

## Finance for an Italian Library of Movies plc

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### Rating

ITL475,000,000,000 Asset-Backed  
Floating-Rate Notes..... A-

### Company Contact

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### Underwriter

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### ■ Summary

Finance for an Italian Library of Movies plc's (Films) Italian lire (ITL) 475 billion asset-backed floating-rate notes represent the first securitization of future receivables originating from an Italian movie library. Investors will be repaid from the proceeds resulting from the commercial exploitation of a library of films, the majority of which have already been released. In recent securitizations of movies in the U.S., principal is expected to be repaid from future revenues of films that have not been released.

Coupon payments to investors will be made quarterly on the last day of March, June, September, and December and will be indexed to the three-month lire London

Interbank Offered Rate (LIBOR) plus 100 basis points (bps) annually. Investors will receive principal repayments starting in June 2000 and terminating in March 2005.

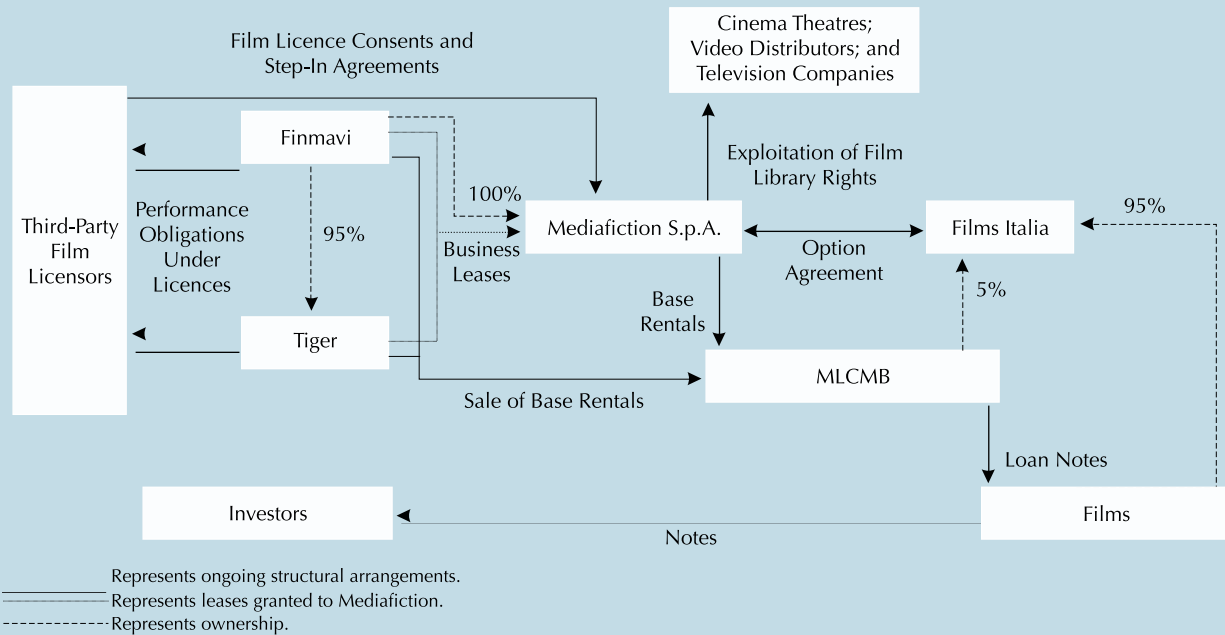
The 'A-' rating is based on:

- > Strong legal and cash flow structures.
- > Available credit enhancement, consisting of an initial overcollateralization of 88.4%, i.e. the present value of the expected revenues from the commercial exploitation of the film library exceed the amount of notes to be issued by more than 88%. Starting in January 1999, the overcollateralization can be reduced to 56%.
- > Debt service reserve of ITL29.34 billion, sized initially to cover three quarterly interest payments and, subsequently, two controlled principal amortization amounts. The interest component of the debt service reserve has been funded on the closing day with issuance proceeds. The principal component will be funded by trapping excess cash flows between December 1999 and March 2000.
- > Hedge agreement entered into with Merrill Lynch Capital Markets Bank Ltd. (MLCMB), whereby MLCMB will cover interest expenses exceeding 9.35% annually.
- > Cecchi Gori Group's experience in distributing films in Italy.

