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Canada

Study of the Audiovisual Distribution Sector in Canada

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Note: Certain characteristics of the audiovisual industry, as presented in this study, may have changed between the time of completion and publication of this document.

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Executive Summary

Over the years, as part of its commitment to developing a stronger Canadian audiovisual (AV) industry, the government of Canada has employed a number of policy measures and funding mechanisms to support the AV distribution sector in Canada. The federal government has monitored the sector throughout this time, but has not commissioned a profile of its development since the mid-1990s. In this time of technological change and business consolidation, it was felt that one is now timely.

This study provides an historical and modern-day portrait of the Canadian distribution industry, within the limits of available data, and outlines some recent trends in the continued development of the sector.

The AV Distributor

The locus of this study is the distributor, and so focuses on the AV content whose rights are typically acquired by individuals and companies primarily in the distribution business in domestic and/or foreign markets. The AV content distributed comprises feature films, television and video content (whether in linear or interactive format). Thus, the AV distributor acquires or licenses the rights to content for distribution to some or all of the conventional outlets and new digital platforms and to whatever markets are negotiated between the rights holders and distributors. These rights may be sold under various constraints regarding terms of license, format of exhibition, territory and the number of plays a given title may receive. The AV distributor, however, is not usually itself the actual physical distributor of the content to customers.

Distributors have been important to the development of the Canadian AV sector in various ways since the late 1960s. Today, in addition to triggering a producer's eligibility for certain funds in the case of feature films, an AV distributor can add value by designing effective content release strategies in a highly-competitive and ever-changing landscape. Professional marketing and publicity campaigns can be a crucial aspect of the role and expertise of distributors and are vital to the sales performance of productions where they play a significant role, particularly for feature films.

While critical to feature films, the Canadian AV distributor plays a smaller role in the distribution of television content. In fact, much of original Canadian television programming does not flow through an AV distributor for first window, home territory licensing at all. Especially as they consolidate, Canadian broadcasters are few enough in number that producers can make their commercial arrangements directly with broadcasters. Thus, original programming is mainly "green lit" (authorized) through broadcasters' pre-commitments to the TV program.

TV programming that is library product is a different story. The waves of new specialty-TV channels added many more broadcast customers who acquired Canadian content off the shelf from producer or distributor libraries – but only programming that had already been exhibited by broadcasters. It is an aftermarket for rights to fill the schedules of broadcasters for low license fees, so the role of distributors is only transactional rather than linked with any marketing to viewers.

Distribution of original TV programming to foreign markets also represents a different pattern. Producers, their distribution arms, or international sales agents are important for international distribution of feature films as well as TV programming – although only for the markets that are not already acquired by the TV production's foreign investors (e.g. foreign broadcasters).

The emergence of new platforms has not altered the basic structure, in that broadcasters tend to acquire the new online rights when they commission original TV programming from independent producers. There is still a limited role in that context for the TV program distributor. As audience viewing habits have started to shift to online downloading and electronic streaming, broadcasters have begun to demand all domestic rights to programming that they were acquiring from producers. They typically acquire from the producer the rights for all TV outlets in Canada for several years, as well as for other platforms, such as video-on-demand (VOD), mobile, and on-line. This dominance of the rights by the broadcasters leaves little opportunity for the AV distributors for the distribution of original content in the domestic TV market.

Federal Film Distribution Policy has Protected Canadian Distributors

The Investment Canada Policy on Foreign Investment in the Canadian Film Distribution Sector is interlinked with Canadian feature film policy.

The Policy states that: 1) no takeovers of Canadian-owned and -controlled distribution businesses; 2) establishments are allowed only for new distribution businesses in Canada that distribute proprietary products (where the importer owns world rights or is a major investor); 3) investors in direct and indirect acquisitions of foreign distribution businesses operating in Canada must reinvest a portion of Canadian earnings in accordance with national and cultural policies."[1] In large part due to these federal measures, the Canadian AV distribution sector that concentrates on feature films has remained strong and relatively stable.

The history of AV content distributors in Canada can be segmented into five eras as shown in the visual below:

Both the policy context and distribution dynamics have evolved through each era. This evolution intertwines with the development and maturation of film production in Canada and provides insight for a portrait of today's AV distribution environment.

AV Distribution in Canada is a $2 Billion Business

[1] The Canadian Film Industry and Investment Canada, "Fact Sheet."

In 2009, the total AV distribution revenues of $1.95 billion included $1.19 billion earned from the distribution of films, television programs and other video content $750 million from the wholesaling of pre-recorded videos, and $18 million from other sources.[2] Between 2003 and 2009, Canada's AV distribution sector exhibited gradual – although very slow – growth in revenues. Over that six-year period, the sector's total revenues increased by an annual average rate of 2.5%, although in constant dollars the increase was just 0.7% between 2003 and 2009. For Canadian-controlled distributors, low or negative profitability was caused by a combination of factors, including rising marketing and promotion spending, high cost of goods sold expenditures and a slowdown in the more profitable home entertainment sales. In addition, much of the desired revenues and savings heralded by digital technology for distributors have yet to be realized.

Foreign productions accounted for the vast majority of domestic distribution revenues between 2005 and 2009. In 2009, foreign productions accounted for 87% of the total domestic distribution revenues, or $1 billion; Canadian productions accounted for just over $149 million, or 13%. Similarly, the domestic market drove 95% of distributor revenues. Foreign market distribution revenues have grown steadily since 2006, but at just $62.8 million in 2009, they remain a very small part of the sector's total revenues.

The Canadian AV distribution sector is based heavily on the domestic distribution of foreign content. In both French- and English-language markets, Canadian feature film distributors have long benefited from forming important output deals with international (primarily American) classics divisions for access to their feature film content. These lasting relationships can contribute to developing the expertise and ability of the Canadian distributor.

Since 2006, distributors have derived the majority of domestic revenues and the highest revenue growth, from distribution to the conventional television platform: 48% in 2007, 52% in 2008 and 61% in 2009. Theatrical distribution revenues, on the other hand, remained stable from 2003 to 2009. In 2003, at $353 million, theatrical revenues constituted 36.1% of total revenues. In 2009, the theatrical revenue share was 36.2% and $369 million – a 0.5% annual growth rate in dollars not adjusted for inflation.

As the sales for physical home entertainment goods (e.g. DVDs and Blu-Ray discs) decline, all eyes shift to online and on-demand sales. On-demand windows have grown in number and complexity with pay-per-view, VOD, near-VOD and other formats exhibiting both film and television content. Sales in these channels are growing rapidly,

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[2] Statistics Canada provides summary statistics for the film and video distribution industry, as well as more detailed financial breakdowns of revenues and expenses by platform and type. The summary revenue data is based on the surveyed portion, as well as administrative data for establishments that were too small to be eligible for sampling. This report is based on financial information that is collected <u>only for</u> surveyed establishments. The summary total revenue figure, however, is greater than the revenue figure which is based on the surveyed establishments. In 2009, the summary operating revenue figure is $1.975 billion as compared to the surveyed total operating figure of $1.953 billion. In order to maintain consistency, this report defers to the lower, surveyed amount ($1.95 billion), as it corresponds to the subsequent revenue and expense breakdowns. More information can be found online at Statistics Canada, 'Data sources, definitions and methodology' Section, "Sampling" available at http://www.statcan.gc.ca/pub/87f0010x/2010001/part-partie3-eng.htm

according to distributors, but are not yet large enough to fill the gap left by the decline in physical home entertainment sales.

Together, these platforms apply pressure on, and threaten the exclusivity of, the traditional first windows such as theatrical (film content) and broadcast (television content). As a result, an AV distributor must negotiate with the broadcast distribution undertakings (BDUs) such as Rogers and Videotron, and over-the-top (OTT) suppliers such as iTunes and Netflix, while simultaneously protecting its own role in the value chain. Intense leverage is being exerted across the sector, as price, revenues and reporting remain variable.

Canadian-Controlled AV Distributors Retain Important Market Share

Distributors operating in Canada can be divided into two categories: 1) Canadian-controlled and 2) foreign-controlled. Foreign-controlled distributors in Canada include the six studios that form the membership of the Canadian Motion Picture Distributors Association (CMPDA): Walt Disney Studios Motion Pictures, Paramount Pictures Corporation, Sony Pictures Entertainment Inc., Twentieth Century Fox Film Corporation, Universal City Studios LLLP, and Warner Bros. Revenue data by country-of-control is limited. In the 2006 to 2009 period, foreign-controlled distributors generated nearly three quarters of the total distribution revenues in Canada, or $1.38 billion in 2009. The Canadian-controlled distributor revenues have remained stable, claiming 29.4%, or $575 million of total 2009 revenues.

Canadian distributors are reacting positively to the advance of Netflix and iTunes into the Canadian market because these international firms tend to deal directly through Canada's key distribution and media companies and not directly with producers. Logically, these large online service providers would prefer to deal with fewer distributors, in possession of larger libraries (i.e. aggregators), rather than myriad individual production companies. This arrangement poses a barrier for some small producers and distributors and so a small market has opened for larger distributors to aggregate and distribute for third parties who cannot access iTunes themselves. iTunes has established, for example, a list of preferred distributors (including large content holders, such as the CBC) as well as a restriction whereby it will only accept files sent through one of three or four iTunes-approved encoding houses in Canada. While these barriers restrict some trade, they are reminiscent of equivalent practices employed over the years by major retailers, such as Wal-mart.

Conclusions

The conclusions drawn from this study about the role, achievements and prospects of the AV distribution sector in Canada are highlighted below.

Policy and entrepreneurship have created a reasonably strong domestic distribution sector in Canada, at least for feature film.

- The various film and TV production policies and the feature film distribution policies have led to the development of a sizeable film/video distribution sector in Canada. Certainly, distributor entrepreneurs took advantage of the potential market opportunities created by the 1988 Film Distribution Policy, and lined up output deals with significant international production/distribution companies.

- Canadian-controlled distributors have grown their share of the total market for distribution of foreign and Canadian films, although have reached a plateau of about 25-30% over the last few years. There is a cadre of experienced executives in distribution and new entrants who bring new approaches to the marketplace.
- This market share for Canadian-controlled distributors has been achieved primarily by the success of domestic films in Québec, and access to a wide range of commercially successful foreign films in the domestic market in Canada.
- The barriers to entry to the Canadian distribution market are not inconsiderable. Building key relationships, credibility and a library of content to exploit all take time, capital for upfront investments and high risk tolerance.
- While more important in the early years before the broadcaster consolidation in Canada, there has been a limited role for independent Canadian distributors of TV programming for the domestic Canadian market.
- While there is a need for sales agents and distributors to access foreign markets for TV and feature film programming, there are fewer Canadian companies focused on the foreign distribution of third-party content than in the past.

The creation of Canadian distributors has helped the growth of the French-language film sector, and offers English-language product a way to get to market.

- The Canadian Feature Film Policy objective of generating box office revenues for Canadian feature films has been successful for French-language films. Although a product of several factors, the existence of a strong feature film distribution sector has been a key factor in achieving box office success in Québec.
- The same results have not been realized for English-language films, but the existence of a strong distributor sector has been essential for Canadian feature films to access movie theatres, home video, and TV markets.
- While feature film producers have frustrations with their distributors, it is a universal phenomenon, and the more experienced producers recognize the value, role, and market limitations of distributors.

Within the overall distributor level of success in revenues, there has been a fair amount of restructuring at the company level.

- A historical review of the distribution sector shows that many distribution firms enter and exit the market, though many veterans have stayed in the business in new formations. This turmoil seems to have been caused in part by an inability to adapt to technological changes in the market, e.g. the introduction of home video technology.

- Lower margins over the last few years are in part responsible for some consolidation of the sector, and have put a premium on scope and scale economies.
- Historically, there has always been a tendency for distributors to take part in the production business, and for producers to create their own distribution arms. And there are periods when distributors disband their production business. These trends seem to be continuing, in part to better access foreign markets, and in part to get the right mix to match domestic and international market conditions.

While overall demand for content supplied on digital platforms is expected to be strong in the next several years, the uncertainty going forward inhibits distributors from seizing the new opportunities.

- Because of ease of access to content and low production costs for entry level content, there exists a lot of product chasing for existing and new markets. It has been described as an exponential growth of AV product available.
- The product availability and the development of new platforms mean that there is a lack of predictability in revenue and business performance. There is also uncertainty about business arrangements due to the destabilization of the traditional release windows market, traditional partners and customers, and the whole business model for AV distribution.
- Lack of predictability and stability in revenue and business performance has made many Canadian producers and distributors quite cautious about defining new business arrangements for fear of making mistakes. It feeds on the largely risk averse culture in Canada, which is also the result of a small, fragmented market.

Canadian distributors will serve the new platforms, but the new sources of revenues will not make up for declines in current ones, and margins may remain low.

- Early indications are that new platforms and aggregators/retailers like Netflix and iTunes will turn to Canadian distributors to acquire their product. In fact, the proliferation of new platforms creates opportunities for Canadian distributors of film and the full range of AV product.
- Canadian distributors have experienced fewer market downdrafts than their American counterparts, as the DVD market has not declined as rapidly and the theatrical release segment has been growing. However, TV markets are not as robust as in the past, and the new platforms are not creating the same level of revenue opportunities to replace the decline in the traditional markets.
- Home video and pay-TV (and other TV outlets) are very important contributors to the bottom line of distributors. But there is less margin (at least at this point) from new platforms, which price their product competitively to gain share and

combat illegal free content. It is possible that at some point revenues will increase but the market is not there yet.

New forms of competition to distributors are emerging, and Canadian distributors will need to adapt.

- Upheavals are common in Canada's AV distribution history but while the firms may change, the professionals in the business seem to remain. Operating in a competitive landscape dominated by a small number of US majors, all distributors must be highly adaptable to change.
- New digital technology is altering the way audiences consume film and television content. The viewers' "anywhere, anytime" content expectation disrupts the orderly, linear windows of exhibition that the AV distributor of feature films has experienced since the advent of television, pay-TV and home video. New competitors, online aggregators, off-shore OTT content providers and VOD providers each jockey for position in the new distribution environment.
- In this time of flux, some security comes from expertise in exploiting all rights. Without knowing how the future of on-demand offerings, online pricing, piracy and the possibility of a regulated internet will unfold, the AV distributor must learn to work with the new platforms and new relationships in order to survive. Such adaptability was not always evident among the Canadian-controlled AV distributors for example, during the introduction of videocassette recorders (VCRs) and DVD players.
- One way to adapt is to "go global" – diversifying with new products, partnerships and markets in Canada and abroad. "Niche" distribution is also an alternative, as some small, savvy distributors market their new platform expertise to the larger firms and independent producers.
- Distributors will need to invest in new platforms of distribution even though there is no certainty in their future.

The advent of new platforms and technology constitute a seismic shift for the AV distribution sector in Canada. To fit into the new, complex value system, Canadian distributors must continue to add value to AV content by continually adapting and redefining their own role.

1. Introduction

In this section, we define audiovisual (hereafter referred to as AV) content and AV distribution for the reader, highlighting in particular the distinction between the distribution of rights and the physical (or virtual) distribution of AV content. We go on to describe the policy context of the report, the report's mandate and scope, and finally the approach we adopted in order to provide a portrait of the sector.

1.1 What is AV Content/What are AV Formats?

AV content includes film and TV programming, as well as all other forms of video production not necessarily destined for the TV broadcasting market or the cinema (theatrical) market. While distinct distribution formats developed for theatrical and non-theatrical film, and television production, there has always been some overlap extending the content's active viewing life. Film content, for example, has always populated TV schedules some time after theatrical runs. Pay-TV (paid by cable subscribers on a monthly fee basis) and home video (first VCR, then DVDs) arrived in the market, so feature films began to reach homes without commercial interruption through these distribution formats. These outlets then preceded the TV broadcast market in the release sequence for features.

More recently, on-demand formats have grown in number and complexity with pay-per-view, video-on-demand (VOD), near-VOD and other formats showing both film and television content online. Today, broadband-enabled video is generating its own demand for AV content, enabling new formats from webisodes (video content produced for the Web) and mobisodes (video content produced for mobile devices), through to user-generated videos (e.g. for YouTube).

1.2 What is Distribution/What is the Distributor's Role?

As AV content was produced, the question of how to link productions to customers became apparent. The mechanism to serve this function started with feature films. The first end-users for film content were theatres, and the role of distributors was created to link the movie rights holders (typically producers or distributors from other territories) to the cinema chains and independent cinemas. Distributors were needed to plan and execute a film's public release, by gaining access to theatres and promoting the film before, during and after its release.

In the case of TV broadcasting, the scheduling, exhibiting, and promotion were clearly broadcaster functions – although distributors have been useful to link the rights holders with the broadcasters. The key distinction, though, is that broadcasters perform some of the key marketing functions for TV programming that the distributors do for feature film. Thus, distributors have a more limited role in TV distribution.

The following explains the different paths in more detail.

Film distribution: From the start, Hollywood studios *integrated* feature film production and distribution (in fact, many were also connected to theatre chains before US anti-trust regulations halted that practice). The integrated distribution model dominated the market but occasionally excess capacity created openings for non-studio productions – in other words, independent productions to be distributed by the distribution arm of the studios.

There had always been independent distributors operating in the margins of major studio dominance of the market. However, by the late 1960s, changes in society, the liberalization of on-screen censorship and the adoption of lighter-weight cameras led to an increase of independent film production and a partial breakdown of the traditional studio system. Studios were soon tempted by the possibility of high profit margins from acquiring lower-cost independent films rather than producing their own high-budget productions (e.g., *Easy Rider*, released in 1969, was produced independently for approximately $400,000 and went on to gross over $60 million globally for Columbia Pictures).

As more independently-produced films fit into the system, such as the Canadian-produced *Outrageous!* (Bill Marshall) and *Goin' Down the Road* (Don Shebib), a role evolved for distributors to take content from the independent producer and bring it to exhibitors, such as independent theatres and small theatre chains. Eventually, this customer base expanded to include video retail outlets, wholesalers and broadcasters. Distributors acted as the intermediary between the independent film producers and the exhibitors.

TV programming distribution: The need for distributors of TV content has, historically, been different from the film side. Much of TV production was created by broadcasters in-house (e.g. news, sports, information, and some variety, documentary and drama programming). The more expensive drama programming was typically produced by the TV production arms of the studios in the US (e.g., sitcoms), and by public broadcasters in other countries (the CBC/Radio-Canada in Canada). Canadian (and other foreign) broadcasters, including the CBC/Radio-Canada, travelled every year to Los Angeles to buy Canadian exhibition rights to these new shows. The top TV series became very valuable to Canadian broadcasters after the CRTC established the "simultaneous substitution" regulations.[3]

Original programming, created by studios, did not require a distributor until rights were available to be sold in the aftermarket (i.e. the programming was no longer new). However, there developed a market need for distributors/syndicators in the US to market the studios' libraries of popular television content to the independent conventional TV stations, or network affiliate stations not owned by the networks) as second releases. This sizeable aftermarket was available for acquired and library programming, and was particularly suited for shows that had at least a few seasons on network TV. These same distributors/syndicators could acquire the Canadian rights and market the product to Canadian broadcasters as valuable re-run properties.

In Canada, a role developed for TV distributors to market Canadian and other non-US network shows to the many independent television stations in Canada. Over time, the broadcasting market in Canada consolidated, so there were fewer doors to open – which lessened the role of the TV distributor. However, as specialty-TV services (called "cable networks" in the US) were licensed in the 1980s and 1990s, there was an uptick in the rights market for those platforms. Production companies with libraries created distribution arms or engaged distributors to sell the rights to that programming to the specialty-TV aftermarket and its substantial Canadian content obligations.

