of thousands more. However, from an investor perspective it is also both financially fragile and commercially under-developed.



Martin Smith

To be frank, the goal of sustainable investment remains as distant as ever. David Elstein was right when he said a few weeks ago that: 'our economic model for content production in this country is too weak...' That is also our perspective at Ingenious and this is what I want to talk about this afternoon.

Some recent history

Gordon Brown became Chancellor in the Spring of 1997. His first official party at 11 Downing Street was for the British film industry. Some of you were probably there! Against the advice of his officials, the new Chancellor announced that there would be 100% tax relief for films costing under £15 million.

Fast forward five years to November 2002, when the then chairman of the Film Council, Sir Alan Parker, delivered a landmark speech. It was entitled 'Building a Sustainable UK Film Industry.' He started by observing that: 'We can never be the biggest film industry in the world, but we should be right up near the top of the league, not permanently hovering in the relegation zone.' He continued by remarking that the UK film industry had had enough of 'quick fixes and band-aids' and needed nothing less than 'radical re-invention.'

Why can't the UK develop a sustainable film industry? This question was asked by the House of Commons Select Committee on Culture, Media and Sport in 2003 in a report entitled 'The British Film Industry.' This report highlighted what the Committee regarded as the key structural weakness of the UK industry - that it was producer-driven. By contrast, it noted, a winning film industry is distribution-led.

The Committee cited a blistering analysis of the problem which had been submitted by the Film Council. This is worth recalling at length:

'The scattered and fragmentary nature of the (British) financing model contrasts sharply with the integrated model which forms the basis of US studio financing. The 'cottage industry' approach of the UK production sector, comprising scores of film companies, is remarkably successful at delivering excellent, culturally significant but ultimately unprofitable British films. This industrial structure (also) fails to deliver a consistent flow of films such that risk can be spread across a slate of projects. This inability to run a

portfolio of films to mitigate financial risk acts as a very strong disincentive to private investment into the production sector. Obviously, this approach (also) does nothing to build the significant corporate structures which are essential to achieve a sustainable industry.¹

Quite so! That critique remains definitive and applies a fortiori in the new digital environment. What, objectively, has changed since the Select Committee's report was published some five years ago? Globally, the scene has of course been progressively transformed by the deepening digital revolution and the consequent fragmentation of the media industry. The commercial impact of these developments was explored by several speakers at this event last year. I was especially struck by the reference to an interview with Dick Parsons of Time Warner. Asked what the future held for Time Warner he had replied with an analogy. He said: 'Imagine 1000 buckets on the floor all catching little raindrops of revenue - that's what Time Warner is going to look like.' I don't intend to go over that ground again, except to point out that in film, as in music, it is the profits made in the distribution part of the value chain, the profits that for many years sustained these industries globally, that are now most at risk in an online world.

In the UK, one of the things that happened after 2003 is that Ingenious created a number of integrated film funds. These were based in the realisation that the keys to commercial success in the film business were, exactly as the Select Committee had described: distribution, sustainable financing and an uncompromising practice of working with the best creative talent available. This allowed us to raise several hundreds of millions in investment capital which was invested, alongside a variety of partners, in such films as *Girl with a Pearl Earring*, *Vera Drake*, *Hotel Rwanda*, *Bride and Prejudice*, *Notes on a Scandal*, *Hot Fuzz* and *The Golden Compass*.

The period after 2003 in fact marked a relative boom in the production of British films. It was stimulated to a degree by government tax reliefs, notably at the lower budget end of the market, but - and we should be clear about this - was due mainly to equity investment. Much of this investment was attracted thanks in part to decades-long accounting rules known in recent times, somewhat inelegantly, as 'sideways loss relief' - the principle that investors' losses can, for accounting purposes, be offset against profits. As everyone knows, the rules changed in March 2007. Whereas private investors previously stood to lose only £60 out of every £100 invested, now they stand to lose the lot in an unsuccessful venture.