Investors will also benefit from:

- > Termination events that will result in a fire sale of the library and, thus, in an early repayment to investors.
- > A portion of issuance proceeds (ITL132.0 billion) held in escrow (reserve account) to make payments to foreign producers under license agreements or to cover production costs on the yet uncompleted films.

### Structural Overview



Finmavi – Fin.Ma.Vi. S.r.l. Tiger – Cecchi Gori Group Tiger Cinematografica S.R.L. MLCMB – Merrill Lynch Capital Markets Bank Ltd. Films – Finance for an Italian Library of Movies PLC.

### Legal Structure

Similar to prior securitizations, this transaction uses a non-Italian issuing vehicle and the sale of the receivables pursuant to Law 52 of 1991. Original to this transaction is the asset type being securitized (lease rentals from a library of movies), the sale of receivables with full recourse, and the legal concept of the lease of a business.

The Cecchi Gori Group Fin.Ma.Vi. S.r.l. (Finmavi) is the holding company for a group of companies involved in movie production and distribution. Finmavi and Cecchi Gori Group Tiger Cinematografica S.r.l. (Tiger) own a library of existing Italian movies and licensed foreign movies, as well as the rights to movies currently in production. Finmavi is fully owned by the Cecchi Gori family and owns 95% of Tiger. Finmavi is legally separate from Media Holding S.r.l., which is the holding company

for all Cecchi Gori companies in the television broadcasting sector, such as TMC and TMC2.

The following are the main legal features of the transaction:

- Finmavi and Tiger (the lessors) have leased (15 years and 19 years, respectively) part of their businesses to Mediafiction S.p.A. (100% owned by Finmavi), a special purpose company.
- Mediafiction will pay rental revenues to the lessors the base rentals, determined by reference to the annual accounting revenues of Mediafiction; and the additional rentals, determined by reference to the cash consideration received by Mediafiction in exploiting the film library. The base rentals are payable quarterly, while the additional rentals are payable annually. Each base rental is subject to a minimum guaranteed amount payable irrespective of the performance of Mediafiction

in exploiting the library. The minimum guaranteed amount has been set to cover quarterly interest and principal payments on the notes.

- MLCMB, through its Milan branch (Merrill Lynch Milan), has purchased the base rentals with full recourse against the lessors in case of default of Mediafiction. The sale has been made in accordance with Law 52 of 1991. The additional rentals are still owned by the lessors. The lessors, however, have waived their rights to the additional rentals in the event of losses by Mediafiction or if a termination event has occurred. The base rentals will be paid to MLCMB only when all other prior payments (such as payments due to licensors that have not been covered by Finmavi or Tiger) in the relevant collection period have been made, and the sinking fund and debt service reserve have been replenished.

- As a result of the sale, the money due on the base rentals will be paid directly by Mediafiction to Merrill Lynch Milan without being commingled with the assets of Finmavi or Tiger.
  - Cash received as part of the additional rentals will only be released to Finmavi and Tiger in January of each year provided that the overcollateralization ratio is greater than 1.56 times (x). The overcollateralization ratio is the ratio between: i) the most recent annual valuation of the film library; and ii) the outstanding amount of the notes after deducting the amount in the sinking fund, and the principal component of the debt service reserve.
  - All the shares in Mediafiction have been pledged to Merrill Lynch Milan.
  - Merrill Lynch Milan has funded the acquisition with a LIBOR deposit received by Merrill Lynch Capital Markets Bank Ltd., Dublin (Merrill Lynch Dublin).
  - Merrill Lynch Dublin has borrowed the money from a special purpose vehicle — Films.
  - Films is an Irish public company which has issued the rated notes in the Euro markets and has agreed to limit its recourse to Merrill Lynch Dublin to the amounts received by Merrill Lynch Dublin from the base rentals or recovered with respect to the security pledges.
  - The notes issued by Films pay a floating interest rate quarterly indexed to three-month lire LIBOR. The final legal maturity is March 2005. There will be a two-year lock-out period. Principal repayments to investors will begin in June 2000 and will be made quarterly in amounts of ITL23.75 billion.
- vency in the 12 months prior. In other jurisdictions, a lease contract can be terminated by the bankruptcy trustee of the lessor.
- The full recourse obligations of Finmavi and Tiger do not jeopardize the true sale status of the transfer of the base rentals to Merrill Lynch Milan provided that the recourse is limited to the extent of the lease rentals deriving from the lease to which each seller is a party (no cross-guaranty).
- Several features in the legal structure of this transaction would cause a fire sale of the film library protecting investors from a potential deterioration in the value of the collateral, in particular:
- Films Italia S.r.l. (Films Italia), a special purpose company incorporated in Italy and 95% owned by Films p.l.c. and 5% by MLCMB, will be able to exercise a call option and substitute Mediafiction, as lessee, under the leases and exploit the library if the base rentals received by MLCMB fall below the minimum guaranteed amount in any collection period, the overcollateralization ratio falls below 1.56x, and Finmavi is declared bankrupt.
  - Merrill Lynch Milan can then sell the base rentals, and Films can sell shares of Films Italia in the open market. Two independent valuations of the library must be obtained before disposal.
  - Following the insolvency of Finmavi and/or Tiger, or the occurrence of other termination events, Merrill Lynch Milan can exercise its voting right with respect to the shares of Mediafiction and replace management.