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[3] To protect the Canadian rights of Canadian broadcasters for US programming, in the early 1970s the CRTC directed Canadian cable operators to substitute the US border station signal (carried by the Canadian cable operator) with the Canadian signal – which had scheduled the show at the same time so that the viewers of the US or Canadian channel would be exposed to the Canadian commercials.

The way in which public funding has been organized in Canada influenced the lot of TV distributors, albeit indirectly. Whereas feature film funding from such sources as Telefilm, for example, is conditional upon the signing on of a Canadian distributor, the TV funding is triggered by a broadcaster's commitment to acquire and exhibit the funded program. Thus, the broadcaster is the guarantee that the program will be aired, which minimizes the role of a distributor in the domestic market with respect to original programming.

The description of the history of distribution in Section 2 and the profile of distributors in Appendix C elaborates on the evolving roles of AV distributors in Canada.

1.3 What a Distributor is Not

In order to fully understand AV distribution and the AV distributor as each pertains to this study, it is useful to clarify the distinction between rights distribution and physical (or virtual) distribution – or what is a distributor and what is not – in the context of this study.

AV distributors are concerned with acquiring and selling AV content rights to certain markets. These rights may be sold under various constraints regarding terms of license, format of exhibition, territory and the number of plays a given title may receive. AV distributors sell or license the rights to the content to their customers (exhibitors such as Cineplex, broadcasters such as CTV and specialty broadcasters such as Corus, online outlets such as Netflix and iTunes, and so on). The AV distributors, however, are not usually themselves the physical distributors of the content to audiences.

It is an especially confusing term for television content, where the rights to TV programming may never need to flow through an AV distributor. The Broadcasting Distribution Undertakings (BDUs), such as Rogers, Shaw, Bell, and Videotron, have affiliations with channels that hold the rights to their own programming. The rights holders, in this case the channels and/or the broadcasters, are then themselves distributors of rights to the BDUs. Even more complex, nowadays BDUs may also buy content directly from producers to feed their VOD, mobile, and other outlets. Further, broadcasters and BDUs regularly refer to themselves as "distributors", though they mean the physical distribution of the content electronically through their networks.

For this study, an AV distributor, such as Maple, E1, Alliance, Mongrel Media, Métropole, TVA or Kinosmith, is concerned with the buying and licensing of the distribution rights to AV content, and not with its physical distribution to audiences.

1.4 Policy Context in Canada

Over the years, as part of its commitment to developing a stronger Canadian film industry, the government of Canada has employed a number of policy measures and funding mechanisms to support the AV distribution sector in Canada. This policy support was mainly related to feature film distribution, rather than distribution in general or related to the TV market. The broadcasting market is regulated in Canada as to market entry, distribution and carriage regulations, licensing conditions, Canadian content requirements, and other factors affecting the economics of broadcasting and domestic television programming demand. Accordingly, TV programming distribution was pursued differently through such broadcasting regulation and the methods by which TV program production is funded in Canada.

The feature film distribution market has also been subjected to regulation, through the 1988 Film Distribution Policy. Foreign investment review regulations establish an economic framework for the sector, such that market entry is regulated. The effect is to influence the relationships of the ecosystem around film distribution and impact the market structure of film distribution. It has led to some market concentration among the major distributors in Canada, and as well to the creation of opportunities for smaller distributors.

Early government policy initiatives regarding feature film distribution focused on how to encourage a greater presence for Canadian-made films in Canadian theatres, which had been largely dominated by films produced by the US film studios. As early as 1930, the government investigated the relationship of Famous Players theatres to the major US studios, and during the 1940s and 1950s periodically engaged in negotiations with the major studios to look at ways of improving their contribution to the Canadian-based industry. The 1965 Firestone Report, for example, considered ways of building a Canadian feature film industry. While emphasis was initially placed on developing a Canadian feature film production industry, there were early indications as to the importance of distribution to a viable sector. By the 1980s, the objective was to encourage the growth of a Canadian distribution sector that would become instrumental in the marketing and distribution of Canadian films in theatres.

Canada's current policy framework can be traced back to the establishment of the Canadian Film Development Corporation (CFDC) (now Telefilm Canada) in 1967. In addition, the recommendations in the 1982 Applebaum-Hébert report and the 1985 Roth-Raymond report, "Canadian Cinema – A Solid Base," first lead to the creation of the Feature Film Fund and eventually the Feature Film Distribution Fund. According to many stakeholders the most important federal measure introduced was the 1988 Investment Canada Policy on Foreign Investment in the Canadian Film Distribution Sector. The key impact of that policy led to the creation of a distinct rights market for Canada, as it brought under foreign investment review any new foreign distribution company that sought to enter Canada, at least for distributors seeking to market films for which they did not own the original rights.[4] Foreign-owned distributors already established in Canada before February 1987 were not subject to the Policy, including the major studios.

Just a few years prior, in 1983, Québec's *Cinema Act* was passed and contained a clause that accorded a general distributor's license for Québec only to those distributors

[4] The Film Products Importation Bill tabled in Parliament in 1987 would have prohibited the import of all foreign films that were not owned by the importer (distributor). This legislation attracted fierce lobbying from the US under the Reagan administration, and died on the order paper.

headquartered in Québec ("principal establishment")[5]. "Special" distributor's licenses could be issued to the producers and distributors who held both world rights to a film and were already established in Québec on 18 December 1982.

In 2000, the Canadian Feature Film Policy, *From Script to Screen*, established the 5% goal for the Canadian share of feature film theatre box office receipts, and increased support for Canadian distributors for marketing and promotion. The federal government doubled the funds available for feature film (to $100 million), which led to different outcomes in the French- and English-language markets. The Policy itself has remained virtually intact since 2000. During this time Telefilm changed the formula to support distributors by axing support of minimum guarantees (MG) to become a co-investor in the distributor's marketing expenditures.

The rationale at the time for employing such policy and funding measures was straightforward. The film industry's economic model depends heavily on distribution; in other words, the link between the producer and the exhibitors, and the marketing of films as explained above. To nurture a viable Canadian film industry, an industry that buys and distributes the rights to Canadian films regularly requires a functioning Canadian distribution market. It was also believed that a distribution system that invested in domestic films was key to a viable film production sector. Though Canadian distributors are under no obligation to buy Canadian productions, federal and provincial funding sources act as incentives for such investments.

Today, as in all of the screen-based sector, the distribution and exhibition of Canadian film faces the opportunities and challenges of broadband distribution directly to the home. New platforms both disrupt and offer new revenue opportunities. As Canada navigates the complex and thorny issues of Internet distribution and the corresponding weakening of the effectiveness of broadcasting regulation, one of the important reasons for this study is to shed light on the sector dynamics in the growing global and multiplatform environment.

1.5 Mandate and Scope

Mandate: The federal government has been monitoring the AV distribution sector for many years, but has not commissioned a review of the sector's development since the mid-1990s. In this time of technological change and business consolidation, it was felt that such a review was needed. Hence, the study's mandate is to provide the following:

- An economic analysis of the AV distribution sector in Canada for both English- and French-language markets over the past 10 years;
- A description of the role of the current AV distribution sector in Canada for both English- and French-language markets as part of the overall AV industry;
- A description of the evolving role of the distribution sector; and

[5] Québec's *Cinema Act*. "For the purposes of this section, the "principal establishment" is the place which is the centre of the decision making and actual direction of the enterprise."

- Insight into the impact of digital technologies related to distribution and consumption.

Scope: For the purpose of this study, we define the AV distribution sector as comprising all content from feature films and television programming where the rights for conventional outlets and new digital platforms, in both French- and English-language markets, flow through AV distributors. This study also covers, to a more limited extent, content developed exclusively for new platforms, such as mobisodes and webisodes.

This definition means that we include content creators and producers who enter into contracts with distributors to reach retailers, customers or other exhibitors – while acknowledging that producers sometimes act as their own distributors. Such producers can deal directly with retailers and exhibitors in domestic and foreign markets. As a result, this study covers most Canadian-produced feature films, as they need independent distributors to access federal and provincial support funds and tax credits.

As indicated earlier, since most new TV programming is commissioned directly by broadcasters, there is a much less developed role for distributors in the TV market. AV distributors are important for television content when it comes to supplying shelf product for specialty TV and foreign markets but not otherwise. As discussed in Section 5, the growing popularity of electronic-sell-through and online streaming home entertainment rights for television content has become a new subject area for existing and new distribution stakeholders.

The primary focus of the study, then, will be on the distribution of feature films in domestic and foreign markets, and on all platforms. The study will also look at the portion of the distribution sector that distributes television programming, and productions intended specifically for emerging platforms (webisodes, etc.).

The main objective of the study is to identify and examine the economic position of Canadian distributors over the past ten years. It will provide background on the sector, stretching back to the 1970s, although the emphasis will be largely on the recent past, where the sector is today, and some exploration of directions for the future.

1.6 Approach

The AV distribution sector in Canada is in itself complex, yet it is also part of a much larger national and international value chain or "system" for AV product. The timing of this study is at once opportune and challenging. The sector is in flux and it is not possible to predict how the future will unfold with any certainty. In order to paint a thorough and insightful portrait of how AV distributors are coping with these uncertain times, however, the Nordicity study team is fortified by industry experts: Guy Mayson, who brings in-depth production and policy experience to the team, and Greg Rubidge, who is working at the leading edge of new platform distribution models.

To understand the challenges the sector is facing from an economic perspective, we mined data from Statistics Canada, the Motion Picture Theatre Associations of Canada

(MPTAC), the Canadian Audio-visual Certification Office (CAVCO) and Telefilm Canada (Telefilm), and created a stand-alone Economic Data Profile (Appendix A), complete with over 70 data tables and figures, and complemented with further analysis.

For greater context we conducted over 35 stakeholder interviews with key industry leaders across the English- and French-language markets. This process included roundtable discussions with some of Canada's top distributors and producers and key industry association representatives from both English- and French-language markets. Our individual interviewees included film and TV programming distributors and producers, independent and national exhibitors, broadcaster and pay television representatives, as well as digital distribution and new platform experts. These many lines of evidence have been used to draw the profile of the AV distribution sector in Canada, and led to certain assumptions about where the sector may be heading.

Study Overview

This study is organized as follows:

- In **Section 2**, we summarize Canada's AV distribution history, and categorize it into five phases. This summary provides important context for the study and some insight into the differences between the French- and English-language markets.
- In **Section 3**, we review the classic AV distribution value-chain structure for feature films and TV programming. Though pressure is being exerted to recast the value chain and release windows, the review is an important starting point for later discussion. We also provide key performance metrics of distributors drawn from the Economic Profile in Appendix A;
- In **Section 4**, we explore windows of exhibition as well as distributor revenues by platform, marketing and release strategies, and changing consumption patterns;
- In **Section 5**, we introduce and analyze developing trends for feature film and television distribution, i.e. the era of new digital platforms and the restructuring of the distribution chain that challenges the Canadian distribution sector to meet new competition and seize new opportunities;
- In **Section 6**, we provide an assessment of the Canadian AV distribution market, including a strengths, weaknesses, opportunities and threats (SWOT) analysis;
- In **Section 7,** we conclude with our perspective on the current and future position of the AV distribution sector in Canada as influenced by policy, technology and markets.

As described in the Approach section above, **Appendix A** is the Economic Profile, an in-depth examination of more recent distributor activity through the lens of economic data, revenues and expenses.

A glossary and list of acronyms is available in **Appendix B**.

Short profiles of select Canadian AV distributors form **Appendix C**.

Appendix D is a review of the evolution of Telefilm's Canada Feature Film Fund criteria for distribution since 2001.

2. Historical Evolution of the AV Distribution Sector in Canada

To establish the context for subsequent analysis of the AV sector, this section provides a summary history of the evolution of the AV industry over the last four decades. The section highlights the chronological evolution of AV distribution. In so doing, the section accounts for: the main differences (where present) between the English- and French-language market; external factors affecting the AV distribution sector; and, the main Canadian policies directly affecting the AV sector. Where useful, the study includes historical references to specific distribution companies.

The history of AV content distributors in Canada can be segmented into five eras as follows:

- **The Early Years 1967-1973,** which refers to early efforts at finding the right model to establish a financially viable national cinema.
- **The Capital Cost Allowance (CCA) era 1974-1982**, which refers to the period in which the CCA method of financing feature films dominated the production sector, and gave the impetus for the first domestic distribution companies. The 1970s is also the period when the Canadian feature film sector begins to develop and the distribution (and distributor) dynamics in that context.
- **Pay-TV, home video and TV production support 1983-1990**, which refers to the period where national, and Québec film distribution policies were introduced and film and TV program production funding grew. The 1980s is also the era when feature film is extended into what were then the new platforms, primarily home entertainment, VCRs and pay-TV. This period is also vital in the evolution of feature film support, the introduction of the Film Distribution Policy and the dawn of television support.
- **Production funding restructuring and growth of film distributors era 1991-1999**, where there were major public boosts for TV program production, the widespread provincial and federal adoption of the labour-based tax credits broadly seen as a replacement to the CCA, and the rise of the Canadian feature film distributors. The 1990s also saw growth through expansion of demand through many more channels as well as financial support from the broadcasting regulations. This period is TV production's golden era in some respects, particularly the late nineties, when the international market is somewhat more receptive to Canadian productions.[6] This timeframe also includes an expansion of feature film distribution as a result of the foreign investment policy as well as the rise of US studio classics divisions and some strong independent US distributors.
- **Consolidation and emergence of digital era 2000-2010**, which was characterized by consolidation in broadcast media, film production and

[6] It happens that this period ends with the 1999 Television Policy as set forth by the CRTC, whereby the "priority programming" categorization was expanded to include entertainment shows and reality TV. There followed a decline in the licensing of high production value Canadian drama series on commercial television.

distribution internationally, and new leading film distributors emerged in Canada. In the 2000s, Québec cinema thrived from the doubling of the funding from the Canada Feature Film Fund and increased funding from Société de développement des enterprises culturelles (SODEC). The fragmentation of TV markets continued and new ways of accessing films started to emerge as digital platforms began to take shape.

2.1 The Early Years, 1967-1973

The late 1960s correspond to the emergence of new independent creative voices and the establishment of national cinema movements in many countries around the world. In 1967, the federal government created the Canadian Film Development Corporation (CFDC), which later became Telefilm Canada. It was established in an effort to give birth to a private sector film industry that was apart from the National Film Board (NFB). In fact, a group of filmmakers, especially in Québec[7], emerged from their experience at the NFB and started producing low-budget personal projects. Such films as Claude Jutra's *À Tout Prendre* (1966), and Don Shebib's *Goin' Down the Road* (1970) are examples of independently released movies of this era that found audiences.

Entrepreneurs, such as André Link and John Dunning of Cinépix, started producing and sometimes distributing their own films, such as *Valérie* (1969) and *L'Initiation* (1970), with a very commercial eye on the marketplace. But for every hit, there were numerous unreleased titles at that time, and that outcome presented policy problems. As Michael Spencer, the then executive director of the CFDC put it, "we had discovered that spending money on pre-production did not necessarily result in completed productions."[8] A second issue was the appropriateness of government investments via the CFDC in exploitive material such as soft porn and horror movies (e.g. *Shivers* by David Cronenberg). A final problem was the faulty premise in the CFDC business model – it did not work as a revolving fund as the recoupment fell far short of the investments. The original one-time launch sum of $10 million was quickly used up, as was the subsequent infusion of top ups. At the time, the emphasis was on production and finding some way to access theatre chains, rather than developing a strong distribution sector.

2.2 The Capital Cost Allowance (CCA) Era, 1974-1982

The next significant period, between 1974 and 1982, is characterized by the tax-induced funding of Canadian features. It had become clear that the CFDC would run out of capital, as there was little or no return on investment from feature films which had received CFDC financing. Although the CFDC budget was subsequently increased to $25 million in 1976[9], new approaches to raising capital from private investors were sought.

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[7] Michael Spencer, *Hollywood North: Creating the Canadian Motion Picture Industry*, p.63
[8] Ibid, 97.
[9] http://www.telefilm.gc.ca/en/telefilm/telefilm/history

The federal government sought ways to provide an incentive for private investors to invest in certified Canadian feature films. Thus, in 1974, the Capital Cost Allowance regulations were modified to extend to film production as eligible for CCA treatment. The new measure allowed Canadians to deduct 100% of investments in Canadian films, creating a tax shelter for investors so that they could write off the investment against their other taxable income. It was assumed that private investors would only be interested in films that would make money, so that a market test would become the dominant factor in films being given the green light. However, many film projects were assembled and produced for tax reasons only and never released.

Film Production and Distribution

In this period, filmmaking in Canada revolved around producers and intermediary brokers selling CCA-based tax products to private investors for funding the production of certified Canadian feature films. These investors had no particular incentive to invest in films based on their commercial potential, since they were driven by the personal tax treatment of their investments. They did not or could not assess whether a project would enjoy commercial success.

An element of the CCA provisions was the introduction of a point system to define whether (or to what extent) a film would qualify as an eligible Canadian film for taxpayers to use the film-related provisions of the CCA. Tax-based approaches were in relatively widespread use internationally as a way to draw investors to the movie business, in addition to the glamour of such investments. In this way, the system established a tension that continues to this day, whereby the commercial incentives to use foreign talent (e.g. Hollywood writers or actors) are balanced against the cultural purpose of the support programs and tax incentives.

Regardless of the effectiveness in attracting private capital to film production, the CCA system failed to lead to films that realized commercial success. In fact, many films that made use of the system never actually received theatrical release and were never seen by Canadian audiences. However, there were some artistic successes (e.g. *The Apprenticeship of Duddy Kravitz* in 1974 – also a relative commercial success), and some commercially successful films (e.g. *Meatballs* in 1979) that were not thought to be artistic successes.

According to Statistics Canada, from 1977 to 1981, foreign-controlled distributors operating in Canada distributed just six of the 226 (2.7%) Canadian feature films produced.[10] Between 1970 and 1984, 184 French-language feature films were made in Canada and only one film (or 0.5%) was distributed in Québec by a foreign-controlled distributor.[11] These figures indicate that in this period foreign-controlled distributors were not active in the distribution of (particularly French-language) Canadian productions in Canada.

[10] Houle, Michel, "Statistical Analysis on the Relevancy of the Canadian Cultural Policy Regarding Distribution." October 1996.
[11] Houle, op cit.

In this period the federal government attempted to address the problems of access to theatre chains more directly, i.e. assisting the distribution of Canadian titles, by implementing a voluntary quota approach for showing Canadian films. Whatever modest success could be claimed at that time, the federal government's lack of jurisdiction over theatre chains (which operated under provincial license) meant that federal authorities had little bargaining power. In that period, the two main chains were foreign-controlled (Famous Players and Odeon), which further reduced the leverage points of the federal government. A footnote in this context is that it was in 1974 that Garth Drabinsky and Nathan Taylor co-founded Cineplex theatres in Toronto.

This era saw the federal government begin to provide promotional support for the film production industry in Canada through its contributions to film festivals, including the Toronto "Festival of Festivals" in 1976, and the Montréal World Film Festival in 1977. While support for film festivals has continued over subsequent decades, there is little evidence that correlates a movie that is well received at a festival with subsequent theatrical box office success. Exposure at film festivals is not normally considered hugely helpful for domestic theatrical distribution. However, film festivals serve as a launch pad for international sales; help create exposure for budding filmmakers; and for publicity purposes, for presales discussions with foreign buyers and other market activities.