The digital revolution and the intensification of investor risk

What difference does the arrival of the online age make to investors? Answer: it magnifies the uncertainty and thereby amplifies investor risk. Why? Well, firstly, it lowers barriers to market entry. Secondly, it generates greater competition throughout the value chain. Thirdly, it progressively whittles away the famed power of the 'gatekeepers,' who effectively controlled prices at both ends in the pre-digital age, resulting in reduced margins.

Market fragmentation continues to proceed apace. We have more channels, more platforms, and more 'choice.' The customer is truly king and, speaking as a consumer, this is surely a wonderful thing. I personally look forward to enjoying weekends of wall-to-wall Einstein or Chabrol, and more generally the development of the new world of specialist micro-markets. But, and here's the rub, can anybody make money in this environment? Can they make enough money to build sustainable businesses? The talk everywhere is of new business models, new delivery platforms, new 'windows,' the so-called 'long-tail' effect, and so on. But would you really advise your best mate to invest their hard-earned cash in funding any of these new market entrants? Would you advise your clients to do so? There certainly are new opportunities out there, some of them very exciting indeed. From an investor perspective, however, I have to say that deepening fragmentation is making life much more difficult.

I was therefore interested, in December, to read a paper on investment in the creative industries, including film, by a firm of economic consultants mainly ex-Treasury guys, which had been commissioned by NESTA. Not surprisingly, market failure was diagnosed everywhere. The consultants' report ends, nevertheless, on a note of tentative, but in my view questionable optimism. Salvation may lie, they speculate, in the long-term growth of the activities of so-called 'alternative' or 'non-correlated' investors, and specifically hedge fund investors. I think this is fanciful, especially for independent production. We strongly agree that the hedge fund model should work on the distribution side of the film business. However, in our view, it is less appropriate as a model for the industry as a whole. The model is based on the idea that you can analyse the key characteristics of a studio's entire slate of films over a period of, say, five years, and project forwards from there. It is questionable because unlike, say, the credit card market, or the insurance industry, where very large numbers of customers provide a solid mass of statistical evidence, in film the data sets achievable are not wide enough.

There are four factors at work here. First, each film is different. Secondly, the total number of films made is very small, even in the USA. Thirdly, market conditions, meaning the state of the theatrical market and the availability of distribution technologies, change so quickly that past experience is never a guide to future performance. And finally, costs are rising, so a well performing historical slate would certainly return less if re-created today.

In our view, hedge funds in the USA have invested in film in spite of this logic because, at least before the credit crunch, they had mountains of spare cash - \$13 billion of which was invested in some 150 movies over a three year period. There have, to be fair, been some noticeable studio slate successes - Fox and Dune come to mind. But just now, as readers of the Los Angeles Times will be aware, several hedge funds are beginning to wish they'd never touched film. A number of very big losses are being sustained - and being swept under the carpet! In any event, as we all know, US experience is not transferable. The big studios run gigantic slates and have a total grip on distribution and other rights. These conditions do not obtain in Europe.

Public policy

The fact is that most independent films lose money, and that all investment in film is a calculated gamble. Even when talking up our credentials in this business, and proudly demonstrating our track record of success, we never attempt to hide the fact that this is high risk stuff.

It is hardly surprising, therefore, that as far as film production is concerned, the UK is still chronically short of investment. Yes, we have creative talent in spades. Yes, we can go on making the 'excellent, culturally significant, but ultimately unprofitable British Films' that the Film Council talked about in its Select Committee submission. Yes, cinema admissions are rising and the industry's contribution to UK GDP has increased by 39% during the last two years. All of this welcome 'good news' was highlighted by the Minister, Margaret Hodge, in her speech to the UK Film Finance Summit on 18 October last year. But these achievements conceal some uncomfortable financial truths. The total annual production budgets of the Film Council, Channel 4 and BBC combined add up to some £33 million annually. If we assume that, between them, they account for 30-50% of a film's budget on average, and add in pre-sales, some bank finance and the tax credit, this would give us an independent UK industry worth between £66 million to £110 million annually. On an international scale this is, of course, pathetically small.