Merrill Lynch Milan has the right, after seven years, to force the sellers to reacquire the base rental streams. The sellers also have the right, after seven years, to force Merrill Lynch Milan to sell back the rental stream.

Fitch IBCA received an opinion from the Italian legal counsel stating that:

- A lease of a business will survive the bankruptcy of Finmavi and Tiger provided that the lessee was not aware of the lessors' potential insol-

## Others Structural Aspects

- The foreign licensors have consented, in writing, to the lease of the businesses. Mediafiction and Films Italia can become the counterpart of the licensors. Under circumstances where the foreign licensors would otherwise have the right to terminate the licenses by reason of the default or bankruptcy of Finmavi.
- The licensors have agreed to certain restrictions on their ability to terminate the licenses upon a default or insolvency of Finmavi.
- Finmavi continues to be fully liable to the licensors for the performance of the obligations with respect to the licensed films.
- Finmavi has entered into a hedge agreement (the initial hedge agreement) with MLCMB. Under the term of the hedge, Finmavi will pay MLCMB the difference between 9.25% plus a spread and the three-month lire LIBOR. Following a bankruptcy of Finmavi, the initial hedge agreement will be replaced by another agreement between Films and MLCMB (the second hedge agreement). The terms of the hedge provide for films to pay a fixed rate of 7.08% annually to MLCMB in exchange for the three-month lire LIBOR plus a spread of 1% annually. In the event of an early repayment of the notes, Films must pay a breakup fee to MLCMB. The payment of the breakup fee, however, is subordinated to payments due to investors.

The obligations with respect to the licensed films for which Finmavi is liable consist of:

- The minimum guaranteed payments (upfront fees due to the U.S. studios).
- Overages, i.e. payments based on the revenue stream generated by the films.
- Nonmonetary obligations, such as respecting blackout periods and various reporting and editing requirements.

Fitch IBCA believes that the risk that the licenses will be terminated due to unfulfilled obligations is minimal because: approximately ITL132.0 billion of the proceeds from the issuance of the notes have been set aside on the closing day to make the required minimum guaranteed payments; Houlihan Lokey Howard & Zukin (Houlihan), an investment bank with expertise in the movie industry, estimates overage payments at approximately ITL8.9 billion with respect to the entire library (since overages are a function of the revenue stream, a sharply reduced value of the library in a stress scenario, such as the ones used by Fitch IBCA (see page 5), would also result in lower overages due to the studios; and, finally, the nonmonetary obligations are minimal and can be easily performed by Mediafiction in the event of a bankruptcy of Finmavi.

### Payments Priorities

All revenues generated from the exploitation of the film library will be paid into the Mediafiction account. On any quarterly interest payment date, monies will be withdrawn from the account to pay:

- Any amount due to the licensors.
- Operating expenses of Mediafiction.
- Tax liabilities and distribution costs.
- Fees due to the cash manager and the tax manager and for updates in the film library evaluation.
- Base rentals into the transaction account.