TV production and distribution

The CCA era had little direct impact on the orientation of the TV production and distribution sectors in Canada. At the time, the CBC mainly produced programming in-house, and so the independent producer lobby – which had been raised in part by the feature film sector - started to encourage the CBC to diversify its sources of new programming.

At the same time, CTV was operating as a cooperative network for news and some network programming, but the independently-owned English-language TV stations mainly programmed their own schedules – and typically acquired most of their popular programming from US networks and US distributors. As explained in Section 1, they scheduled these acquired programs according to the US border stations' schedules to take advantage of simultaneous substitution regulations that the CRTC had established to govern the distribution of US signals by Canadian cable operators. The policy rationale was to protect the copyright of Canadian stations and their exclusive Canadian licenses to air foreign (i.e. US) programming. The result has been an enormous boon to private television stations to this day, as the policy has led to higher audiences for the Canadian stations – which can then charge advertisers higher rates.

Indeed, most of Canadian programming in the CCA era was produced in-house (by broadcasters), and outside the CBC there was little production of Canadian TV drama or other high production value programming. In that period, a TV distribution business developed and served individual stations or the different regional TV broadcaster ownership groups and educational broadcasters across the country. Their product was mainly TV programming, the rights to which were still available for certain regions of

Canada, if the original station or ownership group did not acquire a national license. Even in the latter case, distributors could be used to market to stations in other geographic areas.

Critical to the demand for Canadian TV programming by independent producers in this decade was the creation of independently produced Canadian content – and the related specific conditions of license that were stipulated for private broadcasters. These conditions tended to emphasize Canadian drama programming. Indeed, in 1971 the CRTC introduced Canadian content requirements in broadcasting, establishing a "minimum 60 per cent" Canadian content rule for public and private television. In 1976, *The Canadian Radio-television and Telecommunications Commission Act* expanded the CRTC's jurisdiction to include telecommunications companies.[12] The CRTC then set Canadian content quotas for CTV in terms of hours of original programming for peak time exhibition (7 p.m. to 11 p.m.). This regulatory policy, after withstanding legal challenges by CTV, created a demand for Canadian drama, children's and documentary programming that had to be aired in peak time and not buried in off-peak parts of the schedule.

This regulatory induced demand created a market for Canadian content, but distributors of TV product had no large role in this part of AV distribution. Although in its infancy, the role of independently produced TV programming had yet to grow beyond a cottage industry in Canada.

2.3 Pay-TV, Home Video and TV Production Support, 1983-1990

In the "pay-TV/home video" era, federal and provincial governments indirectly and directly encouraged the development of a Canadian-owned distribution sector through new policy initiatives. Feature film distribution became a key focus of government, at least partly in response to the continued difficulty in the English-language market for Canadian films to gain access to domestic theatre screens (which at that time were primarily foreign-owned). This lack of retail access led to the 1988 federal policy that created *de facto* a separate Canadian rights market for film and television distribution. As explained in Section 1, foreign companies can only establish in Canada if they distribute proprietary films. The result has therefore been that foreign independent films are acquired by Canadian distributors for the Canadian market.

This period also experienced a significant growth in Canadian distributor revenues – largely due to the introduction of a new exhibition window: home video and the rental of prerecorded videocassettes. According to Statistics Canada, Canadian distributor revenues in 1983 were approximately $301.3 million. This revenue figure rose to approximately $394.5 million in 1986-1987 – and kept on growing to $649.4 million in 1989-1990. This growth can be attributed primarily to the home entertainment sector.[13] However, most of these distribution revenues – 60.5% – accrued to the foreign majors whose distributor arms had long been established in Canada.

[12] "CRTC Origins" http://www.crtc.gc.ca/eng/backgrnd/brochures/b19903.htm

[13] Houle, Michel, *Profile of the Film Distribution and Movie Theatre Industries in Canada (1988-1992)*. October 1994.

In spite of this growth in home video, however, many of the independent Canadian film distributors of the 1970s failed to position themselves for the market shift that would come with the arrival of home video. By securing only theatrical rights, and failing to anticipate a newer, more consumer-friendly revenue stream deriving from home video, many of them folded shop just before the boom. Examples include: Danton Films, Citadel Films, Creswin Films, Frontier Amusements, International Film Distributors, New Cinema and others.

Policy Initiatives

In the "pay-TV" era, several new policy initiatives were implemented to support the production and distribution of Canadian film content. Such policy initiatives include the following:

Québec's *Cinema Act* (1983): The government of Quebec introduced this Act to stipulate that general distribution licenses are reserved for Québec-based distributors.[14] In other words, a Canadian distributor that did not have its headquarters in Québec, and did not have a provincial license on December 17, 1982, had to subcontract distribution to a Québec-based Canadian firm regardless of whether it had the Québec market rights or not. Hollywood majors, with businesses already established in Québec, were grandfathered under a renewable agreement, and therefore were not covered by this new regulation.

Some argued at the time that the Act "discriminates more against English-language distributors from other parts of Canada than against the majors."[15] The Act essentially made it illegal for Canadian distribution companies with offices in Toronto rather than Montréal to directly distribute their films in Québec. That is why, to this day, Toronto companies such as Maple and Mongrel must pay sub-distribution fees to Québec distributors (in this case E1 and Métropole respectively) to "open" (i.e. exhibit in cinemas) in the province.

CFDC transitions to Telefilm (1983-1988): In 1984, the CFDC was renamed Telefilm Canada[16] and continued to manage the Broadcast Fund (as it had since the previous year). In 1986, the Feature Film Fund was established and also administered by Telefilm with a $30 million increase in budget. This infusion of production funds was followed in 1988 by the Feature Film Distribution Fund, which provided credit lines to Canadian distributors to encourage the widest possible distribution of Canadian films in the various markets. These lines of credit enabled Canadian distributors to acquire and market Canadian films primarily by subsidizing the MGs paid to producers. Telefilm guidelines also required a Canadian distributor to be involved for any Canadian film project financed by the production fund.

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[14] Acheson, K .and C.J. Maule. *The Proprietary Rights Initiatives in Canadian Film Distribution Policy*, 2000, p. 4.

[15] Ibid. p 5.

[16] Although there was no specific amendment to the *CFDC Act* to change the name or any aspect of its incorporation until many years later.

The Film Distribution Policy (1988): The Roth-Raymond Report in1985 concluded that the lack of Canadian ownership in distribution was a major problem and new policy in this area was essential. The subsequent Film Distribution Policy in 1988 helped ensure the Canadian market became a separate distribution market for feature films.

An original critical component of the Policy was a legislative underpinning which was never enacted. As noted in Section 1, in early 1987, the Minister of Communications, Flora MacDonald, proposed legislation (The Film Products Importation Bill) which aimed to create a system of national distribution licensing to give Canadian distributors exclusive access to independently produced (i.e. non-studio owned) films. The proposed legislation would have relegated the distribution majors in Canada to the distribution of "proprietary" films only, i.e. any film for which the distributor owns world rights or is a major investor. While this bill was shelved after strong US lobbying, the central element of defining Canada as a separate rights market for independent films became pivotal to federal distribution policy and program funding going forward.

The 1988 Policy stipulated the following: that foreign takeovers of Canadian-owned and -controlled film distribution businesses would not be allowed; that new foreign distribution businesses would only be allowed to distribute proprietary films; and that direct and indirect takeovers of foreign distribution businesses operating in Canada would be allowed only if the investor undertakes to reinvest a portion of its Canadian earnings in accordance with national and cultural policies. The Policy did not apply to companies already established in Canada before February 1987.[17]

Feature Film Distribution

In 1983, pay-TV was launched in Canada after the CRTC issued several competitive licenses under the assumption that the market could support more than one pay-TV license in any given territory.[18] Pay-TV did not live up to expectations, however, as the pay-TV value proposition in Canada failed to attract more than approximately 10% of cable subscribers.[19] Eventually the CRTC allowed industry consolidation to alleviate the financial burden on the surviving pay-TV licensees. It permitted the restructuring of the pay-TV sector through regional pay-TV monopolies in the mid 1980s for the English-language market in Canada (The Movie Network in the East, and Superchannel in the West). Similar restructuring was permitted to resolve the over licensing of pay-TV in the French-language market, as two competing pay-TV networks were permitted to

[17] Canadian Heritage: Investment Canada: The Canadian Film Industry and Investment Canada at http://www.pch.gc.ca/pc-ch/org/sectr/ac-ca/eiic-csir/film-eng.cfm

[18] See a full analysis of the launch of pay-TV in "Canada's Video Revolution", by Peter Lyman, Lorimer Press, 1983.

[19] The pay-TV story was slightly different across the border. Pay-TV started several years earlier in the US, before home video took hold of the market. As well, pay-TV became the main reason for households to subscribe to cable, because cable was not needed for most households to access the three US networks (CBS, NBC, and ABC). In Canada, besides facing the home video competition, the value proposition for cable was to bring in the US border station signals – and a one channel pay-TV network at roughly $15/month extra cost was not attractive to most pay-TV subscribers.

merge, leading to the creation of SuperÉcran (founded on the fusion of Premier Choix and Télévision de l'Est du Canada – TVEC).

In theory, pay-TV was to have been a significant distribution outlet for Canadian feature films, whereby their exhibition could be assured through broadcasting regulation (unlike access to cinema chains). Original projections by pay-TV applicants showed major infusions in license fees for the movie distributors, but the low market penetration resulted in license fees being far less than anticipated. Indeed, it took nearly two decades before the three pay-TV operators were profitable and started paying a more substantial license fee for Canadian movies – although never to the original levels anticipated.

In fact, a major contributing reason for pay-TV's lack of success was the rapid growth of the videocassette home video market – mainly the rental market. Film distributors in this period generally worked through video wholesalers who would manufacture the tapes and distribute to the independent home video retail outlets scattered across Canada. Like theatrical distribution and unlike pay-TV, there were few public policy intervention possibilities to ensure the access of Canadian titles in the home video platform. However, the home video platform became incredibly important to distributors, and for well into the DVD era generated much greater returns than from theatrical exhibition.

Television Programming Distribution

In 1983, as part of the Broadcasting Policy, the Minister of Communications, Francis Fox, announced the creation of the Canadian Broadcast Program Development Fund (Broadcast Production Fund) at Telefilm Canada, which aimed to revitalize Canadian television. At the time, 85% of all programs aired in peak time for TV viewers by English-language Canadian broadcasters were imported from the US. The new Broadcast Production Fund was a boost to Canadian independent producers, as they had been lobbying the federal government to "order" the CBC to procure some of its programming from independent producers instead of in-house production. The CBC was financially induced to commission product from independent producers because the only way to access the Broadcast Production Fund was to work through these external producers.

In fact, the CBC was the only real user of the Fund for much of the 1980s. In the early years, private broadcasters occasionally used the Fund for investing in feature films that would also be aired on Canadian stations. But it was not until the CRTC decision (and as upheld by the Supreme Court) to impose peak time drama programming requirements on CTV that private broadcasters in the English-language market began tapping into the Fund. While these new arrangements and support funds were very important to program producers, their relationships were directly with broadcasters. Accordingly, there was no real role for AV distributors in that context.

In this period, however, several new TV licenses were awarded to new independent TV stations for many Canadian markets, and the proliferation of new TV stations created a larger market for TV programming distributors. Broadcast station groups sought to increase their geographic footprint in Canada through new licenses, as well as acquisition of existing stations. For example, Baton acquired more CTV affiliates in a struggle to control the network, while the Winnipeg-based CanWest acquired Global and other stations. By forming national networks (both Baton and CanWest were able to negotiate national program rights buys – thus eroding the local market opportunities for Canadian TV distributors.[20]

In the middle of the decade, the TV situation was complicated by the introduction of specialty-TV channels. To that end, in 1984 the CRTC licensed Much Music and The Sports Network (TSN), and in 1987 licensed 10 more new specialty channels, including Showcase and Bravo! Cable operators soon introduced the concept of a "negative option"[21] – a creative, if consumer-unfriendly way to extend subscription take-up rates to high levels. As a result, most specialty channel services reached profitability relatively quickly[22] and began to grow more important in the licensing of Canadian programming. Typically, they acquired original programming directly from producers, and from distributor libraries for shelf-programming ('library' usually refers to the older product available for licensing that has already received its first-run windows on television).

Important Distributors in this Period

Many of today's distributors have their origins in the pay-TV era in Québec, although Cinepix was well-established by this time. Between 1985 and 1987, three major distributors launched in Montréal: first, Alliance Communications and Atlantis Communications and, two years later, René Malo founded Malofilms. One veteran of the distribution industry, with over 25 years of experience, attributes this concentration of activity in Montréal to the stronger star system in operation in the province. Part of the explanation may also reside in the stricter distribution legislation keeping foreign distributors, as well as Ontario-based companies, at bay. Between 1987-1988 and 1993-1994, distribution revenues in Québec nearly quadrupled to roughly $95 million.[23]

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[20] In fact, the CanWest Global ownership group was not required to file for a "network" license. In various licensing applications to the CRTC, the station group was referred to as a "system" partly in order to avoid requiring a network license and possibly attracting new "network" license programming obligations.

[21] The negative option approach has been used in several retail situations, whereby the supplier changes the offering to customers, and bills them accordingly unless contacted by the customer to opt out. The "negative option" enabled cable operators to offer several new channels at a low price, unless the subscriber asked to cancel the new additions. For example, a cable operator would offer 5 US superstation channels plus one Canadian specialty-TV service (to satisfy CRTC regulations on tiering and linkage) for an extra $1.99/month. Technically, all the cable operator had to do was to "trap out" the extra signals with a simple piece of equipment that cost $15 in bulk (say), and only for the 5-10% of subscribers who asked to opt out of the service. The approach worked and several new Canadian specialty-TV services owe their immediate commercial success to negative options. However, consumer backlash finally ended the negative option practice.

[22] In fact, depending on different factors, some "waves" of new licenses had a much easier time to reach profitability than others; e.g. the 1987 wave of new licenses was more successful than the 1995 licensees; the 1997 wave was more successful, and the digital wave in 2001 took longer to achieve profitability.

[23] Wall Communications, *The Canadian Film and Video Industry: Economic Features and Foreign Investment*, March 1996

2.4 Production Funding Restructuring and Growth of Film Distributors Era,1991-1999

In this era, Canadian feature film distributors grew in importance, buoyed by early output deals with the American mini-majors that helped to build the success of firms such as Alliance Films and Lionsgate. In 1991-1992, distributors earned gross revenues of approximately $1.2 billion. Excluding wholesale, 1991-92 distributor revenues in Canada amounted to $643 million. Just over half (56.5%) of these distribution revenues can be attributed to foreign-controlled companies, while 43.5% or $279.8 million was earned by Canadian-controlled firms.[24]

Policy Initiatives to Stimulate the Supply of AV Productions

In late 1995, the Canadian Film or Video Production Tax Credit was announced, effectively replacing the Capital Cost Allowance as a way of providing tax incentives to attract production investment. This policy provided a refundable tax credit for up to 12% of the production budget of eligible Canadian productions, and was based on the domestic labour expenses incurred in the project's shoot. Another condition was the requirement for the project to be licensed by either a Canadian broadcaster or distributor to be eligible. This tax credit was in part responsible for a TV production boom in Canada in the late 1990s, and ensured a ready supply of productions for Canadian distributors.

There was also a substantial increase in production funds through the creation in 1996 of the Canada Television and Cable Production Fund (CTCPF), and its merger with Telefilm's Broadcast Production Fund – which the Government then doubled to the $100 million level. CTCPF administered the License Fee Program, while Telefilm administered the Equity Investment Program for Canadian TV program production.

According to Statistics Canada, theatrical distribution revenues in 1997-1998 totaled $276.8 million.[25] In this era some production companies expanded into international markets and financing for TV productions through treaty coproductions with European producers and pre-sale commitments from US cable channels. While treaty film coproductions were not always distributed theatrically, the TV coproductions were generally only produced if they had commitments from TV networks from all the nations participating in the coproduction. Seemingly, it was financially desirable for foreign partners to have such distribution lined-up as a matter of course with TV content.

In 1999, the CRTC released *Building on Success – A Policy Framework for Canadian Television*. Among other features, this Policy created priority programming categories[26] and changed the requirements for private networks concerning the production of

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[24] Houle, Michel, *Profile of the Film Distribution and Movie Theatre Industries in Canada 1988-1992*, October 1994

[25] Wall Communications, *Analysis of the Feature Film Distribution Sector*, August 2000

[26] The four priority programming categories defined by the CRTC are: 1) Canadian drama programs; 2) Canadian music and dance, and variety programs; 3) Canadian long-form documentary programs; 4) Canadian regionally produced programs; and 5) Canadian entertainment magazine programs.

drama. The Policy was decried for years afterwards as having eliminated expenditure requirements for over-the-air broadcasters, and for allowing entertainment and celebrity gossip shows to substitute as priority programs in lieu of scripted dramas – under the well-intentioned objective of trying to create a Canadian star system.

Effect of the Film Distribution Policy

Once established, the 1988 Film Distribution Policy was most notably challenged in international trade forums during the Polygram transaction in 1996-1997. At that time, Polygram challenged the Policy, which prevented a foreign-controlled company from setting up shop in Canada as a distributor, at least not without going through a foreign investment review. As a significant international media conglomerate, the company was seeking to establish a new business in Canada that distributed more than just proprietary product. It was critical for Polygram because it did not function as a studio and, as a result, required partners to assist in the production of films/content.

In attempting to resolve the matter through the Foreign Investment Review process (as set out in the 1988 Policy), and ultimately through the international trade forum at the World Trade Organization (WTO), the Policy came under much public scrutiny. Eventually, there was an ownership change at Polygram. Seagram's (technically a Canadian-firm) purchased Polygram from Phillips and rolled Polygram's distribution business – Polygram Film Entertainment- into Universal, which Seagram's already owned. The result was a shift in the company's strategic direction, and the waning of Polygram's interest in moving into Canada.

The majors which were established before the 1988 Film Distribution Policy continued to operate as distributors in Canada without restriction even for titles they had not produced. However, they began the practice of expanding into various territories through their newly-established "classics divisions". These divisions could not open shop in Canada without a foreign investment review, and so they signed output deals with Canadian distributors, such as Alliance. Canadian distributors also benefited from developing relationships with the independent mini-majors in the US – Orion, Vestron, Miramax and New Line. From these sources, Canadian distributors could acquire the domestic rights to commercially viable, non-studio film projects, which has been especially important in the English-language market in Canada. Thus, the consequence of the Policy led to effective impact during the nineties.

Film Distribution through Pay-TV, DVDs, and the Value of Film Festivals

In the 1990s, pay-TV became quite profitable as it graduated into multi-channel pay services. As essentially a movie-driven service, pay-TV became a good but ultimately modest market for Canadian features. As noted above, the pay-TV take-up rate was far lower than in the US, and of course it is limited by the number of TV households in Canada.

By the mid-1990s, DVD sales superseded VHS, and ushered in a new "sell-through" market that large-scale retailers (e.g. Blockbusters, Videotron, Rogers and Wal-Mart) dominated. Their strength led to the decline of the wholesaler as the intermediary between distributors and retailers, as distributors made their deals directly with the retailers.

Also during this period, film festivals grew in importance as business venues in both Europe and North America. One such example, the Toronto International Film Festival (TIFF), gained stature as a destination on the film festival circuit, rivaling Sundance and the New York Film Festival. TIFF has established itself as a major market for independently produced films and can be an important source of product for Canadian distributors.