Faced with these facts, the response from government worries me. I think that ministers have frankly been in denial, on one occasion deriding investors who form part of 'wealthy partnerships.' This raises an obvious question: where is the required risk capital going to come from? The Treasury response to this question privately is that it is not their job to 'second guess' the markets. So we have made zero progress on this the most vital issue of all.

Alternative future scenarios

Let me conclude with Sir Alan Parker again. This was his warning in 2002:

'...now is the time, once and for all, to recognise that our industry's obsession with public funding for production is taking us nowhere.'

That remains true. And the UK film 'industry' is still only the cottage industry it was five years ago, and so it will remain unless more sustainable investment is generated. The effect of digitalisation is to magnify our competitive weaknesses. This doesn't mean the end of film-making in our time of course. There will always be passionate film-makers and visionary cultural entrepreneurs who are able to get the money together somehow. And thank heavens for that! But we need to understand that we, in UK plc, are likely to find ourselves capturing a smaller and smaller portion of the commercial upside generated by our creative talent. We may gradually be consigned to the role of suppliers of commoditised, off-shore film industry support services while bigger rewards are enjoyed in Los Angeles, or Mumbai, or who knows, Shanghai.

Some will be satisfied with that. At Ingenious, we would prefer to raise our sights a little higher. But to be in a position as a nation to capture more of the commercial upside, we will have to start building more business capacity. To achieve that, we need sustainable investment which, in turn, would then enable us to attract more talent - business and creative talent - to work with us.

To some extent this is a circular problem, but it should be clear that we will not make progress without first developing sustainable investment models. To do that we need, I suggest, to understand what risk-adjustment rate of return would bring in new investors in significant numbers. We would be very happy to work with the Treasury on that one!

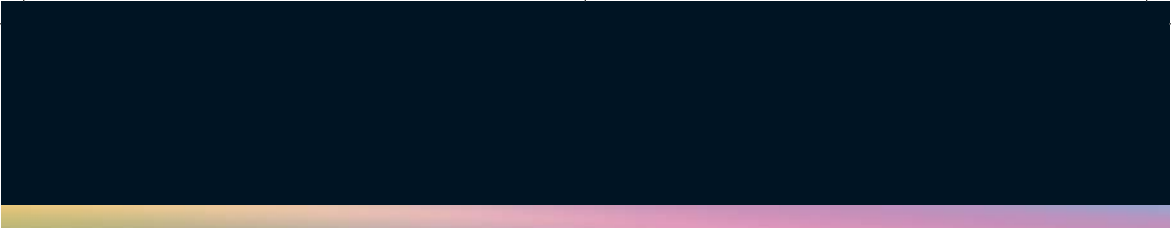
Are we optimistic about the future? If to be optimistic is to be contrarian, then we are optimistic! We also have some pretty smart people at Ingenious, most of whom are unfailingly upbeat. But we are also realistic. Our investors know that we do everything possible to mitigate their risk and so persuade them to stay in the game. They know that we know that investors will only commit capital to an investment proposition that earns a return on capital greater than the cost of capital. That's the test. They know, too, that we only work with the best, that we have a track record of delivery, and that we are uncompromisingly commercial in our approach. This does not always make us popular in the business, but it surely demonstrates our continuing commitment to film.

Conference Chairman: Are there any questions from the floor?

Philip Otley, Senior Executive, Accenture: You laid out a number of requirements for the film sector to be thriving in the UK, what other countries might you use as models of success?

Martin Smith: That's a very interesting question. I think one of the things that we suffer from in the UK is cultural. In the States, to be in the film industry is to be in a serious business, as it is to be in the music industry or the video games industry. Culturally the media and creative economy business part of the economy is taken seriously and that is measured by the fact that it can attract the very highest level of talent, MVAs and so on. That is not the case in the UK, with some honourable exceptions. It is not true that our creative industries have been able to attract the highest level of business talent. I think that is a reflection of the fact that, for a lot of people to work in the cinema business, the movie business is not real. It's something that guys with pigtails do. There's a whole cultural problem that we have, and I think that unless we are able to tackle that in the next five or ten years then we will continue to have some of the problems I talked about.