Also, on Jan. 10 of each year, following the update in the film library evaluation, excess cash can be withdrawn to pay additional rentals to Finmavi.

In the transaction account held in MLCMB's name, there will be deposited base rentals paid out of the Mediafiction account and any amounts payable by MLCMB to Finmavi under the initial hedge agreement.

On each interest payment date, monies will be withdrawn from the transaction account in the following order:

- To pay any amount due to the licensors and not already paid out of the Mediafiction account.
- To pay to Films amounts due under the loan notes.
- To pay to MLCMB amounts due under the initial hedge agreement.
- To replenish the debt service account.

Any excess will be deposited in the sinking fund account.

Money paid by MLCMB from the transaction account to Films will be deposited in the operating account together, with any amount due by MLCMB under the second hedge agreement following the insolvency of Finmavi. On each interest payment date, Films will make payments out of the operating account in the following order:

- To pay fees due to the trustee.
- To make payments due to the agent bank.
- To pay interest on the notes.
- To pay principal on the notes.
- To pay any amount due to MLCMB under the second hedge agreement.

### ■ Movie Library

The film library leased to Mediafiction consists of a mixture of Italian films (generally produced by the Cecchi Gori Group), non-Italian films for which Cecchi Gori has distribution rights, and films in production or not yet in production (see table above right).

The Cecchi Gori Group acquires, from the major U.S. studios, only the free television rights that have been leased to Mediafiction. All the U.S. major studios have their own video and cinema distribution channels for Italy. From the independent studios, Cecchi Gori

### Library Inventory

	No. of Films
Pre-1995 Library	
Italian Productions	212
Pre-1995 library	
Non-Italian Productions	971
Post-1994 Releases	
Italian Productions	31
Post 1994-Non-Italian Productions	81
<b>Unreleased Films</b>	
Completed and Delivered Italian Films	3
Completed and Delivered Non-Italian Films	58
Italian Films in Production	7
Non-Italian Films in Production	49
Italian Films not in Production	4
Non-Italian Films not in Production	4
Italian Films	257
Foreign Films	<u>1,163</u>
Total	<u>1,420</u>

acquires all the distribution rights (free television, pay television, video, theatrical, and ancillary) for each movie. The terms of the licenses are usually five to 15 years. For the Italian movies owned by the Cecchi Gori Group, Mediafiction, as lessee, has unlimited distribution rights, including distribution rights outside Italy.

Houlihan values the library on an ongoing basis, net of minimum guaranteed payments, production costs, and overages, at approximately ITL693 billion. Since ITL68.1 billion of minimum guarantees were paid to the U.S. licensors out of gross proceeds on the closing day, and ITL132.0 billion for minimum guarantees due in the future and movie production costs have been deposited in the reserve account, the expected cash flow from the movie library available for payments to investors is estimated at ITL895 billion.

## ■ **Cecchi Gori Group**

The Cecchi Gori family has been involved in the movie business for 50 years (first with the late Mario Cecchi Gori, now with his son Vittorio Cecchi Gori and his wife). Some of the most famous recent Italian movies, such as ‘Il Postino,’ ‘Mediterraneo,’ ‘IL Ciclone,’ and ‘Fuochi D’ Artificio,’ were produced by the Cecchi Gori Group. Cecchi Gori’s activities in the film industry are conducted through Finmavi, the largest movie producer and distributor in Italy, and its subsidiaries. Finmavi’s upper management is very experienced and has been with the company for several years. Some members of senior management are now employed or act as consultants to Mediafiction.

In recent years, the Cecchi Gori family has also expanded into television broadcasting by purchasing Telemoncarlo and Videomusic. The television station now broadcasts two channels, TMC and TMC2, which, together, have a 3% market share. The television station and its affiliates are controlled by the Cecchi Gori family through Media Holding and are legally separate from the family’s activities in the film industry.

The Cecchi Gori Group’s position as the largest film producer and distributor in Italy benefits from, among other things: obtaining higher revenues in distributing American movies in Italy by bundling them with its own successful Italian movies; offering licensors a distribution infrastructure that encompasses a complete range of media (theaters, home video, and television); the fact that its main competitor, Mediaset, only recently started to produce movies; and making quick decisions, whereas Rai, the Italian government-owned television network.