Television's Impact on AV Distribution

Through the 1990s to the digital licensing decisions of 2001 there were waves of CRTC licensing of new analog Canadian specialty-TV channels. Each time, programming requirements became more specific, certainly in terms of minimum Canadian programming expenditures, genre definitions, and other stipulations. At the same time, satellite direct-to-home (DTH) services were introduced as an alternative to cable. As a result, TV distribution was stimulated as producers' shelf product came into higher demand as new channels were launched in a competitive BDU infrastructure.

The definition of Canadian content has been important since the first introduction of tax incentives to attract investments in Canadian film and TV production. On a ten point Canadian content scale, whereby points are awarded for using Canadians as talent, screenwriting, directing, etc., the CRTC and CAVCO consider programming as Canadian if a production merits 6 of 10 points. However, such 6 point productions did not qualify for the Telefilm's Broadcast Production Fund, or by the end of the decade, the Canada Television and Cable Production Fund (CTCPF – later called the Canadian Television Fund (CTF) and now the Canada Media Fund (CMF). The latter required 8 points, and in the late 1990s it was changed to 10 points.

As mentioned earlier, most of the original Canadian programming in the key drama, documentary, and children's categories was pre-licensed by broadcasters before production. Thus, this direct link to the broadcaster "exhibitor" led to a diminished role for distributors in television production. The foreign market for television production distribution remained important, however.

Important Distributors in this Period

In 1996, the following ten distributors formed the membership of the Canadian Association of Film Distributors and Exporters (CAFDE): Allegro Films, Alliance Vivafilm, Alliance Releasing, Astral Distribution, CFP Distribution Inc., Cineplex Odeon Films, Film Tonic, Malofilm Distribution, Norstar Releasing Inc., and TSC Film Distribution.[27]

[27] Paul Audley and Associates, *Survey of CAFDE members: Distribution of Canadian Feature Films Produced in 1995 and 1994-95 Corporate Gross Distribution Revenues*.

- In 1991, Peter Emerson launched Oasis International, specializing in the production and distribution of TV movies and long-running series around the world.
- In 1994, recognizing an opportunity for a niche, up-market distributor, Hussain Amarshi founded Mongrel Media in Toronto.
- In 1997, André Link and John Dunning sold Cinepix (the Québec based production/distribution house) for $36 million in cash and shares to the Vancouver-based investment group led by Lionsgate Entertainment.
- In 1998, Alliance Atlantis was formed from the merger of Alliance Communications and Atlantis Communications. This merger reflected the strategy of both these former production companies (though Alliance was also in distribution) to get out of production and strengthen their broadcasting (specialty-TV) and film distribution operations. Alliance had developed a strong domestic distribution operation, while Atlantis gained a successful foothold in international sales.

2.5 Consolidation and Emergence of Digital Era, 2000-2010

This era was one of consolidation and vertical/horizontal integration in broadcasting, telecommunications, and to some extent in content distribution and even production. In the AV distribution sector, some large entities were created with interests beyond domestic movie distribution into international distribution, television production and distribution, as well as new digital media, music and publishing. Such companies with multiple lines of business included: Lionsgate (although it has spun off its distribution arm), E1 Entertainment, Alliance/Vivafilm (formerly Alliance-Atlantis), TVA and Remstar. New technology and the advent of digital media were perhaps the most defining aspects of the latter part of this era, and surely the next.

Policy Initiatives:

In 2000, the Canadian Feature Film Policy, *From Script to Screen*, was announced, building on previous Telefilm programs to form a new Canada Feature Film Fund (CFFF). The CFFF began operations in 2001, with an annual budget of almost $100 million, more than doubling Telefilm's film funding. The CFFP was established with four objectives, including building larger Canadian and international audiences for Canadian films through improved distribution and marketing. The key policy target was for Canadian films to capture 5% of the domestic box office over five years. To achieve these audience goals, the Policy also set targets for average production budgets and average marketing budgets; for example, to encourage more comprehensive national and international marketing strategies by promoting an increase in average marketing budgets to at least $500,000.

In 1999-2000, the Feature Film Distribution Fund – established as a component of the 1988 Film Distribution Policy – grew to $11 million. In 2002-2003, however, Telefilm began to shift the funding from the support of MGs to support for prints and advertising spend. This shift placed more risk on the distributor, as the fund no longer included a grant portion, and to this day remains entirely based on a recoupable advance. (In fact, it had always included a recoupable portion, based on the earliest tenets of the CFDC model). Impressions of the impact of this change in distribution support are mixed. Some stakeholders argue that the advance approach has resulted in distributors choosing to mitigate risk, and therefore giving lower MGs to feature film producers. Others argue that putting real money at risk represents a truer test of the market viability of a project.

In 2003, there were major increases to the production budgets of feature films in the Québec market as SODEC became the main financier.[28] Between 2002 and 2005, Québec produced about 50% of the total number of CFFF-supported productions (all the French-language films and some of the English-language films). This concentration in Québec constituted a critical mass of production that is referenced by some as part of the reason for the success of Québec-based producers (in English as well as in French).

Feature Film Distribution

In this era, policy protection allowed Canadian distributors, especially in the English-language market in Canada, to make the bulk of their revenue through exclusive output deals with mini-majors and classics divisions, largely based in the US. Output deals with foreign distributors outside the US were not as significant at this time in terms of revenue potential for Canadian distributors and so individual film distribution deals sufficed. As the international market became more important to the major movie studios, and financing more complicated, many "semi-studio" projects were financed differently and Canadian rights became available separately.

As the industry matured internationally, key relationships developed with some of the major independent studios (Focus Pictures, Fine Line, as well as Miramax and New Line mentioned above). Significant output deals followed and resulted annually in a strong slate of projects for Canadian distributors. These output deals enabled Canadian-owned distributors to build larger operations and develop greater leverage with Canadian theatre chains and DVD retailers. E1's five-year multi-territory distribution deal with the US production and distribution studio Summit Entertainment is one such example.

By 2008, however, the classics division model began to falter as studios focused more on blockbuster franchises. In the US, Warner Bros. decided to absorb New Line, and Miramax was purchased by Disney, although the Weinstein brothers (who created Miramax) struck out on their own. Alliance lost its output deal with New Line; which ceased US distribution activity and became an in-house production label for Warner Bros., though evidently, the value was in decline after the heady days of the *Lord of the Rings* trilogy and the *Austin Powers* franchise.

[28] "SODEC anchors Quebec's new wave" *Playback Online*, November 21, 2005

The international market was very challenging at the end of the decade, as many international distributors could not get access to institutional capital; many films did not obtain international distribution, and where there were customers, MGs for markets declined. More recently, the full impact of the economic downturn took a toll on the number of films released, theatrical admissions and overall revenues, though the Canadian distribution market was much less affected. A glut of films on the global market has led distributors to become increasingly wary of overspending on acquisition and promotion.

As consuming filmed entertainment in the home becomes more appealing to families with flat-screen HD TVs, traditional theatrical exhibition has countered with the 3D experience. It is the 3D blockbusters which command higher ticket prices in theatres, and in many cases, higher returns for both exhibitor and distributor (when the film in question is a high-budget action or animation genre). The Canadian theatrical marketplace reported strong revenues over the last two years, mainly due to the 3D product – typically distributed by the majors through their foreign-controlled distributors. The theatrical window, while in itself a breakeven-at-best proposition for distributors, continues to be the main driver of success in downstream windows.

In this era, the home entertainment DVD market shows signs of decline, as video-on-demand and on-line distribution grow. The drop is far more pronounced in the US, but Canadian distributors are beginning to feel the squeeze as sales from their highest margin revenue sources plateau. Though revenues from electronic sell-through and rental are growing, it has not yet replaced the decline from sales through bricks and mortar chains. The risk of losing this revenue source is putting more pressure on distributors to attain and monetize all future rights on digital.

Emergence of VOD and Shift Away from Pay-TV

In 1999 and 2000, the traditional pay-TV channels began to buy more television series rather than remain tied to movies only. The Movie Network picked up *The Sopranos*, for example, while Bravo bought *Sex and the City*. The Canadian pay-TV services also spent more on Canadian TV series, but the overall effect dampened the demand, and revenues, for feature films.

After a few false starts at the end of the last century, VOD licenses were awarded to BDUs, or undertakings related to BDUs. All VOD licensees were subject to similar license conditions."[29] In 2002, Rogers Cable launched its video-on-demand service. For distributors, the arrival of VOD marked another new window and revenue opportunity for both feature film and television content.

In the latter part of this era, broadcasters began streaming made-for-TV content online (e.g. through iTunes, Rogers VOD on-line), as well as on VOD. For TV series and most other programming, these new distribution alternatives were considered extensions of the broadcast exhibition, and did not command a separate revenue stream. Early

[29] Grant and Houle

initiatives for on-line mobile services were included, but did not yet directly contribute much, if anything, to revenues.

Important Distributors in this Period

The consolidation trend for major Canadian media firms strengthened throughout this era and some producers/distributors restructured to focus on one or the other line of business.

- In 2005, Lionsgate ceased distribution activities and founded Maple Pictures (of which it retained only a 10% stake) as a separate entity to continue to exploit Lionsgate library product in Canada.
- In 2006, Toronto-based Think Films changed hands, ultimately relocating to New York and ceasing operations in Canada - and soon after in the US too.
- In 2007, Goldman Sachs backed the CanWest Global acquisition of Alliance Atlantis' production unit, including half of the CSI franchise. This transaction left Alliance Films as a pure-play distributor.

E1's Canadian feature film distribution unit was formed in August 2007, with the acquisition of Seville Pictures in Montréal, followed by Toronto's Maximum Films in July 2008. When Christal Films entered bankruptcy protection in 2007, E1 (through Seville Pictures) acquired its library. In 2008, E1 also acquired Oasis International as it vied with Maple for the number two distribution position in Canada.

2.6 Findings: AV Distribution Evolution

This historical account of the evolution of film/TV production and AV distribution suggests a few general findings that are the result.

1. The history of AV distribution in Canada (since 1967) has undergone five distinct eras, each largely defined by public policy frameworks and the on-going evolution of communications technology. The constant presence of US studios and their distributors in Canada has been a major stimulus for the government of Canada to enact AV policy.
2. As each new technology has been introduced into the marketplace (e.g. home video, DVD, VOD, etc.) distributors have been forced to amend their approaches to accommodate (and profit from) new distribution windows.
3. While feature film production and distribution attracted the most policy attention in the 1960s, 1970s and 1980s, the major policy and industry preoccupation over more than the last two decades (or more) has been the development, production, and exhibition of Canadian TV programming.
4. In the new millennium, new AV formats and platforms have diffused into the market – notably, home video, pay- and specialty-TV, VOD and more recently broadband. Canadian-controlled AV distributors have met their challenges and opportunities with mixed results.

5. While distribution companies in Canada have risen and fallen over the five eras of AV distribution, many practitioners and leaders in the industry have built up considerable expertise over time.

3. Traditional AV Distribution Models and Economic Performance

This section examines the traditional distribution business models from a value chain perspective, first for feature film and then TV programming. This description focuses on the existing practices, and is followed by a profile of the economic performance of the AV distribution business stretching back several years. This performance data set is drawn from the more detailed Economic Profile in Appendix A. The Economic Profile includes data from Statistics Canada, Telefilm Canada, the Motion Picture Theatre Associations of Canada (MPTAC), the Canadian Audio-visual Certification Office (CAVCO),and the Institut de la statistique du Québec.

Historic revenue profile figures for the distribution sector are disaggregated into revenues by origin of content (Canadian or foreign), by origin of geographic market (foreign or domestic), and origin of control of the distribution firms (foreign or Canadian). This broad revenue profile is followed by an overview of the expenditure profile and profitability of distribution firms – with the latter singling out the economic performance of Canadian-controlled firms. The performance of Québec-based distributors is also reviewed, as is the rate of reinvestment in Canadian productions by Canadian-controlled distributors.

The section ends with preliminary conclusions based on this profile of the distribution model and its economic performance.

3.1 AV Distribution Business Models and Value Chains

In the following sub-sections, we describe the AV distribution value chains for TV programming and feature films. In fact, "chain" is not the best metaphor to describe the complex "system" involved in creating a production and taking it to the Canadian and foreign markets. The UK Film Council's 2009 report, "Re-defining the Independent Film Value Chain", argues that the value chain does not reflect the nuances of the independent film business:

> "A feature film is not made and delivered to its final audience by a single company. Instead there is a chain of companies, businesses, and freelancers, all working on different elements of the production and exploitation process, and adding value in different ways along the chain. Furthermore once the film is exploited, the money handed over by the consumer (whether it be in return for a cinema ticket, DVD purchase or online download) is subject to various revenue shares or commissions as it passes back through the chain, which then complicates the revenue flow." [30]

The report goes on to describe the limitations of the chain concept in that it is "unable to represent the importance of reputation and personal relationships; timescale; and,

[30] Bloore, Peter *"Re-defining the Independent Film Value Chain"*, UK Film Council 2009

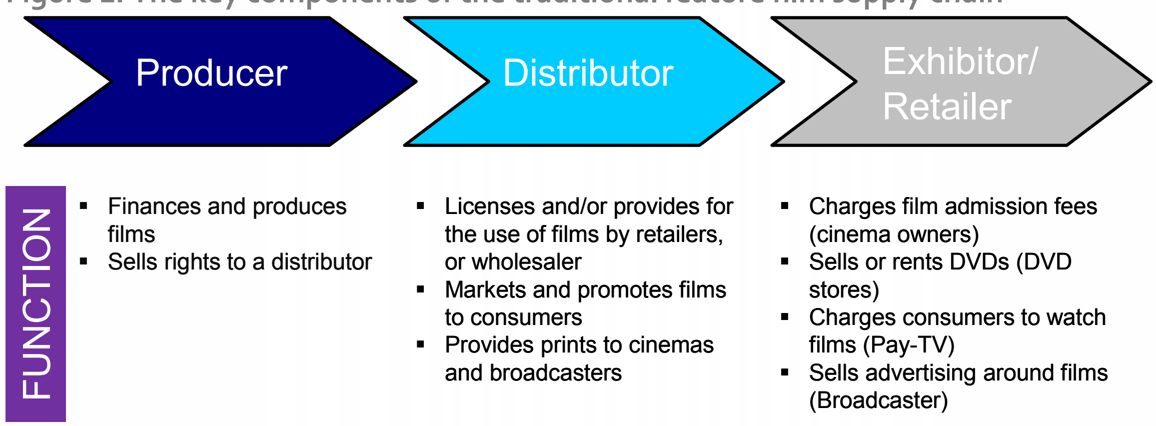
above all, the levels of investment and recoupment at different stages" and argues instead for an understanding of the entire value system at hand. This study aims to offer insight into the full AV distribution value system, both in its current form and, later in the study, as it evolves to accommodate new platforms. However, as the term "value system" has yet to become widely accepted, in this study we continue to adopt the term value chain, but with an appreciation for the complexity of the business.

Canadian AV distributors fit into a complex value chain, adding value to productions at various stages, including financing, marketing and promotion, platform sales and foreign sales. At the most basic level, the traditional global supply chain for feature film and television begins with the producers who secure financing for, and produce, the production. From there, the two paths diverge and lead to different roles and implications for AV distributors, as discussed in the following two sub-sections.

3.1.1 Feature Film Value Chain

A simplified version of the traditional feature film value chain is shown below in Figure 1.

Figure 1: The key components of the traditional feature film supply chain



Producers sell the feature film rights to a distributor. The distributor readies the film for use by retailers and exhibitors, markets and promotes it to consumers, and may pursue foreign sales opportunities. The distributor may operate through a wholesaler. Traditionally, wholesalers helped distributors reach the retail market and manufactured hard copy products (e.g. DVDs). However, distributors have evolved to a more direct relationship with major retail chains. At the end of the traditional value chain lie the retailers (e.g. cinemas, DVD stores, broadcasters, etc.) who charge, in various models, consumers to view the film.

The unpredictable nature of the cultural marketplace means that distributors expose themselves to significant risk with many of the films they distribute. From the perspective of the simplified value chain above (Figure 1), generally speaking the earlier (or further to the left) you are in the chain, the higher the potential risk for the capital investor. This heightened risk is due largely to its distance (in control and time) in the chain from the customer's payment.[31] Distributors with more capital can spread the risk over more projects; achieve some economies of scale in distributing larger projects, and bring some leverage in their relationships with suppliers and retailers.

In Canada, distributors commonly provide financing to projects in the pre-production phase (an arrangement typically referred to as a "pre-sale" commitment), and in so doing can trigger eligible Canada Feature Film Fund investments for the production of feature films. The distributor pays the rights holder an MG for the rights to distribute the film in a particular territory (typically for all platforms). Alternatively, the distributor can acquire a film after it has been completed (usually referred to as an "acquisition" or a "pick-up"), and provide an MG against the producer's share of future revenues. Canadian film producers tend to prefer the former, "pre-sale" scenario, as it allows them to access additional (private and public) sources of funding. The "pre-sale" also acts as a form of assurance to Telefilm and other funders, such as the CPTC tax credit, that the film will eventually reach the marketplace (as a firm has already invested in its distribution). One large Québec-based distributor calls attaining a distribution deal "the first test or hurdle for any film production". Distributors are perceived as the voice of the market, because their risk tolerance correlates directly to their prediction of how a production will fare upon its eventual release.

Telefilm funding previously absorbed a portion of the distributors' risk. Now, however, distributors expressed the perception that the already thin risk cushion has eroded with the shift in focus to marketing loans and away from MGs (the amount a distributor pays the producer *in advance* of the completed production, for the right to sell and license the production upon completion). Critics of the former system, especially producers, had complained that subsidized MGs encouraged a no-risk/no loss cynical mindset on the part of many distributors. As a result, they maintain that there was a tendency for distributors to ensure their financial exposure rarely exceeded TV revenue projections, and that little money was spent on theatrical marketing or release efforts. They could recoup their MG with a pay-TV sale; so with little money truly at risk, there was less incentive to invest in theatrical exhibition marketing.

Once funded and produced, the distribution of a film affords distributors several opportunities, or 'windows', to extract revenues from the product they have licensed. The illustration below shows the traditional progression of these exploitation windows (see "Distribution & Exhibition Phase"):

Figure 2 Traditional phases of production and windows of exhibition for feature films[32]

[31] Bloore, Peter "Re-defining the Independent Film Value Chain", UK Film Council, 2009

[32] Illustration based on Nordicity's understanding of the audiovisual industry.

The value chain structure is based heavily on close - though at times charged - relationships and a clear understanding between all parties involved. For example, there must be an agreed upon standard for the period of delay between the DVD and TV sales windows. While exhibition windows operate in a similar fashion in both English- and French-language markets in Canada, as described later, the business operates more smoothly in Québec because of the relative success of French-language Canadian films.

3.1.2 TV Programming Value Chain

The environment in Canada has evolved to allow only a diminished role for distributors in TV programming. In the 1990s, the distributor played a more active part in the TV value chain largely because the ownership of conventional broadcasters and specialty services was a varied retail landscape consisting of different owners and umbrella groups. Then, there was a need for the distributor to absorb some of the risk in financing a production. Consolidation and cross-ownership over the last five years, however, has removed much of this need. Today, the majority of television content producers deal directly with broadcaster program commissioners for original programming. The money from broadcast licensing fees similarly flows directly to producers, bypassing distributors. Once commissioned, producers will endeavor to line up further financing for a production. Today, this financial backing includes other partners, such as a foreign broadcaster. Increasingly, the Canadian broadcaster will demand all Canadian rights, on all platforms, for the first window of licensing.