Conference Chairman: Creatively, the UK can hold its head up as high as anybody else, I don't think anyone would dispute that, either here or in Hollywood. But I think you may have a point on the business side.



Andy Paterson, Independent Producer: I think we'll all agree with much of what you've said in terms of being an under funded industry. We need companies like Ingenious that look at the market and see how to put scale into it, but I didn't hear a specific proposal as to what you think needs to be done?

Martin Smith: At Ingenious we believe that the creative industries, not just film but also music, musical theatre, video games and TV production, have a peculiar risk profile. They're not just risky investments in the way that all investment is risky, they are particularly risky. Until we can get the Treasury to understand that there is a peculiar risk category here, I don't think I'm going to be able to answer your question very precisely. We're trying to work out with all the government departments how to get more investors in this sector. At the moment they won't engage because, in a film context, the line is 'we've given you the production tax credit and that's it', period. But that won't get us up to being able to raise equity funding that we've had in the recent past.

CRYSTAL BALL GAZING: FINAL ROUND-UP WITH LEADING INDUSTRY FIGURES

Conference Chairman: John Howkins
Sue Bruce-Smith, Head of Commercial Development, Film4
Ajay Chowdhury, Chief Executive, EnQii Holdings plc
Marc Gareton, SVP, International, Warner Bros. Digital Distribution
Christine Langan, Commissioning Editor, BBC Films
Paul Webster, Head of Film, Kudos Film and Television
John Woodward, CEO, UK Film Council

Conference Chairman: Our final panel is very informal: we invite people up to tell us what's on their minds, tell us what they've learnt over the day and speculate on what they think might happen over the next 12 months.

Marc Gareton, SVP, International, Warner Bros. Digital Distribution: It's amazing how quickly 2005, 2006 seems to have passed. If you look at a period of six months between December 07 and May 08, there are probably five or six significant changes in windows and pricing models. The evidence so far in other markets is that money spent on digital content is not cannibalising existing businesses; theatrical exhibition, DVDs and so on. So it looks like the pie is getting bigger. I think we've only seen the tip of the iceberg, and there will be multiple new models coming in between now and the end of the year. So, the short answer to your question about future developments is appetite and speed. A lot of changes in a short period of time, but very different levels of appetite from content owners to move as fast as the consumer demand.



Marc Gareton

Sue Bruce-Smith, Head of Commercial Development, Film4: I think it's quite encouraging comparing last year's conference, where I had the feeling that the industry was slightly frozen. I feel today that there is a real sense of animation and innovation and a sense of meeting the challenge, although I still feel that Ben Keen's words ring very keenly in our ears. We've got to move very fast if we're going to really create the opportunities that the industry needs to be sustainable.



Sue Bruce-Smith

Conference Chairman: What's stopping you move as fast as you would like?

Sue Bruce-Smith: Well I think the fragmentation of national markets in Europe is a major issue, the fact that the States has a huge advantage in that respect. I think we've been slow to recognise how fast windows need to change. The online market is all about sharing, you see all these kids sharing. I think as an industry we need to copy that a little bit more and share and be more flexible in the way that we approach the windowing and how we create an industry that is sustainable. If a film doesn't work in the theatre,

why are we waiting until we can show it on television? We should have the ability to move more quickly in response to how a film is going.

Christine Langan, Commissioning Editor, BBC Films: For BBC Films specifically, we have a very paradoxical scenario in that we are a cornerstone to so much of film finance, yet the amount of money we have to play with is really quite small. We have to feel very responsible about it, but as we know, it's a gamble. Somebody like me is involved essentially in editorial decisions, harnessing, nurturing, encouraging and finding raw creative talent. I think we have to keep our confidence and sense of what works, what's good, what there's an appetite for. Not be too phased by the technical challenges and the fragmentation within the marketplace and the falling away of financial backers, but somehow stay fresh and stay confident.