Currently, the Cecchi Gori Group’s market share in the theatrical distri-

bution business is 38%. The group is the leader in home video and is a major supplier to free and pay television stations.

## ■ **Stress Scenarios**

In appraising the fair market value of the film library, Cecchi Gori engaged Houlihan Lokey as a valuation consultant. Houlihan Lokey has specified a “monte carlo” simulation model that computes long-run estimates on simulated cash flows accruing from film rights included in the library. The cash flows are net of remaining costs associated with acquisition, production, and release of all titles. Cecchi Gori provided information on costs. Probability distributions assumed in the model are estimated from aggregated industry data on film distribution in adjacent markets. The Houlihan Lokey base case simulation generated 1,000-5,000 random samples for each cash flow forecast. The Houlihan Lokey base case estimates discounted cash flows at rates ranging from 8%–11%.

Fitch IBCA analysts evaluated the structure and specification of the Houlihan Lokey monte carlo model: the appropriateness of the model assumptions, the adequacy of the aggregated data as a proxy for the library performance, and the convergence of the model estimates to the theoretical long-run estimates for the library. In general, Fitch IBCA found the Houlihan Lokey model approach to be reasonable and consistent with standard practices for monte carlo approximations.

As the result of its model validation review, Fitch IBCA made the following requests of Houlihan Lokey:

- An increase in the number of samples generated by the simulation to 10,000 to account for adequate model convergence and statistical significance of the estimates (a suf-

ficient number of observations at the tail of the simulated cash flow distributions).

- The reporting of the sample variability in the simulation over repeated model runs.
- Worst case (1%) and pessimistic scenarios as described in the following section.

Due to the specialized nature of film library assets, Fitch IBCA engaged an independent consultant to verify its conclusions. In conjunction with its consultant, Fitch IBCA also reviewed the level of the overages and valuations of individual titles in the library and evaluated the economic and market assumptions made in the valuation.

Fitch IBCA has applied various economic and credit stresses to the portfolio of films to calculate an appropriate credit enhancement level for an ‘A-’ rating on the notes. One of the most stringent stress scenarios involves the following assumptions:

For titles that have already been released theatrically in Italy prior to and after 1994:

- Video and pay television sales revenues were cut by 50% from the estimates made by Houlihan.
- The retention rate for free television was lowered to 53.7% from 70% for A titles and to 43.5% from 50% for non-A titles to reflect the 1% percentile case from a simulation run of 10,000 iterations.
- Video (manufacturing) costs cut proportionally.
- Cash flows discounted by 17.5%.

For titles that have not yet been released theatrically in Italy:

- The ratio of box office to acquisition costs for non-Italian films was lowered to 61% from 100% to reflect the 1% percentile case from a simulation run of 10,000 iterations.

- The ratio of box office to acquisition costs for Italian films was lowered to 87% from 188% to reflect the 1% percentile case from a simulation run of 10,000 iterations.
- The ratio of video receipts to theatrical rentals for slates of 50 was lowered to 10% from 30% to reflect the 1% percentile case from a simulation run of 10,000 iterations.
- The per film allocated free television receipts for slates of 25 was lowered to ITL1.07 billion from ITL1.4 billion to reflect the 1% percentile case from a simulation run of 10,000 iterations.
- Pay television and foreign sales revenues were cut by 50% for titles that have been released theatrically and 75% for titles that have not been released theatrically.
- Acquisition/production costs were kept constant.
- Theatrical prints and advertising costs were kept constant at ITL500 million.
- Residual costs were dropped proportionally to the new theatrical performance levels.
- Video (manufacturing) costs were dropped proportionally to the new video revenue levels.
- Overages were cut 75% to reflect lower revenues.
- Cash flows were discounted by 20%.

It is important to note that the aforementioned assumptions were applied immediately and for every year in the future, even though the Italian economy is not currently in a recession and any recession is unlikely to last more than three years.

The motivation for applying such extreme stresses is to account for low-probability and severe adverse industry conditions not observed historically.

Under such a scenario, the value of the library, net of overages but gross of the minimum guarantees and production costs covered by the escrow account, is estimated at ITL503.4 billion.

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