The two key areas where a distributor may play a more active role are in 1) distributing shelf-product and 2) foreign market distribution. Distributors with TV programming libraries distribute such shelf product to TV services (e.g. specialty-TV channels) that need supply to fill their schedules. Distributors may also acquire home entertainment rights (e.g. DVD) to shelf product. Revenue opportunities for shelf product are becoming more limited, however, as licensing periods to broadcasters are being extended, lengthening the period before broadcaster rights expire and either the distributor or producer has a chance to re-monetize.

The role of distributors in TV with respect to international production differs slightly. In some cases, distributors are called on to reach foreign markets through festivals such as MIPCOM, though producers may retain that role too. Producers and distributors can also collaborate in finding international markets for TV product, including lining up foreign broadcasters with pre-sale commitments to the original product upon completion. Partly on this basis, Canadian television productions have enjoyed some strong success in recent seasons, including *Being Erica*, *Rookie Blue* and *Degrassi: The Next Generation*. Some commentators point to the 2007-2008 Writers Guild of America strike as a cause of investment in Canadian television productions, such as *Flashpoint*. This logic contends that a shortage of American productions led networks to look for an alternative supply of programming. One television industry stakeholder reported that the net effect of US successes is that broadcasters now expect a US sale when licensing a Canadian production (from a producer or a distributor), and are more likely to pass on a project that does not come with such a commitment. Distributors active in the international television market can complement producers and even broadcaster efforts to find international markets and investors for large budget TV series.

The new platform market is complex. In some cases AV distributors will hold and sell those rights and in other cases, the broadcasters will acquire the rights for new platforms directly from the producer. Leverage is being exerted by BDUs, by online retailers such as Netflix and iTunes, by producers and distributors as prices, revenues and reporting remain variable.

3.2 Canadian Distributors' Economic Performance

Operating within the traditional value chain described in Section 3.1, the economic performance of distributors can be measured in terms of revenues and profitability. As indicated above, Appendix A provides a detailed account of the economic performance and a description of the data sources and their reliability. In this section, we highlight key elements of distributor performance, beginning with revenues, expenses and profitability. This cut is followed by a brief look at Québec-based distributor performance, as well as an overall snapshot of distributor reinvestment in Canadian productions.

Interviews with Canadian distributors, in the French- and English-language markets, supplement the analysis of financial data and shed light on the underlying issues and trends. The main filters we adopt throughout the study are:

- **Geographic market**: Whether the revenues are derived from domestic or foreign distribution activity;
- **Origin of content**: Whether the distribution revenues relate to a production that is Canadian or foreign (note: Canadian may include treaty coproduction);
- **Country-of-control**: Whether the revenues are recorded for Canadian-controlled distributors or foreign-controlled distributors based in Canada.

The data and interviews suggest that the AV distribution sector as a whole is not a growth sector with regards to total revenues, number of companies and employment. It is a sector dominated by a small number of large, consolidated, highly-leveraged distributors, and a large number of small, niche distributors catering to specific needs in the marketplace. The current business model continues to be viable but as new platforms emerge, distributors will face more competition from the vertically integrated media companies that, in many ways, control the digital environment in Canada.

The total revenues for AV distributors in Canada according to Statistics Canada were $1.95 billion in 2009.[33] As summarized in Figure 3, the total revenues have been stable

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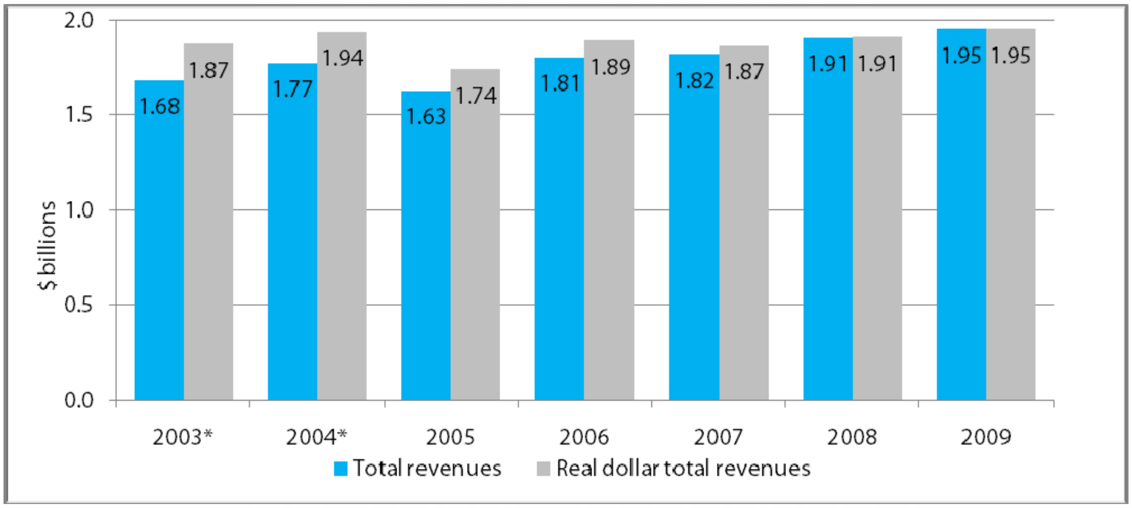
[33] Statistics Canada provides summary statistics for the film and video distribution industry as well as more detailed financial breakdowns of revenues and expenses by platform and type. The summary revenue data is based on the surveyed portion as well as administrative data for establishments that were too small to be eligible for sampling. The more detailed financial information, on which this report is based, is collected only for surveyed establishments.

over the last seven or eight years, especially if measured on a constant (real) dollar basis, which removes the inflation variable from the profile.

Figure 2 Total revenues of AV distribution industry in Canada nominal vs. real dollars (distribution and wholesaling), 2003-2009

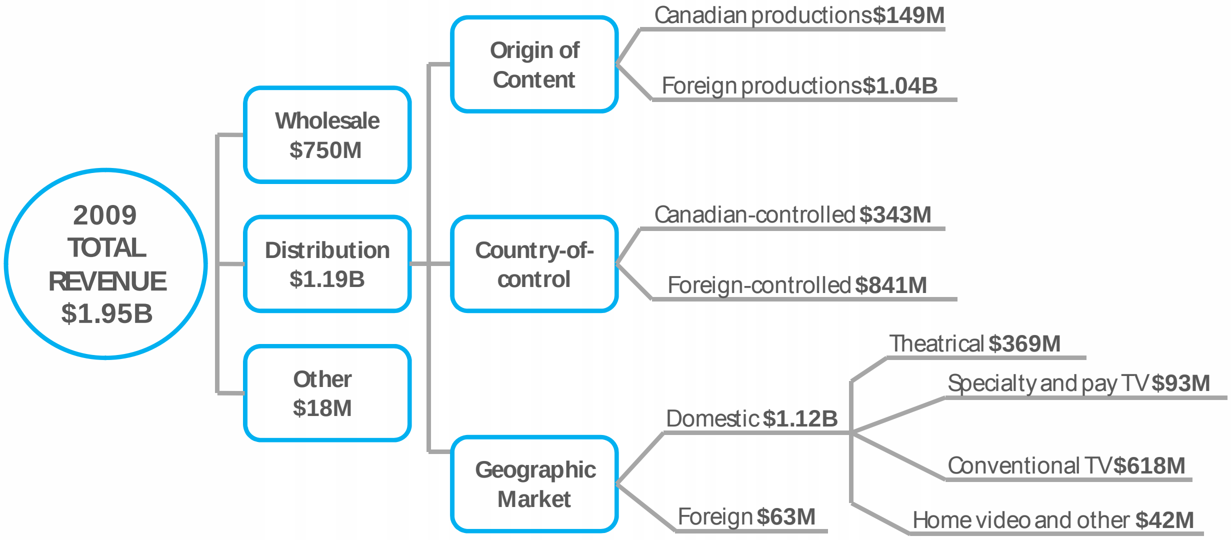


Source: Statistics Canada; *Backcasted

To profile the distribution performance, we segregated the top line revenue figure into several different components, as illustrated by the schematic in Figure 4 below. The 2009 total AV distribution revenues of $1.95 billion included $1.19 billion earned from the distribution of films, television programs and other video content, $750 million from the wholesaling of pre-recorded videos, and $18 million from other sources. As Figure 4 illustrates, foreign film/TV productions accounted for the vast majority of distribution revenues in 2009 – over $1 billion vs. Canadian productions of slightly under $150 million. Similarly, about 95% of the revenues for distributors were derived from the domestic market ($1.12B), and only a small portion from foreign markets ($63 million). The breakdown of the domestic revenues shows that conventional TV was the most significant end user market, followed by theatrical, pay/specialty-TV, and home video, in that order.

As surveyed establishments must meet certain criteria thresholds, details from the establishments who do not reach the required threshold are estimated using administrative data. As a result, the summary total revenue figure is greater than the revenue figure which is based on only the surveyed establishments. In 2009, for example, the summary operating revenue figure is $1.975 billion as compared to the surveyed total operating figure of $1.953 billion. In order to maintain consistency, this report defers to the lower, surveyed amount, as it is corresponds to the subsequent revenue and expense breakdowns For more information visit: Statistics Canada, 'Data sources, definitions and methodology' Section, "Sampling" available at http://www.statcan.gc.ca/pub/87f0010x/2010001/part-partie3-eng.htm

Figure 3 Distributor revenue breakdowns, 2009



Source: Statistics Canada

The foreign market is less straightforward and has experienced two major drops in revenues, one in 2005 and again in 2006 (Table 1). Since the 2006 low of $33 million, foreign market distribution revenues have grown steadily, but at just $62.8 million in 2009, they remain a very small part of the total sector's revenues. Potential causes of the overall decline in foreign distribution include: a challenging marketplace with fewer foreign buyers (and smaller budgets); the growing trend of using foreign-based distributors as, for the most part, established Canadian distributors cease to operate internationally.

Though Canadian distributors themselves conduct less foreign business (or fewer distributors conduct less foreign business), it does not necessarily follow that the performance of Canadian content outside Canada has declined. One option available to Canadian distributors is to work through local distributors in the foreign market (e.g. Wild Bunch and Celluloid Dreams, both based in France), rather than develop international sales agents themselves. One expert interviewed explained that it is extremely expensive to exploit the international market properly and efficiently. It requires a regular presence abroad, booths at the major international festivals such as Cannes, Venice and Berlin for feature film and MIPCOM for television content, to build relationships, as well as top notch marketing material to support pitches. Local distributors in foreign markets may be stronger at exploiting those foreign markets, leading to a strong performance for Canadian content.

Recent growth, albeit from a small base, may point to new potential for foreign market sales or reflect the success of the relatively few distributors engaged in foreign distribution for feature films. One large distributor[34], currently focused entirely on

[34] Throughout the study, we refer to interviews with distributors: "small" denotes those with annual revenues under $5 million; "medium" those with revenues ranging from $5-50 million; and "large" those with revenues of more than $50 million per annum.

domestic distribution, explained that if more Canadian films with a global appeal were produced, the distributor would want to exploit that appeal in the foreign market – particularly as the domestic market is often too small to make a sufficient return on Canadian films. If the domestic market consistently cannot provide an adequate return on investment on Canadian (particularly English-language) films, it may deter Canadian distributors with no foreign market access from acquiring Canadian productions.

One prominent television sales director at a large distributor referred to the common practice of Canadian television producers selling foreign rights directly to global media firms, such as Endemol and FremantleMedia, effectively forcing producers to forfeit a chance to build the capacity of Canada's television industry. Producers are under pressure to prioritize a sale over building expertise, visibility and relationships in foreign markets and maintaining control of their output. This vision is not shared by all television executives but raises questions about future opportunities for exploiting the foreign market. Lack of capitalization often hinders the producer from taking the risk, albeit for greater reward, of holding on to rights for future revenues.

Table 1 Total distribution revenues by geographic market (all productions), 2003-2009

	2003*	2004*	2005	2006	2007	2008	2009	CAGR† 2003-09
	($ 000s unless indicated otherwise)							
Domestic distribution	992,623	1,014,004	991,482	948,356	898,065	1,046,684	1,122,256	2.1%
Distribution to foreign clients	199,050	180,970	90,244	32,832	49,897	54,340	62,847	-17.5%
Total revenues	1,191,673	1,194,974	1,081,726	981,188	947,962	1,101,024	1,185,103	-0.1%

Source: Statistics Canada; *Backcasted; † CAGR – Compound annual growth rate

Shifting our focus from distribution markets to the productions themselves, we see that distribution revenues can also be disaggregated by origin of content; in other words, by whether a production is foreign or Canadian. Foreign productions accounted for the vast majority of domestic distribution revenues between 2005 and 2009 – 92% or $1 billion in 2009. In the same year, Canadian productions accounted for just over $90 million, or 8% (Table 2). These figures are TV and feature film at the distributor level, not the box office results for feature films only – which typically fails to meet the 5% objective target.

Table 2 Domestic distribution revenues by origin of content, 2005-2009

	2005	2006	2007	2008	2009	CAGR † 2005-09
	($ 000s unless indicated otherwise)					
Canadian productions	86,330	102,905	90,478	105,983	90,416	1.2%
Share of total	*8.7%*	*10.9%*	*10.1%*	*10.1%*	*8.1%*	--
Foreign productions	905,152	845,451	807,587	940,051	1,031,840	3.3%
Share of total	*91.3%*	*89.1%*	*89.9%*	*89.9%*	*91.9%*	--
Total domestic distribution revenues	991,482	948,356	898,065	958,051	1,122,256	3.1%

Source: Statistics Canada; † CAGR – Compound annual growth rate

Though the Canadian distribution policy acts as a significant barrier to entry for foreign competitors in AV distribution, the policy does not require Canadian-controlled distributors to purchase and distribute Canadian content of any kind. On the television side, expenditure and scheduling regulations, as well as conditions of license, drive demand for Canadian content, but no buying obligations exist for feature film distributors – or theatrical exhibitors. Indeed, distributors exhibit varying commitment levels to acquiring Canadian productions. Interviews with feature film distributors suggest the range varies from 1) very low, e.g. in one case one of a hundred films distributed in a year were Canadian productions; 2) medium, where between 10-15% of films in a year are Canadian (out of 40-60 films); to 3) high, where 60% of productions are Canadian (out of 45 films). On the other hand, domestic distributors of television content estimated annual distribution slates (including specials, coproductions and movies of the week) ranging from 50 to 90% Canadian productions.

The main reason for the focus on foreign content in English speaking Canada is the perceived better risk-to-return ratio for distributors. Canadian films, as we discuss in Section 4, cost more to market than foreign ones. They do not benefit from the spill-over effect from a substantial American marketing and publicity campaign (consider stars' appearances on popular talk shows, magazine covers, blog coverage and more).

As well, the distributor must also produce all the necessary marketing material, such as trailers, from scratch rather than simply re-purpose what is already designed by the American distributors. This additional time, effort and budget is not often recovered. One large distributor explained, for example, that while 15% of its slate is English-Canadian, those films generate just 5-7% of total revenues. Admittedly, the 10% of its slate devoted to French-language productions generates roughly an equivalent proportion of sales, but as box office records show the Canadian French-language films capture a much larger market share than English-language films. Generally, for English-language Canadian films, distributors believe they are less likely to recoup their investment.

Overall, we can see that the Canadian AV distribution sector relies enormously on the domestic distribution of foreign content. That is to say, distributors seek to acquire 100% of available Canadian rights for exploitation on a given production. Further detail on the breakdowns highlighted in Figure 4 is available in Section 2 of Appendix A to this study.

Total distribution sector expenditures are available from 2005-2009, and are presented below in Table 3. As a whole, the sector saw its operating profit margin remain relatively steady over the period, rising from a five-year low of 16% in 2007 to 20.8% in 2009 (Table 3). In 2009, the licensing costs paid for rights, royalties and other fees capture the most significant portion of revenues. Indeed, licensing cost expenditures also rose at the highest compound annual growth rate, 25% between 2005 and 2009.

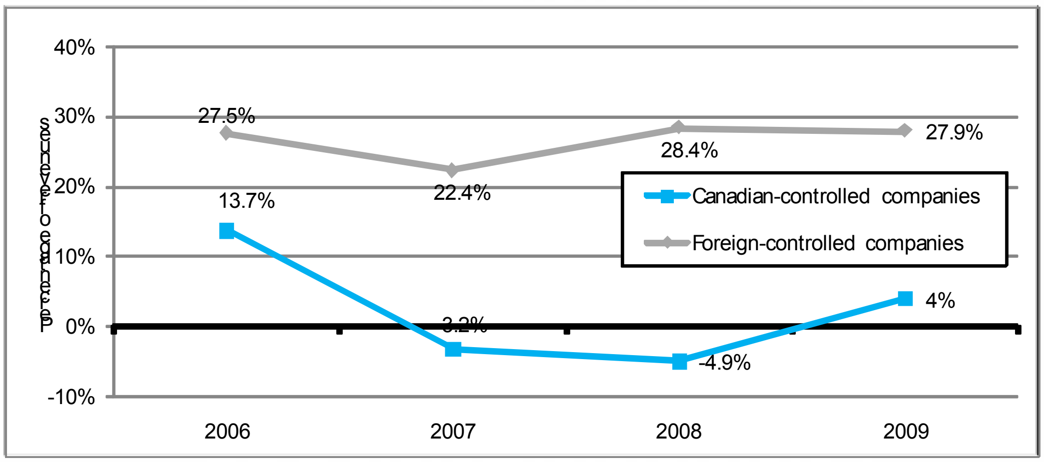
Table 3 Operating revenues, expenses and profits, total distributor sector, 2005-2009

	2005	**2006**	**2007**	**2008**	**2009**	**Percent of total revenues (2009)**
	($ 000s unless indicated otherwise)					
Total operating revenues	**1,627,753**	**1,805,462**	**1,819,231**	**1,906,051**	**1,952,847**	**100.0%**
Salaries, wages and benefits	71,494	63,638	93,335	91,228	79,703	4.1%
Licensing costs (rights, royalties and other fees)	238,402	368,309	459,808	506,976	581,857	30.0%
Cost of goods sold	590,271	578,009	552,047	555,803	541,592	27.7%
Advertising, marketing and promotions	167,350	133,336	243,372	252,982	191,989	9.8%
Other operating expenses	249,649	230,817	179,526	141,337	151,177	7.7%
Total operating expenses	1,317,166	1,374,109	1,528,088	1,548,326	1,546,319	79.2%
Operating profit	310,587	431,353	291,143	357,725	406,528	20.8%
Operating profit margin	18.9%	23.9%	16.0%	18.8%	20.8%	--

Source: Statistics Canada

While the total sector's operating profit margin remained fairly stable between 2005 and 2009, if we examine operating profit margin by country-of-control, we see the gap between the profitability of Canadian-controlled distributors and foreign-controlled distributors widened considerably in 2008 before narrowing in 2009 (Figure 5). Foreign-controlled distributors enjoyed a relatively steady profit margin while over the same period Canadian distributors' revenues fluctuated and so their profit margin dropped from a high of 13.7% to -4.9% in 2008 before rebounding to 4.0% in 2009 (Figure 5). More detail on profitability and expenditures is provided in Appendix A to this study.