Christine Langan

Conference Chairman: At bbc.co.uk you have one of the most watched websites in the UK, if not the world. Is the iPlayer an asset to that you want to explore more?

Christine Langan: Yes, definitely. It's being worked on constantly to be more available and more flexible. It's hugely instrumental in the renovation of the image of the BBC and its desire to participate in the online world and ability to share and make available its material. It's a further exemplification of content being king in that it's not about schedules or specific slots. One of the greatest things that challenges BBC television is the ebbing away of awareness of channels and schedules. The online environment is a really good place to explore the culture and appreciation of film making.

Conference Chairman: I'm sure Rupert Gavin would be very keen to get his hands on the traffic that goes through bbc.co.uk. Paul, tell us about working as an independent like Kudos?

Paul Webster, Head of Film, Kudos Film and Television: Working with a very busy successful television company has enabled me to be more flexible in my approach. On the creative side it's very encouraging. On a practical business level, it makes a lot of sense because synergies of cost come into play. I'm not sure if I were an independent producer starting out in the UK today that I'd be very optimistic about the future. It's a very, very tough row to hoe in many cases. I'm encouraged by certain innovations in the last few years from companies like Vertigo and Warp who seem to be exploiting the cross over between film, television, short form, online etc. I think as a younger producer I would certainly emphasise that kind of polyglot approach. I'm very encouraged by being part of a company which is now beginning to be a significant player. That kind of alliance is



Paul Webster

something that's helping me in my business reach out. When I was running Film4, I tried to build a proper alliance and exploit the symbiosis between a broadcaster and its film arm which is an extremely difficult relationship to manage. I hope they sustain it because they're essential to the life blood of the independent film industry in this country. As a producer, when I have a project one of the first ports of call is always the BBC, BBC Films or Film4. Hopefully we'll be able to grow Kudos Pictures as a viable film production company in time, but the basic economics of the deal that we attempt to manage frustrate us at all times. Until such time as we are able to control the right stream, which I'm not sure will ever happen frankly, trying to produce films of scale will always be a struggle. Nevertheless, I remain guardedly optimistic about our fragmented future.

Conference Chairman: John Woodward, what do you think we should be thinking about over the next 12 months?

John Woodward, Chief Executive Officer, UK Film Council: It seems to me that we're entering a world where distribution costs are going down; where the issues of shelf space, in the cinema, at Blockbuster, and for analogue TV start to disappear. You have the opportunity for the British film industry in that context to be much more nimble than it has been, without being locked out as it was in the past. For me, the area of greater concern is the need for risk investment in the content business, across the board, which certainly includes film.



John Woodward

Whether or not the British production sector needs, or can handle £700 million of equity being invested into it, is a very real question. There is evidence to suggest that when that has happened in the past, the net result has been a slew of films that are not that good and which cause reputation damage internationally to the market. Whichever way you look at it, content and investment in content remains a very high risk business activity. We're not getting enough new investment into the content business, and particularly the film sector. There are other countries who are working very hard now to use public policy to promote and build both the infrastructure and the creation of intellectual property. It's about making sure, over the next few years, that we don't lose the kind of innate advantage we've got around talent. Where you have to be really clear about asking for support from government is on the tricky issue of risk. Reducing the risk for investors by providing a tax break is a very legitimate and very sound policy. But we have to bear in mind that the reasons that the government closed down the so-called sideways loss relief is because some, not all, funds were out there in the marketplace operating schemes that appeared to offer absolutely no risk at all. The 'Creative Britain: New Talents for the New Economy' strategy document was a very big statement from the government recognising that this area of industrial activity is a very big part of the British economy. Whether or not in the end that will translate into other fiscal benefits remains to be seen.

Conference Chairman: Ajay, you look at this from a rather different perspective...