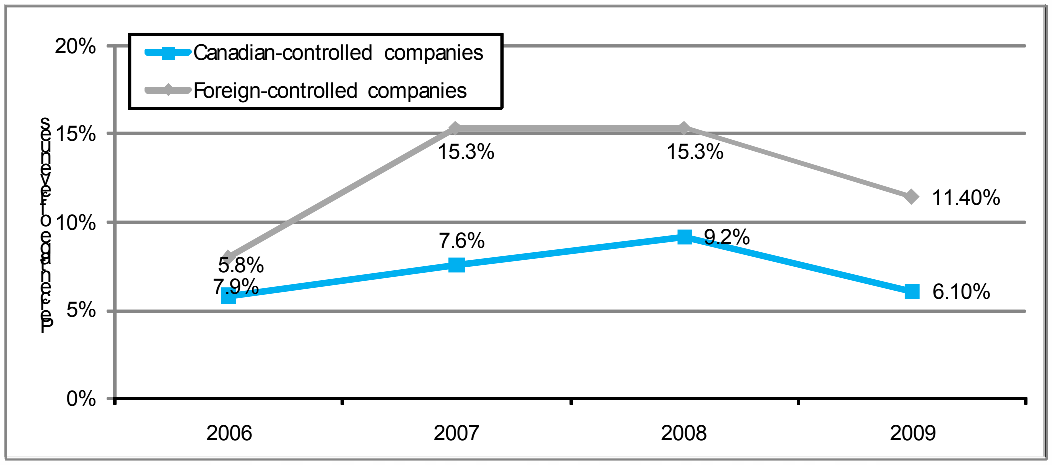
Figure 4 Operating profit margin, Canadian-controlled vs. foreign-controlled companies, 2006-2009



Source: Statistics Canada

Between 2006 and 2009, total distribution sector expenditures on advertising, marketing and promotion grew at a compound annual growth rate of 3.5%, reaching $192 million in 2009, or 9.8% of total revenues (Table 1). As we examine marketing expenditures by country-of-control, we see that foreign-controlled distributors consistently spend more on advertising, marketing and promotion as a share of total operating revenues. In 2009 Canadian-controlled distributors allocated 6.1% of operating revenues to marketing compared with 11.4% of foreign-controlled company revenues in the same year (Figure 6).

Figure 5 Marketing expenditure share of total operating revenues, Canadian-controlled companies vs. foreign-controlled companies, 2006-2009



Source: Statistics Canada

Further detail on employment figures and the number of establishments in the AV distribution sector is provided and analyzed in Appendix A to this study.

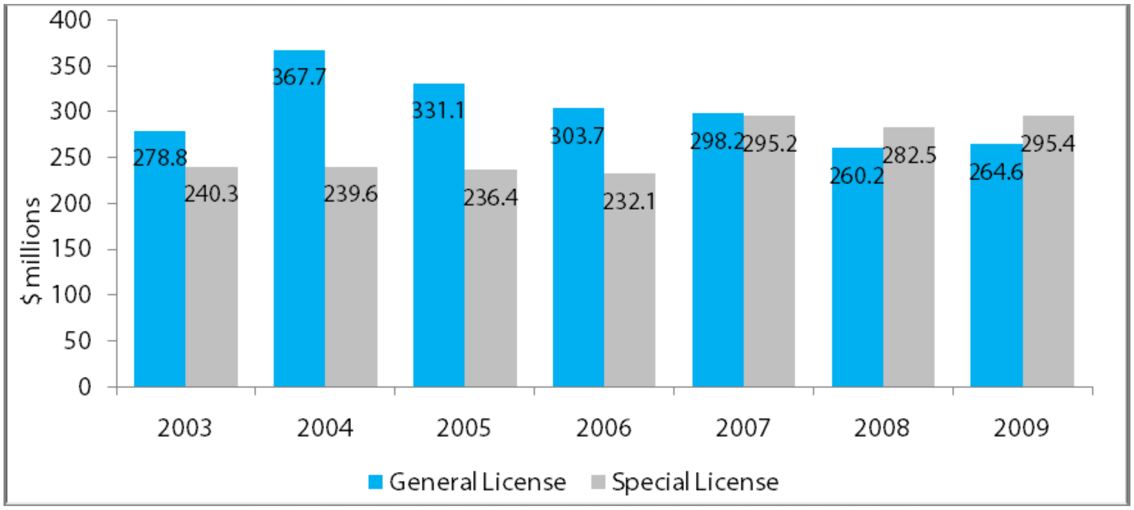
3.2.1 Revenues of all productions by category of license, Québec

As described in Section 2, Québec's *Cinema Act* of 1983 introduced two classes of license:

- **General** distribution licenses for Québec-based distributors ("having its principal establishment in Québec"); and
- **Special** license for only "the producer of the film or holder of the world rights to the film and who, on 17 December 1982, held a license issued under section 30 of the *Licenses Act*."

We are able to compare the revenues of the two license classes to find that between 2003 and 2009, total AV distribution revenues in Québec declined by a compound annual growth rate of -1.8%, to $560 million in 2009. Over the same period, special license holder revenues increased by 4.3%, meaning that the majority of the decline can be attributed to general license holders (in other words, Québec-based distributors) (Table 4). Within the total Québec AV revenues, the general license share ranges from a high of 60.4% in 2004 to 47.3% in 2009 (Figure 7). When compared to the total Canadian AV distribution market, the Québec market consistently generates around 30% of revenues (Table 4).

Figure 6 Distribution revenues by category of license, Québec 2003-2009



Source: L'institut de la statistique du Québec

Table 4 Gross revenues of distributors by license class in Québec, 2003-2009

	2003	2004	2005	2006	2007	2008	2009	CAGR † 2003-09
	($ 000s unless indicated otherwise)							
General license, QC	278,800	367,700	331,100	303,700	298,200	260,200	264,600	-0.9%
Share of total, QC	*53.7%*	*60.5%*	*58.3%*	*56.7%*	*50.3%*	*47.9%*	*47.3%*	--
Special license, QC	240,000	239,600	236,400	232,100	295,200	282,500	295,400	4.3%
Share of total, QC	*46.3%*	*39.5%*	*41.7%*	*43.3%*	*49.7%*	*46.3%*	*52.8%*	--
Total, QC	519,100	607,300	567,500	535,800	593,400	542,700	560,000	-1.6%
Share of total, Canada	*30.8%*	*34.2%*	*34.9%*	*29.7%*	*32.6%*	28.5%	28.7%	--
Total revenues	**1,682,866**	**1,774,014**	**1,627,753**	**1,805,462**	**1,819,231**	**1,906,051**	**1,952,847**	**1.9%**

Source: L'institut de la statistique du Québec, and Statistics Canada

Distributor insolvency in both English- and French-Canada is a frustration for broadcasters. Bankruptcies and mergers (e.g. Christal Films) have created disruptive challenges in the past as broadcasters tend to rely on early distributor marketing efforts to carry exposure into the broadcast window. One advantage of American blockbusters is in part due to the fact that, regardless of value or appeal, marketing efforts are so widespread that films are still generally remembered when they reach the specialty and conventional windows. One specialty TV channel interviewee explained that from her perspective, any initiative would be welcomed that enhanced the stability of Québec distributors, as well as their ability to launch effective marketing campaigns.

3.2.2 Distributor "reinvestment" in Canadian feature film production

To gauge Canadian-distributors' rate of reinvestment in Canadian feature film production, we compared the sum of Canadian distributors' advances for Canadian features films to the total revenues earned by Canadian-controlled distributors within and outside Canada from the distribution of Canadian and foreign feature films and television programs.

- The Statistics Canada data does not permit us to isolate Canadian-controlled distributors' revenues within Canada, nor does it permit us to isolate Canadian-controlled distributors' revenues from the distribution of feature films as opposed to television program. As such, the denominator in our calculation of the reinvestment rate is somewhat overstated; and therefore, the estimated reinvestment rate is understated. That being said (as already noted), we understand that feature film distribution accounts for the vast majority of Canadian-controlled distributors' revenues; and so, our calculation of the reinvestment rate can be considered a reasonable estimate of the actual reinvestment rate.
- In 2007, Canadian distributors made advances totaling an estimated $44.2 million to the production of Canadian feature films. This total represented 16.7% of the total worldwide distribution revenues of $264.8 million. In other words, Canadian distributors reinvested 16.7% of their distribution revenues in Canadian feature films in 2007. In 2008, the value of Canadian distributors' advances for Canadian feature films dropped to $30.7 million; their rate of reinvestment in Canadian feature films also dropped to 9.5%. In 2009, the reinvestment rate rose to 10.4% (Table 5).

Table 5 Canadian distributors' reinvestment in Canadian feature film production

	2002	2003	2004	2005	2006	2007	2008	2009
	($ millions unless indicated otherwise)							
Canadian distributors' advances for Canadian features films	39.2	27.3	21.7	32.8	35.4	44.2	30.7	35.7
Canadian-controlled distributors' total revenues from AV distribution*	--	--	--	--	x	264. 8	323.2	343.7
Reinvestment rate	--	--	--	--	--	*16.7%*	*9.5%*	*10.4%*

Source: Nordicity tabulations based on data from CAVCO and Statistics Canada.
* Includes revenues earned from the distribution of Canadian and foreign feature films and television programs within and outside Canada; excludes wholesaling and other revenues.
X – data suppressed due to data confidentiality

3.3 Findings: Value Chain and Economic Performance

This description of the AV value chains and the brief examination of economic performance suggest the following findings.

1. There are substantial differences between the value chains for feature film and TV programming. At any rate these value chains could be better described as "systems" rather than "chains," which suggest a straight line linkage. In reality there is an interrelated ecology of functions and firms, and many feedback loops surrounding each of the main components of the value chain.
2. While the annual revenues of distribution companies are over $1 billion, most of that is for US movie and TV product that is sold to the Canadian market by the foreign-controlled distribution arms of the majors. Most of these revenues emanate from programming sales to Canadian broadcasters.
3. Revenues from Canadian product represent some $150 million vs. over $1 billion for foreign product.
4. Until 2009, Canadian-controlled companies showed declining profitability, although stable revenues. In 2009, Canadian-controlled company profit margins rose to 4%.

4. Performance of AV Content by Platform

This section profiles the economic performance of Canadian- and foreign-controlled distributors in terms of audience and revenues generated by platform, i.e. for theatrical release, home video, and television (pay-TV, specialty-TV, and conventional TV). Some context to this data is based largely on interviews of distributors, and to some extent on the literature review. The market shares for French- and English-language feature film productions are highlighted, illustrating the starkly different performances of feature films on different exhibition platforms for each.

Further detail and analysis on revenues by platform is provided in the Economic Profile (Appendix A, Section 3), drawing on data from Telefilm, MPTAC and CAVCO).

4.1 AV Distribution Revenues by Platform

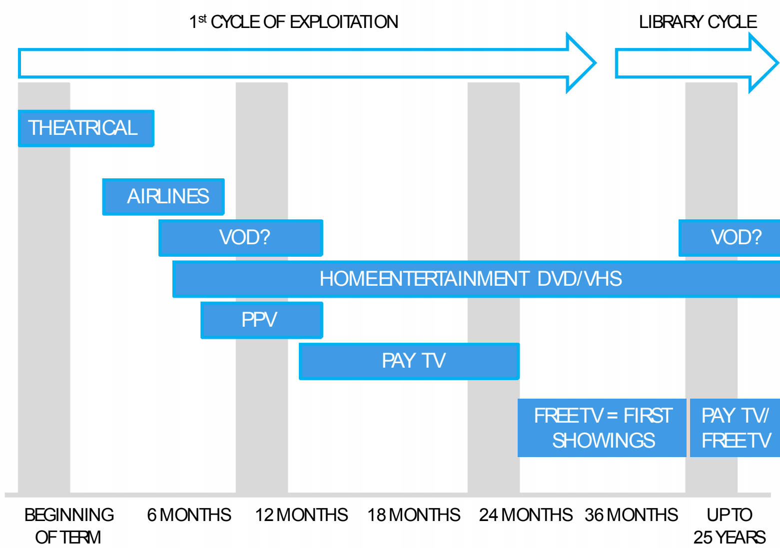
From Statistics Canada historical data, we can disaggregate the domestic AV distribution revenues for all forms of content by platform of distribution, namely:

- Theatrical: e.g., through exhibitors such as Cineplex, AMC and Cinema Guzzo.
- Specialty-TV (numerous channels) and pay-TV services: e.g., SuperÉcran, Movie Central and The Movie Network.
- Conventional TV: e.g., through broadcasters such as the CBC, CTV, Global TV, TVA and SRC.
- Home video and other: e.g., bricks and mortar DVD retailers, airlines, hotels and online sell-through platforms.

This set of data captures both feature film and TV programming content, but only where that content has flowed through an AV distributor in Canada. It is logical, for example, that the theatrical platform is composed entirely of feature film content revenues, while home video is predominantly, but not exclusively, features as well. AV distributor revenues from TV programming will be reflected mainly in the broadcasting platforms: specialty- and pay-TV and conventional TV – while TV revenues are also important for feature films and are compiled within the figures for distributors. The "other platforms" also capture film content and television programming revenues (if they flow through an AV distributor). Throughout this section, revenue data is reviewed alongside research and interview findings.

The exhibition windows depicted below represent an organized, traditional linear model, where each window enjoys a degree of exclusivity – and so business models have been developed to generate revenues in each window.

Figure 7 Traditional windows of exploitation



In this model, it is highly efficient for feature film distributors to demand and gain rights to sell across all Canadian windows and platforms, as such a deal would maximize distributors' flexibility in the exploitation of a given product across a number of platforms for a specific length of time.

A review of the revenues as they are split among platforms is highly revealing as to the relative importance among platforms. As reported in Section 3, the overall revenue picture for distributors has been quite stable, resulting in a 2.5% growth (non-inflation adjusted) over the period from 2003-2009 from all distribution activities in including wholesale and other revenues. However, as shown in the domestic revenues by platform figures below, there is a great deal of relative change in the revenue categories of that overall revenue picture.

The 0.5% compound annual growth rate in revenues from the theatrical platform suggests a stable, if flat; market for the cinematic exhibition of feature films (Table 6).

The "break-even at best" principle for the theatrical window, however, translates into more distributors (across Canada, but more specifically in Québec) considering the advantages of taking select films directly to the home entertainment window or DVD. Québec-based producers, for example, suggest that just 15-20% of films are successful theatrically, and say they are open to exploring new release strategies with distributors (this notion is discussed in more detail in Section 5).

The conventional TV revenue category has climbed steadily, and in fact has overtaken theatrical exhibition to the point in 2009 where it is 75% more than theatrical. While the latter category has not grown, it has remained relatively steady over that period. This growth in conventional TV programming represents the annual increases in sales of US TV programming to private broadcasters. Very little of it is the sale of Canadian programming since, as explained in Section 2, the rights to original Canadian programming are not sold by distributors.

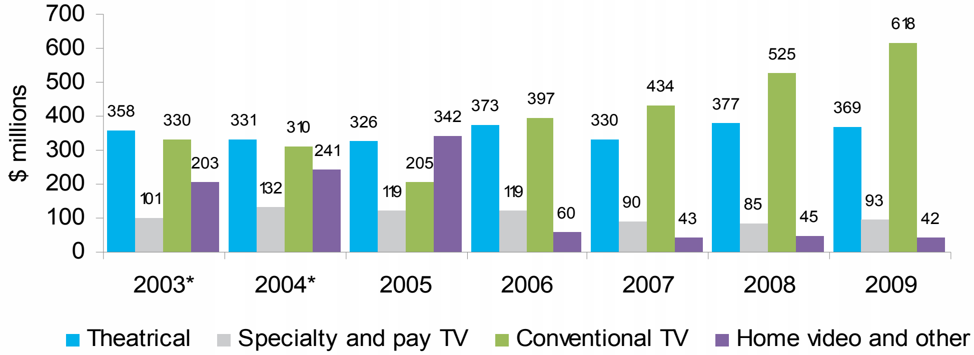
The surprise of the figures may be the steep decline in home video, which does not reflect the home video retail sales trends. There is a decline, but not the precipitous drop shown in 2006 (Figure 10, Table 7). Rather, this drop may be overstated as a result of the classification and data issues explained in greater detail in Appendix A.[35] Distributor interviews further contrast the severity of the drop and suggest that Canadian distributors have not yet experienced the "bottom fall-out" of the home entertainment market, as has occurred in the US. One large distributor described the platform's revenues as closer to a "levelling off" and only just entering year-on-year declines. This distributor believes DVD is simply a maturing technology and observes that Blu-ray sales have defied the trend and continue to grow. The growing popularity of TV content on home entertainment platforms such as DVD and Blu-ray was highlighted by distributors as a welcome growth area in recent years. There is a general expectation that these sales will transition to digital platforms such as iTunes and Netflix in the same vein as feature film content.

It is interesting to note that at the same time as those sales were being accounted for outside the distributors' purview, the conventional TV and other categories largely picked up the slack to sustain the overall revenues of AV distributors in Canada.

[35] Interpreting the Statistics Canada data on AV distribution involves three challenges: 1) a change in methodology resulting in the need to generate backcasted data for 2003 and 2004. The backcasted data is Statistics Canada's "best estimates"; 2) in 2007, it was discovered that a major Canadian-controlled AV distributor was excluded from the sample. Information from this distributor was subsequently requested for 2007 and 2008 and backcasted two years – to 2005; 3) during this period, Canadian-based distributors became their own wholesalers in dealing with large-scale retailers, meaning the revenue was not recorded by platform ("Home video") but by business line ("Wholesaling"). These factors make it difficult to analyze trends across the 2004/2005 divide.

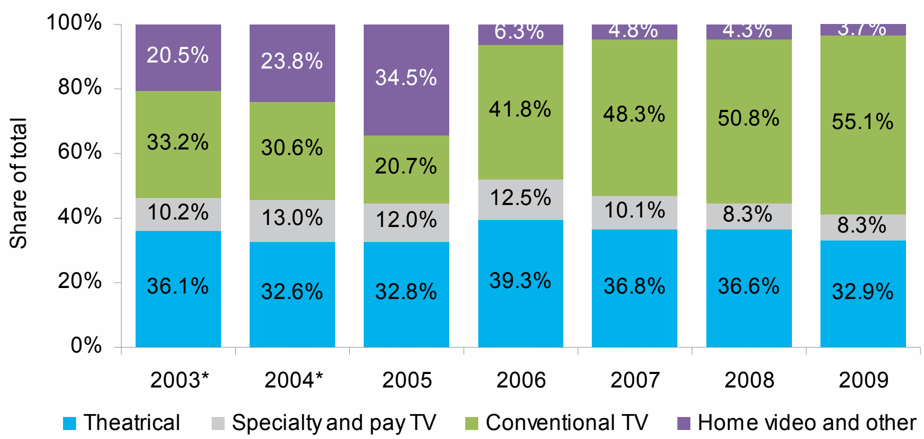
Revenues from All Productions – Canadian and Foreign

Figure 8 Revenues by platform, all productions, 2003-2009



Source: Statistics Canada; *backcasted

Figure 9 Share of total revenues by platform, all productions, 2003-2009



Source: Statistics Canada; *backcasted

Table 6 Total domestic revenues by platform, all productions, 2003-2009

	2003*	2004*	2005	2006	2007	2008	2009	CAGR † 2003-09
	($ 000s)							
Theatrical	358,457	330,654	325,524	373,140	330,485	377,459	369,000	0.5%
Specialty TV and pay-TV	101,151	132,039	119,097	118,881	90,438	85,302	93,410	-1.3%
Conventional TV	329,668	310,387	204,829	396,678	434,017	524,794	618,256	11.0%
Home video and other	203,347	240,924	342,032	59,657	43,125	44,841	41,590	-23.2%
Total	992,623	1,014,004	991,482	948,356	898,065	1,032,396	1,122,256	2.1%

Source: Statistics Canada; *backcasted; † CAGR – Compound annual growth rate

4.1.1 Performance of Canadian Productions by Platform

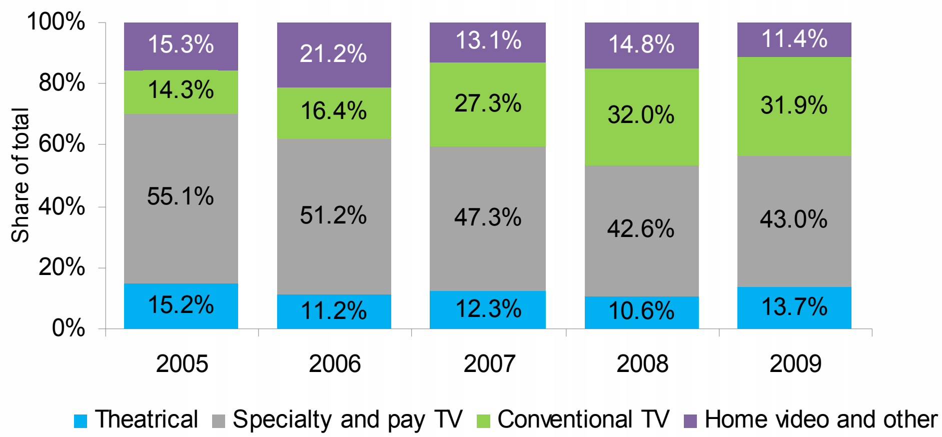
To explore the profile for Canadian distributors further in terms of which market represents their best sales, we reviewed the performance of Canadian productions by platform, i.e. the revenues attained by these productions for distributors operating in Canada. Table 8 and the chart in Figure 11 below disaggregate Canadian distributor revenues by platform for solely Canadian productions – mainly derived from Canadian-controlled distributors.

The total distribution revenues for Canadian productions remained relatively flat between 2005 and 2009, with just 1.2% compound annual growth with no inflation adjustment. However, the theatrical platform constituted just 13.7% of total distributor revenues on Canadian productions for 2009, while theatrical revenues for that year were $12.4 million – higher than any previous year since 2005, but a negative compound annual growth rate of -1.4% over a multi-year timeframe (Table 7). This lack of growth signals the continued challenge of theatrical success for Canadian productions.

From 2005 to 2009, specialty-TV and pay-TV accounted for the majority of revenues for Canadian productions: 43% in 2008 and as high as 55% in 2005 (Figure 11). The composition of content acquired by broadcasters through distributors was both TV programming and feature films. Thus, it is a much bigger market than feature film theatrical runs, as Canadian programming expenditures (CPE) on pay and specialty channels was up from $735 million in 2005 to $1.1 billion in 2009 (according to the CRTC). The 5% compound annual negative growth rate of Canadian productions for specialty- and pay-TV services as a market for Canadian product is startling in that context (Table 8). This decline is a frustration for distributors who suggest that over the last ten years channels that were once predominantly feature film platforms, now regularly buy headliner TV series – both Canadian and foreign. Original Canadian television content, as explained in Section 2 is, for the most part, no longer sold through a distributor, but rather commissioned from the producer.

The growth of the conventional TV market for distributors marks a bit of a contradiction - especially since the total revenues from conventional TV broadcasters are two to three times more than theatrical and have been growing at more than 20% per annum during that period. Again, the sale to conventional TV broadcasters comprises TV programming as well as feature films, i.e. a much larger pool. As a percentage of the total Canadian programming expenditures this amount is relatively small. In 2009, for example, expenditures on Canadian productions by private broadcasters were $176 million, more than six times the distributor revenues from conventional television in the same year.[36]

Figure 10 Share of total revenues by platform, Canadian productions 2005 to 2009



Source: Statistics Canada

Table 7 Domestic revenues by platform, Canadian productions, 2005-2009

	2005	2006	2007	2008	2009	CAGR† 2005-09
	($ 000s)					
Theatrical market	13,147	11,558	11,160	11,228	12,414	-1.4%
Specialty- and pay-TV	47,607	52,702	42,839	45,181	38,838	-5.0%
Conventional TV market	12,335	16,829	24,662	33,883	28,814	23.6%
Home video and other	13,241	21,816	11,817	15,691	10,350	-6%
Total	86,330	102,905	90,478	105,983	90,416	1.2%

Source: Statistics Canada; † CAGR – Compound annual growth rate

4.1.2 Performance of Foreign Productions by Platform

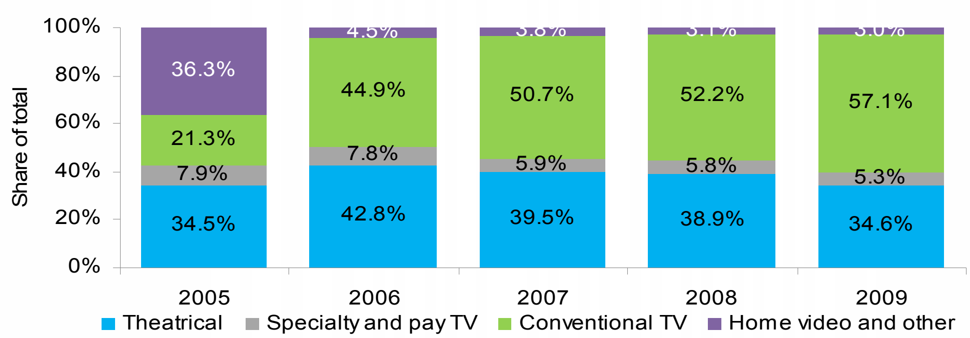
[36] *Profile 2010*, "Expenditures on Canadian Independent production by private Canadian broadcasters", p.48.

Table 9 and the chart in Figure 12 below represent distributor revenues by platform for solely foreign productions. The total distribution revenues for foreign productions remained relatively flat between 2005 and 2009, with just 0.8% compound annual growth.

In contrast with Canadian productions, theatrical revenues derived from foreign productions increased at a compound annual growth rate of 4.2% between 2005 and 2009. Theatrical revenues on foreign productions command the second largest share by platform as compared to third largest (or second smallest) for Canadian productions (Figure 11, Figure 12).

As with Canadian productions, from 2005 to 2009 conventional TV was a major growth area for AV distribution revenue from foreign productions – achieving a compound annual growth rate of 37% (**Error! Reference source not found.**). The source of this increase, for either Canadian or foreign productions is not entirely clear nor is it corroborated by interviews. Similarly, the sharp fall in home video licensing, again, may be overstated due to the previously mentioned inconsistencies in distributor reporting as raised by Statistics Canada.

Figure 11 Share of total revenues by platform, foreign productions, 2005-2009



Source: Statistics Canada

Table 8 Domestic revenues by platform, foreign productions, 2005-2009

	2005	2006	2007	2008	2009	CAGR† 2005-09
	($ 000s)					
Theatrical market	**312,377**	**361,582**	**319,325**	**366,231**	**356,586**	**3.4%**
Specialty and pay TV market	**71,490**	**66,108**	**48,049**	**54,409***	**54,572**	**-6.5%**
Conventional TV market	**192,495**	**379,849**	**409,355**	**490,911**	**589,443**	**32.3%**
Home video and other	**328,790**	**37,912**	**30,858**	**29,150***	**31,239**	**-44.5%**
Total	**905,152**	**845,451**	**807,587**	**940,701**	**1,031,840**	**3.3%**

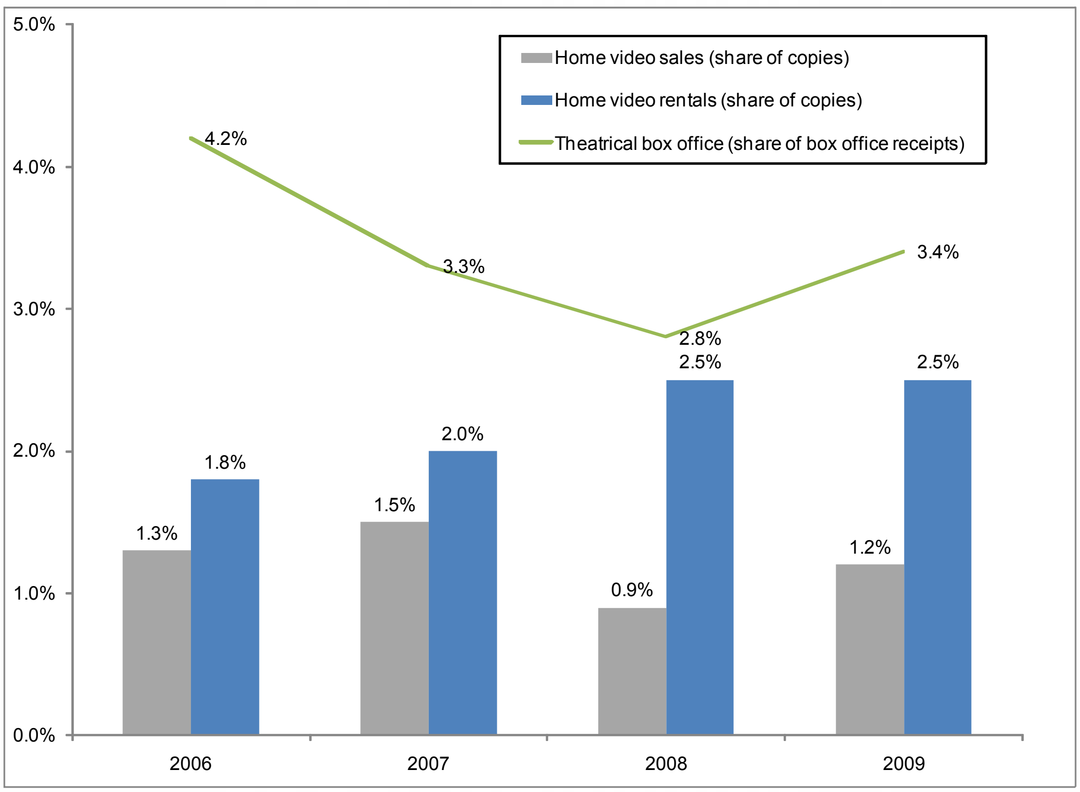
Source: Statistics Canada; † CAGR – Compound annual growth rate

4.2 Distinct Audience Consumption Patterns: French- and English-Language Markets in Canada

The *Profile 2010: An Economic Report on the Canadian Screen-based Production Industry*[37] highlights the differences between the consumption patterns for audiences of Canadian feature film in English- and French-language markets in Canada. The distinctions point to the relative value of different platforms to distributors of French- vs. English-language feature films.

First, we examine the overall exhibition preferences of the market by comparing the market share statistics for home video windows and the Canadian theatrical box office. Figure 13 shows Canadian feature films' box office market share above its share of the home video segment in Canada. That is to say, between 2006 and 2009, the market share of Canadian feature films, as measured by copies sold or rented, was lower than the overall share of box office revenues in Canada captured by Canadian feature films.

Figure 12 Market share of Canadian feature films in Canada, home video vs. theatrical box office



Source: Department of Canadian Heritage analysis of data from Nielsen VideoScan (sales) and Rentrak Corporation (rentals).
Note: Home video sales market share based on share of top 3,000 feature film titles that had theatrical release; home video rentals market share based on share of top 400 feature film titles that had theatrical

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37 *Profile 2010: An Economic Report on the Canadian Screen-based Production Industry*, CMPA/APFTQ and Canadian Heritage.

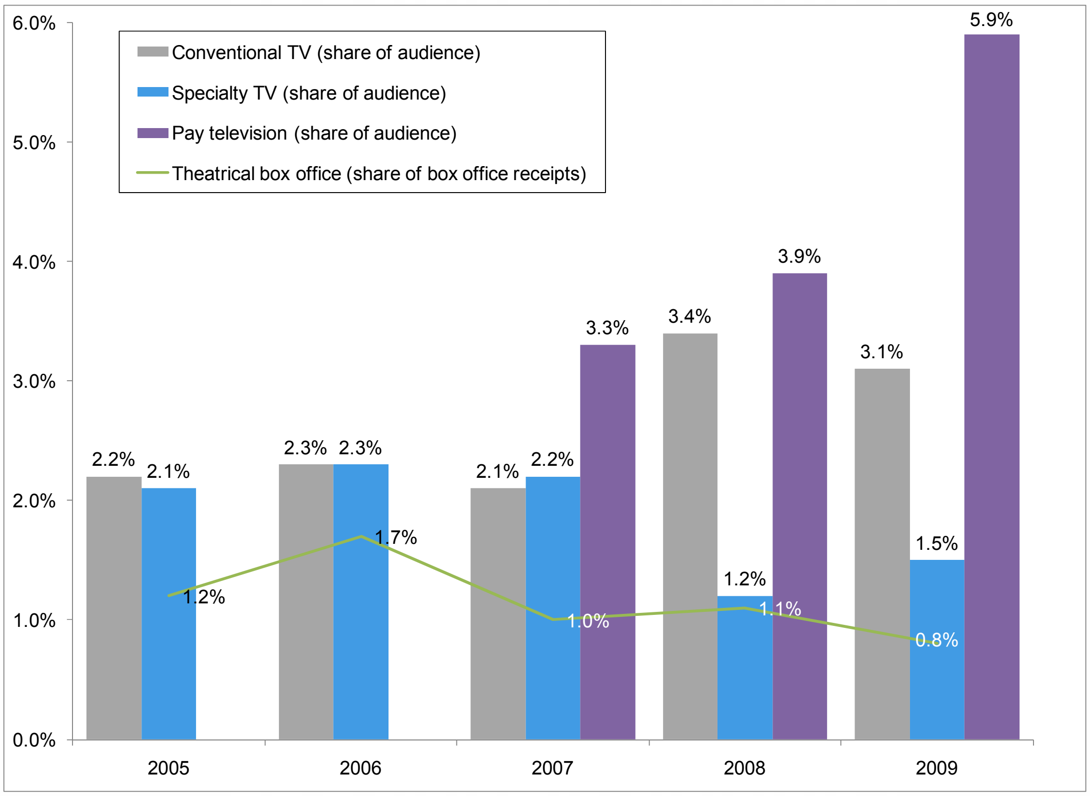
release.

Once split by language of exhibition, however, the audience shares exhibit very different patterns.

4.2.1 English-language Feature Films Audience Performance by Platform

Between 2006 and 2009, audiences for English-language Canadian feature films were greater in terms of market share for conventional, specialty and pay television platforms than the theatrical box office platform (See Figure 14). In other words, English Canadian films are finding audiences in television, far above what they find in the theatrical exhibition window. This result is particularly apt for pay-TV last year, as the audience vaulted ahead – relatively speaking – for Canadian features.

Figure 13 Market share of Canadian feature films exhibited in English in Canada, television windows vs. theatrical box office



Source: Department of Canadian Heritage analysis of data from BBM Canada.
Note: Conventional TV market share based on share of audience to top 500 feature film titles that had theatrical release; specialty TV market share based on share of audience to top 600 feature film titles that had theatrical release; pay-TV market share based on share of audience to top 500 feature film titles that had theatrical release.

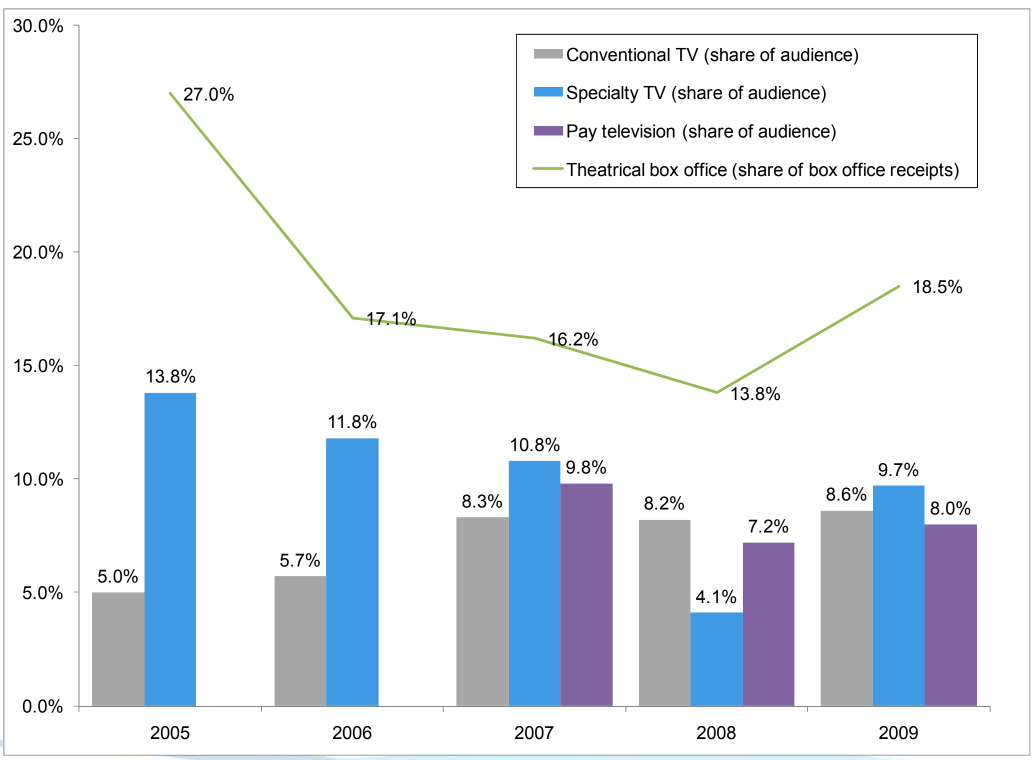
In particular, as shown in the aforementioned *Profile 2010*, Canadian feature films captured higher audience shares on all the TV platforms. In the extreme case in 2009, for example, Canadian feature films exhibited in English on pay television captured an audience share that was more than seven times the market share of Canadian feature films exhibited in English at theatres in Canada (Figure 14).

The comparison of audience shares in the theatrical and television platforms suggests that Canada's content regulations in the pay, specialty and conventional television segments contribute to building audiences for Canadian feature films. In the theatrical segment, where cinema owners face no exhibition requirements for Canadian films, market share has consistently been lower than in the television windows where there are exhibition requirements.

4.2.2 French-language Feature Films Audience Performance by Platform

As described in the previous section, Canadian English-language films find a larger audience via television platforms than through theatrical exhibition. As expected, Canadian feature films exhibited in French on Canadian television captured higher audience shares than Canadian feature films exhibited in English. However, in contrast to the Canadian English-language films, the audience share for Canadian French-language films on television platforms were lower than the market share earned for Canadian French-language films at the theatrical box office (Figure 15). In other words, more French-language audiences are watching Canadian films in theatres but, perhaps as a result, there is less of an appetite or market for the content down the line in the home entertainment and television windows.

Figure 15 Market share of Canadian feature films exhibited in French in Canada, television windows vs. theatrical box office



Source: Department of Canadian Heritage analysis of data from BBM Canada.

Note: Conventional TV market share based on share of audience to top 500 feature film titles that had theatrical release; specialty TV market share based on share of audience to top 600 feature film titles that had theatrical release; pay-TV market share based on share of audience to top 500 feature film titles that had theatrical release.

One small Québec-based distributor interviewed believes that, despite evidence of box office success, the supply of French-language films in Québec is too great for the availability of venues in which to exhibit, making some films difficult for distributors to place theatrically. On the other hand, a representative of an independent cinema chain in Québec observed anecdotally that blockbuster foreign films, exhibited in French, are simply not as successful in the French-language market as compared to the same films in the English-language market across Canada. This exhibitor was quick to point out that the lack of success is not for a lack of promotion, however, as blockbuster campaigns tend to start months earlier than either Canadian English- or French-language productions. While Québec-based distributors enjoy some audience advantages over their fellow Canadian distributors who are aiming at English-language markets, interviews suggest the French-language theatrical market is still intensely competitive and revenues therein have to be earned.