Ajay Chowdhury, CEO, EnQii Holdings plc: My background is much more in the online world and something's been nagging me all day. I recently attended an Online Consumer Conference which was all about the consumer. The presentations were about what the consumer wants, how these companies were going to give the consumer what s/he wanted, and they all had great ideas. Some were good, some were not so good. By comparison, it suddenly struck me pretty much that every presentation here was about 'us' and 'our company'. The issue seems to be about what we're going to do, how we're going to do it, and hang the consumer; with the slight exception of Babelgum. That strikes me as a mindset problem in the industry.

This is a very old industry with billions of dollars at stake, and it's an industry that likes control. It's an industry that's controlled how people get content for a very long time. Intellectually people understand they don't have that control anymore, but emotionally I think a lot of people who spoke didn't get it. I'm a big fan of Sondheim, Tim Burton and Johnny Depp, so *Sweeney Todd* for me was sort of a marriage made in heaven. I was out of the country when it launched here, and I came back desperate to see it and can't find it anywhere. I'm not going to be able to see it for four months, and part of me is thinking that I really don't want to wait four months. And there are a lot of people out there, I suspect, who feel the same. Until people in the industry realise they don't have this control and that they've got to figure out another business model, where they can give the consumer what they want and still make the money, there are going to be real problems. I'd love to see a world where *Sweeney Todd* gets released on the same day, with lots of different formats at completely different price points. So if I want to see it in Odeon Leicester Square, I'll pay £15, if I want to see in Imax I'll pay £30 and if I want to buy the DVD I'll pay £10. My instinct is that the amount of money made in the industry will probably be about the same, and that piracy will reduce quite a bit. That's my feeling for the utopian future anyway.

Conference Chairman: And what do you think is stopping us?

Ajay Chowdhury: The entire industry is built around windows, and I realise that you cannot dismantle that. But that industry is built around a notion which doesn't exist any more. I can't think of a single other industry where I can't get the product I want when I want it. If I went to Sainsbury's to buy a packet of Kellogg's, and they said 'well actually Kellogg's were selling last week, you'll have to wait four weeks to get another one' I wouldn't go to Sainsbury's any more. The music industry's realised that. TV's realised that. But the film industry is the one industry that seems to be resisting it wholesale, and I think it's because of the structural nature of the business.

Jane Wright, General Manager, BBC Films: How much would you have paid to see *Sweeney Todd* on pay-per-view when you came back and wanted it when you wanted it?

Ajay Chowdhury: *Sweeney Todd?* A tenner easily. I paid £40 for the Radiohead album. I'm a fan, and that's the point: I'm a huge fan.

Marc Gareton: A large number of people who have seen the movie in theatres are buying the DVD. Consumers in the UK spent more money going to the movies and buying DVDs in 07 than 06, and 08 is on a pretty good track. What is going to happen is multiplicity of avenues to get your content at different price points, in different quality. You pay more for high definition the way you pay more for Imax or 3D, and you probably pay more if it's available earlier. There will be a sequence of windows because the studio doesn't make money on only one showing of a property, but on the aggregate of all the monies spent by the consumers.

Conference Chairman: I want to tease out a couple of issues. Firstly, things are happening very fast, but there is also this rock solid assumption that the windows are going to be very hard to get rid of. That means that we're going to be very slow at changing. For years we've been saying: 'look at the music industry, they left it too late, ha ha!' We tell ourselves that we can learn from them and manage the change in the digital environment. And you can see it happening in some areas, but not on the timescale it should be.

Paul Grindey, Head of Business Affairs, Film4: The problem is how to get the consumer to pay several times over for the same content, and what's been discussed so far is collapsing of windows and multiple price points. But there's a very old game that other consumer retail industries play which is cross-promotion at the point of sale. There are all kinds of things that the film industry can do to increase multi-buys. You could have a theatre ticket that entitles you to a download three days later, or you could have an exclusive video, DVD retailer that can sell during the theatrical window, but for that accessibility the DVD retailer takes the profit back to the exhibitor. This is old hat in many other industries and it's kind of ridiculous that it's not being explored in film.

Ajay Chowdhury: I fully agree and I think it is happening in film. George Lucas has sold us *Star Wars* a million times over and people have gone and re-bought it time and time again because it's had another tweak. *Blade Runner* has now come out in five different incarnations, so I think the studios are very good at doing this. I don't think it's a question of selling the same content, I think the issue is how do you add the value that needs to be added? So when someone's going to Odeon Leicester Square or the Vue, they're going because it's the first night, and because it's an experience which is completely different from watching it on my iPhone. It's a pricing game.

I'm somewhat sceptical about all these wonderful new ad-funded models that'll come on the internet. If you look at advertising on the internet now it's a multi-multi billion dollar industry. But the vast majority of that industry is pay-per-click, when you do a search and get what you want and you click through to go to it. When I'm watching a film, I'm not going to click through and go somewhere else, so the model is very much a TV cost per

thousand model. For a cost per thousand model to work seriously, you either need millions and millions of people viewing the content at that point in time, or you need very high cost per thousand. My instinct is that's a long way off. I love Babelgum and you know I really applaud it, but I wonder how much revenue it's really going to generate. If you don't generate the revenue, you're not going to get the best content on, because people aren't going to make any money out of it, and suddenly you're in a vicious circle. I really hope that doesn't happen, but I've seen a lot of consumer models based on that, and it worries me. Google talked about 20 million views and that generates a lot of money. Yes great, but not a lot of things are going to get 20 million views.

John Woodward: I feel like I'm in a North London media dinner party on a Saturday night. We know what the problems are and the different things at play by now. The question for me is: what's going to give first? If the windows are under pressure, then my hunch is that there are two things holding it back. One is the fact that we're all still worshipping the god of DVD, because DVD is still driving revenues in the film industry. Until you can move away from this business model to somewhere else, I don't think the windows issue will move very quickly. Secondly, until you get fast speed broadband penetration up, you actually have a problem with getting your numbers to work on VOD. A lot of people in Britain aren't wired to the net, and if you can't receive VOD you're not going to be buying our movies. So you've got to drive broadband first. My instinct is that it's the point at which people start to lose interest in DVD as a revenue driver, when things will develop quickly.

Conference Chairman: How long will that be? How many years ahead?

Marc Garetton: Well it's happening. Consumers spending less money on DVD on a worldwide basis is a pretty complicated equation. Moving the VOD window day and date with DVD in the US and in Northern Europe, not only had a multiple impact on VOD transaction, I think the average in the US has been publicised as 51% increase. We've seen in Belgium more than twice the number of VOD transactions on comparable titles. It had a positive impact on DVD sales, about 9% upside in the US. The reason is there is more advertising on the content at time of release, so you make the consumer aware that a movie is available at one given time. And you give them the choice to rent or buy physical or digital at the same time. DVD has not been impacted by any of these changes of acceleration of windows. It's even more evident in the TV world. A TV series used to premier on a network and then, after some time, would go on DVD. Many networks now actually make the pilot available on the website of the network, prior to the first broadcast. They also make that content available on iTunes for free. Now, the TV series with the highest rating is the TV series with the highest number of free downloads, happens to be the TV series with the highest pay for downloads on iTunes, happens to be the TV series with the highest DVD sales. So the acceleration of windows makes the pie bigger. That's the evidence we have so far. How long will it last? I don't know, but there is an opportunity we need to embrace now, and we're doing it.

John Wolstenholme, Producer, Film and TV Entertainment: A question for John Woodward: are you feeling optimistic about the issues Margaret Hodge raised such as R&D tax breaks and co-productions in relation to current tax breaks? And do you think that there is any possibility of the UK rejoining Eurimages?

John Woodward: I don't see any immediate possibility of Britain re-joining because the money has not been set aside in the latest comprehensive spending round, which sets out all the public spending plans for film, that aren't lottery related, for the next three years. At the end of the day, that's a matter for the British government as much as the Film Council. On co-production, we are due to deliver a report to Andy Burnham in about a month's time, which takes a view on what happened last year as a result of the way in which the new tax credit has bedded in. The level of film co-production out of the UK basically halved last year. And there is quite a lot of evidence to suggest that that is directly linked to the so-called 'used or consumed' provisions of the new tax credit, whereby you don't get tax relief on film production expenditure incurred off the soil of the United Kingdom. We will be seeking to have that discussion and make the arguments with the government in the course of this year. Whether or not the arguments stack up is slightly too early to say. The situation's slightly complicated by the fact that there is evidence to suggest a lot of films that didn't get made were exactly the sort of films that the government didn't want to get made, i.e., films that brought absolutely no value to the UK under the old sale and lease back structure. The R&D tax credit is a broader creative industry issue and right now I'm still focussing on trying to get the film tax credit absolutely where we all want it to be.

Conference Chairman: We've enjoyed being, and some companies are very proud of being, a supply-led industry, in the sense that the voice of the author and the director is the most important thing in that industry. And there's a debate about the extent to which we should move, or modify that, by becoming demand-led, market-led. Ajay wants to watch *Sweeney Todd* and I want to watch *Peter and the Wolf*. These films are around and we just can't get to see them because of the rigidities in the business. What are the problems that stand in the way of being able to watch the films we want to watch when we want to watch them?

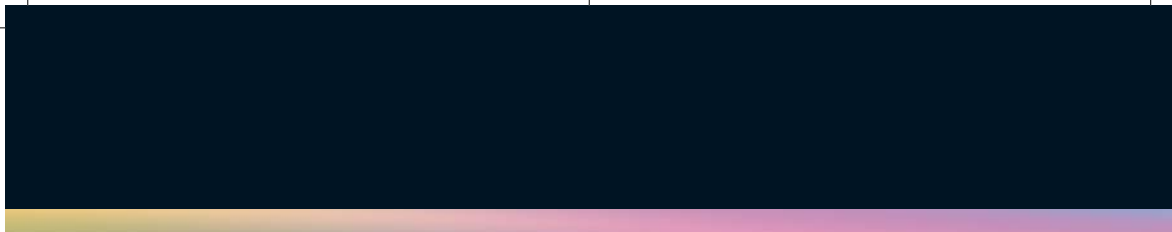
Paul Webster: Film is a mix of art and commerce and my view is that commerce does lead the charge. If we're going to have a sustainable author-driven industry in this country then it has to, as in all other models, be supported by some kind of subsidy. That's always been the case in the history of cinema. I'm pretty gloomy because I don't believe government actually considers film a cultural artifice in the way that it considers opera to be. The problem from the production point of view, is that we're not connected sufficiently to the marketplace and you will see a withering away of the small British film, which continues to have less and less meaning to the audience. The question I ask is how do you sustain the economics of making films and does the multiple convergence of windows impact on that price?

Marc Gareton: There will be an acceleration of windows on certain movies and probably some pretty long windows on other movies. Piracy is increasing, I think there is a report to come out that it increased from £640 million to £870 million a year for the UK industry, so it's bigger than the legit business. So we need to do something about it by finding new business models today.

Sue Bruce-Smith: In America ISC, with their first tape programme, have done very well taking films like Ken Loach's *The Wind That Shakes the Barley*. The studios are very well suited to being able to take up this opportunity. I think the independents need to forge alliances with broadcasters, with VOD stations, in order to be able to do something similar with their films, so I think the day is coming when you'll be able to do just what you want to do with *Sweeney Todd*.

Conference Chairman: That's the final session! There is a line in the programme that the Chairman's going to sum up - well, the Chairman is not going to sum up. He's going to apologise for running over and anyway he finds it impossible to sum up. I want to thank all of today's speakers, and once more, Time Warner for sponsoring the event. Thank you very much for coming and we look forward to seeing you again next year.





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