Risk for French-language distributors is particularly front-heavy in this regard, as the possibility of downstream revenue, based on audience figures, is lower. However, the relatively better performances of French-language films in theatres suggests that distributors, theatre chains, and the Québec publicity machine work well together in generating high box office numbers.

Distributors in each market must balance very different revenue stream opportunities, trends, risks, and audience desires in order to succeed with the Canadian productions they acquire and distribute. The performance by exhibition outlet (or platform), however, differs significantly and may herald different outcomes for each market's relative success in the new distribution platforms. Any reduction in cinema audiences would hinder the performance of French-language feature films, while any diversion of audiences from TV to the unregulated online environment (or to the on-demand yet regulated VOD services) could weaken the performance of English-language films.

4.3 Behind the Numbers – How Distributors Generate their Revenues

Having described the results of the activities of distributors and AV products in terms of revenues and audience generated, it is useful to go behind the numbers and describe in more detail how distributors generate their revenues. Because of the relatively larger role distributors have in theatrical exhibition, where they are the only conduits to the theatre chains, we concentrate on feature film distribution.

Distributors negotiate directly with the cinema chains and independent theatres on everything from revenue share splits, trailer exposure and even the posters displayed in cinema lobbies. Distributor interviews reveal that the terms of these agreements vary a great deal depending on: a) the type of theatre; b) the individual film; and c) the eventual box office performance. Distributors can, for example, negotiate stronger terms for stronger box office performances, but will lose share for poorer runs.

As Canada's English-language theatrical market is still largely dominated by a single chain in Cineplex, many distributors are not truly in a position of power in these negotiations. Foreign-owned distributors can exert more influence as they can leverage the major releases they have in the pipeline. Theoretically, output deals with the American classics distributors (and formerly the mini-majors) aid Canadian distributors in the same way. One large distributor's average theatrical deal structure settles around 46-48% of box office revenues for the distributor, though this can drop to as low as 43% for a poor performing film.[38] Between 2003 and 2009, theatrical distribution revenues in Canada for foreign productions were consistently around 40% of the total cinema box office earned by foreign films in Canada. Over the same period, theatrical distribution revenues for Canadian productions were more volatile, ranging from 24.8% to 43.2%.[39]

The last ten years have not drastically altered the percentage of theatrical revenues allocated to distributors, though exhibitor and distributor negotiations are on the verge of change. For example, most Canadian cinemas are embarking on the transition from physical to digital prints. This shift was anticipated to result in lower costs for distributors in servicing the often unprofitable theatrical window (where physical prints are expensive and difficult to manage, the digital print requires less investment by distributors). Digital print fees, already in effect in the US, are anticipated to come online in Canada in 2011. Digital print fees are the contribution distributors must make to help major exhibitors transition to digital and will neutralize distributor cost-savings for the near future. Higher ticket prices for 3D may also add to the complexity of the distributor-exhibitor deals.

According to distributor interviews, most medium and large distributors in Canada obtain the largest returns in the home entertainment window, while smaller distributors are more likely to split revenues evenly between television and home entertainment. A healthy home entertainment window is vital for distributors because, according to one large distributor, it is where they "make full fees". As you travel further down the windows, gross revenues decline but net revenues, and profitability, go up.[40] This financial arrangement is the essence of the distributor business model, and a part of why Canadian distributors believe it is so crucial that distribution of content onto new platforms continues to flow through them. One broadcaster calls it the "wobbly economics" model of placing a lot of promotional emphasis and spending early – hoping for returns later in higher margin windows. Overall, however, the home entertainment market is embarking on a challenging period and further declines are anticipated in the near future. While electronic and digital sales are growing rapidly,

38 Though the structure of the deal may change over time, it is interesting to look back to a report from 2000 which states: "While there is no standard contract in the industry, a distributor will typically get 30-35% off the top of box office revenues. In addition, the distributor will recoup its marketing and related expenses, as well as its minimum guarantee. As a rule of thumb, this implies a distributor will typically receive about 40% of box office revenues."

39 Source: Statistics Canada and MPTAC; with more detail in Appendix A: The Economic Profile, Section 3.1.1 Total Domestic Revenues of Distributors in the Theatrical Exhibition Segment.

40 This profitability margin, as we will see later in the study, is one area of tension in the new platform reality.

they are still too small to bridge the gap created by an overall decline in physical copy sales.

As explained in Section 3, most original content gets to TV broadcasters without passing through distributors. As discussed earlier in this section, TV revenues form over half of distribution revenues, especially from conventional television acquiring the Canadian rights to US TV shows. Nevertheless, it can be an important market for library Canadian product for the pay- and specialty-TV and conventional TV markets. Because Canadian content is a requirement for TV broadcasters, the study team obtained some feedback from broadcasters saying that distributors of that product sometimes gave the impression that Canadian content should therefore sell itself – in contrast to distributors of foreign product who take the time to understand the broadcaster's audiences and the programs and films that would appeal to them.[41]

4.4 Marketing and Release Strategies for Feature Films

Because marketing and publicity campaigns are a crucial aspect of the role and expertise of feature film distributors, it is useful to expand on how the release strategies are executed. Such campaigns are key factors for box office success of any given film, by raising awareness and attracting audiences to feature films, first in the theatres and eventually in home entertainment. As already observed, theatrical success is the major driver of revenues from platforms downstream, but this success is an enormous challenge for distributors, particularly for Canadian films and particularly for English-language Canadian films. New release strategies by broadband platforms for niche and art-house films include bypassing the theatrical window altogether, but more on these strategies in Section 5.

Marketing campaigns typically consist of trailers distributed through movie theatres, on television, and online channels; outdoor poster campaigns: print ads in newspapers (weekly, daily, national and local) and glossy magazines; publicity interviews and magazine stories (much of this may be spillover US activity). It is vital to find the right balance of media to use in a marketing campaign for a film, i.e. a hook for one's target audience and an appropriate budget to make the desired impact. One Canadian exhibitor of primarily English-language feature films believes that, "Creating awareness in the marketplace is a very expensive proposition" and notes that, for the most part, "Canadian movies are made and marketed with smaller budgets and are trying to vie for the audience's attention against movies from around the world that have huge budgets attached to them." The exhibitor suggests that small production and marketing budgets create major difficulties when it comes to attracting audiences to Canadian movies, "or any independent movie for that matter."

[41] One TV channel executive, for example, criticized distributors in that respect. When asked to contrast Canadian and Hollywood distributors, he explained, "Canadian distributors don't take the time to look at programming, don't understand your wares, they haven't looked at the TV schedule." His belief was that the distributors sometimes think, mistakenly, that because they have Canadian content to offer, and the broadcaster needs Canadian content to schedule, the deal is all but guaranteed.

Budget is indeed important; however, the size of a marketing budget alone will not drive audiences to the theatres. The careful design and implementation of successful marketing campaigns is a complex endeavour and an area where distributors' must continually develop their expertise and take risks as they test the effectiveness of new trends in reaching audiences.

Small, medium and large distributors described different ranges of typical marketing spend. One small distributor, for example, budgets between $15-30K to spend on prints and advertising per film. This distributor will, however, examine each production individually and allot more or less funds depending on the production. The same flexibility applies to medium and large distributors, though they begin with far more substantial marketing budgets. One large distributor, for example, divides marketing campaigns into the following marketing budget categories: 1) $80-100K; 2) $200K; 3) $1-2 million; and, rarely, 4) $2.5-3 million for a major release.

A large Québec-based distributor described its average marketing spend as anywhere between $80-100K and up to $1 million for a major film. More information and analysis on these budgets is available in the Appendix to this report. To get a sense of the split within the categories, one large distributor described the marketing mix for a major Hollywood summer release (with a younger target audience) as two-thirds TV advertising (including radio, newspaper and online), one-fifth poster advertising, and 10% on publicity and promotional expenses. The total budget in question was $1.5 million. The marketing strategy is the same for Canadian and foreign productions in terms of the fact that the budget is based on the expectations of the film's performance. A film's production budget is one variable factored into decisions regarding levels of marketing spend – release schedule, competition, expectations and targets all form part of the strategy. Canadian films are judged alongside foreign films and so must survive in a highly competitive landscape.

In 2003, Telefilm increased its emphasis on marketing activity reporting and prints and advertising (P&A) spending, shifting the focus away from acquisition and development support through MGs. Since then, required deliverables for distributors to obtain funding have included a detailed marketing plan. Telefilm evaluation criteria introduced in 2005-2006, targets CFFF productions most likely to achieve the box office objective and considers: box office expectations, the detailed marketing plan, the size and strength of P&A commitment, the distributor's risk and track record. The shift from MG support, that included partial subsidies, to recoupable marketing support, increases the up-front risk for distributors. The message from small, medium and large distributors in interviews is that while they appreciate the P&A funding, as it allows them to take more aggressive positions on marketing campaigns, it is not enough of an incentive to persuade them to take a risk on a Canadian film that they would not buy otherwise.

Best practices for marketing strategies (put forward by distributors and producers) include maintaining a constructive and collaborative relationship between distributor and producer, mounting a comprehensive, planned marketing campaign, timed-to-perfection (release patterns, ambient activity, hooks), with a clearly identified target audience and strategy for reaching it. The best marketers will think beyond the theatrical life of the film, through to home entertainment, electronic sell-through and television windows. Key materials and artwork such as stills, posters, and trailers must be ready, of excellent quality, tailored for the Canadian market (date, time, language) where possible and actively exploited. One medium-sized distributor, as explained previously, argues that in many respects costs are actually higher when marketing Canadian films as compared to foreign productions because the material must be produced from scratch, rather than inherited from the foreign producer or distributor, and there is no guarantee of spillover exposure from US promotional activity on talk shows, magazine covers and more.

More than one producer and distributor raised the point that, in some respects, large distributors have lost aspects of their marketing expertise, because they regularly repurpose and adopt the campaigns that are devised by their US partners in the major output deals. As a result, when it comes to designing a bespoke campaign for a niche or independent Canadian film, they may not have the skills or imagination to execute it. Producers, both young and established, admitted to taking on many marketing responsibilities for fear that the distributor would not pay adequate quality attention to their production.

Multiple stakeholders pointed to the stronger star system in Québec as part of an explanation for its box office success in Canadian cinemas. One large distributor said not only are there more outlets, shows, magazines and newspapers to target for coverage or to place advertising in, but there is also a genuine interest in the stars. In English Canada, he exclaimed "We don't even have the Mike Bullard show anymore!" Another large distributor pointed to the fact that Québec stars cross more easily between media and can succeed on the radio, in television, and on stage, without sabotaging the success of their feature film careers. In interviews, one large Québec-based distributor and an independent Québec-based exhibitor both described the need to concentrate on local differences when marketing a feature film. No single marketing formula or prototype will lead to success. Marketing efforts must be tailored, not only by demographics but also by region. This emphasis on the "local" is highly relevant to films that need to be marketed in entirely different ways in regions of the English-language market and in the French-language market (i.e. mainly Québec) – if a national market for the film exists in the first place.

Posters and theatrical trailers for upcoming Québécois movies dominate most theatre lobbies and screens in Québec. One interviewee suggested that instituting a quota system for lobby cards and on-screen trailers in the English-language market might be a relatively painless way of enhancing film marketing for Canadian films outside Québec.

4.4.1 Film Festivals Effect on Marketing

A question arises as to the role and value of film festivals on the marketing and promotion of feature films, given the public and industry support they have received over the last few decades. Over the last 15 to 20 years, international festivals and markets grew to become critical deal-making events for content producers and distributors alike. However, in 2009 the media blamed the recession for the lack of deals made at Cannes and TIFF, but it is possible the recession simply masked a greater change in the industry. Festivals, according to a *Playback* article are "only one of the many interesting conduits for a distributor that covets Apple and Xbox as key retail partners."[42] While this comment was made in 2009, it is likely more valid today as the potential from other platforms grow.

The value of the major film festivals is as a marketplace - a source of product where distributors can access and purchase rights and an access point to reach potential international buyers (for Canadian films). They are potential drivers for international sales if they gain exposure for international distributors. While not directly related to distribution, festivals are also a means for early career producers to gain some exposure and attention for their next project.

In terms of helping build box office results, film festival exposure typically has little impact on domestic box office performance of a film. TIFF, one of the most important festivals on the global calendar, can be an efficient lure to attract major American stars that might otherwise not come to Canada to promote a film. These visits are enormously expensive, however, and can involve large entourages.

The best case scenario according to distributors, for Canadian and non-Canadian films, is that the festival creates a halo effect of publicity around a film, a sort of multiplier effect on the publicity you would typically expect. This PR boost is generated at enormous cost, however, and occurs in a crowded window. Consider the 2010 festival opener, for example, the already-mentioned *Score: A Hockey Musical* premiered at TIFF on September 10th. Distributed by Mongrel, the film opened across Canada on October 20th and was a disappointment at the box office, earning only $300,000. When the distributor's wider release is even further away from the festival, the effect of the initial publicity coverage will likely have been diluted. One major Canadian exhibitor admits that inclusion in film festivals has "very little" influence on its decision to place films in its theatres.

Distributors do not receive box office revenues for film festivals; generally speaking, it represents a cost whether in the form of a handling or administration fee or more substantial charges. One small Québec-based distributor raised the possibility that film festivals can have a negative market impact in that they absorb vital space in an already crowded theatrical market in the province. Film festivals appear to contribute to the already difficult task of placing films d'auteur or independent features in Québec's theatres. Then again, others argue that on the smaller scale, there is power in the niche, genre-led (sci-fi, LGBT) or foreign (e.g. Italian, Spanish, Asian) festivals that can deliver the exposure, buzz and audiences which can help distribution.

[42] "Maple Pictures: Number three with a bullet", *Playback Online*, August 31, 2009.

4.4.2 Findings: Performance by Platform, Audience, and Marketing

The above analysis of the economic and audience performance by platform and the characterization of the way in which distributors undertake their marketing functions suggest the following findings:

1. Conventional television has been growing rapidly as a revenue source for distributors – including foreign- and Canadian-controlled, while theatrical and pay- and specialty-TV services have changed little in the aggregate sense.
2. For Canadian productions (mainly by Canadian-controlled distributors), theatrical revenues hover around 12-15% of the total revenues for Canadian productions, while around half their revenues are derived from the pay- and specialty-TV markets.
3. In fact, pay- and specialty-TV markets have declined relatively for Canadian productions – from 55% in 2005 to 43% in 2009. In 2009 the total value derived by distributors for pay and specialty productions was about $39 million out of the total of $90 million for all platforms. This figure is relatively small when compared to the over $1 billion spent by Canadian pay- and specialty-TV licensees for Canadian content in 2009.
4. The situation was quite different for foreign productions, which generated $357 million from theatrical release, $589 million (up from $192 million in 2005) from conventional broadcasters, and only $55 million from pay- and specialty-TV markets.
5. With respect to audiences for Canadian feature films, the theatrical market is generally about twice the size of television and home video for French-language films. In contrast, for English-language films, television is higher – especially pay-TV – though home video is lower.
6. The marketing and promotion environment is quite different in English- and French-language Canada. The tools and applications such as trailers, review coverage and print advertising overlap, but are exploited differently in each market to achieve desired results. These diverse vulnerabilities have an impact on theatrical success, revenues on downstream platforms, as well as distributor profitability.
7. Overall, marketing approaches and release strategies for feature films need to evolve as the distribution platforms evolve. It raises the question of which partner will carry out the marketing function for future content that crosses multiple platforms. Traditionally a function of distributors, content producers and broadcasters, future marketing and promotion activity may be undertaken by a new breed of experts.
8. Festivals play a unique role in the business of film and TV production, especially for foreign distribution, but typically have no pronounced effect on the domestic success of distributor efforts.

5. Evolving Business Models: Online Distribution in TV and Film Content

This section reviews the current trends in the development of new electronic platforms and the consequent rapid evolution of distribution options. Part of this review includes an examination of the repositioning of major stakeholders and the new business arrangements that are upsetting long-standing business models and traditional relationships between producers, distributors and broadcasters. In so doing, this section makes reference to publicly available forecasts to underscore the potential scope of the general trends outlined.

The section presents an overview of the changing structure of the AV distribution sector in Canada, reviews the key new actors in this changing system, and finally outlines a number of issues critical to the continued evolution of AV distribution in Canada. Finally, the section provides a summary of the impact of the discussed changes on the AV distribution system in Canada.

5.1 Changing Industry Structure: Evolving Market Structures and Distribution Platforms - From Old World to New World

As described in Section 3, the traditional role of a distributor for the two main AV product forms – feature films and TV programming – has been as follows:

Feature films

- Feature film distributors have acquired rights from producers (or foreign distributors) for domestic theatrical release, home video, PPV/pay-TV, and conventional television – in an orderly release window.
- Such distributors have also undertaken marketing programs to promote the theatrical release to the audience; the success, or lack thereof, of the production greatly affects its home video and subsequent TV sales.

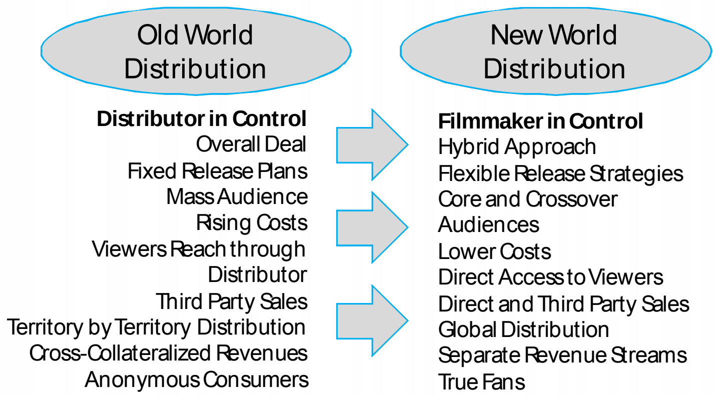
TV programming

- Distribution of Canadian productions has been largely producer-broadcaster driven, whereby original programming is commissioned by broadcasters from producers, and the broadcaster increasingly acquires all digital rights for the Canadian domestic market.
- Distributors have exploited library product (i.e. previously aired programming for which they have the rights) to sell to TV markets. Sales channels have included specialty-TV services, syndication in the US, home entertainment markets and other foreign broadcasters and distributors.

These traditional business arrangements have, however, been disrupted by the game-changing shift away from a linear model of distribution to a non-linear one. The central element of this shift is the move from scheduled exhibition of content (as in conventional television) to an on-demand environment. The repercussions arising from this change include an apparent decrease in the amount consumers are willing to pay for content (e.g. in part because of the suggested perception that Internet content is free, the desire for evidence of additional value before paying and the proliferation of free, cheap, *à-la-carte* content online); a breakdown in the traditional rights windows of exclusivity; and changes in stakeholder roles and responsibilities.

More than simply facing the challenge of new technologies, distributors are being forced to embrace a new mindset of distribution. Peter Broderick, an American AV distribution expert, describes the market as shifting from "Old World" to "New World" distribution, and categorizes the two worlds as follows:

Figure 14 Old vs. new world distribution[43]



The "New World" presents many challenges and threats to distributors in Canada, but it also offers opportunities including, though not limited to, extending the reach and viewership of Canadian content both within Canada and abroad. These opportunities (and threats) will be expanded upon in the next section of this report (see Section 3 – AV Distribution Market Analysis).

5.2 Changing Industry Structure: New Platforms and New Tensions in Release Windows

Generally, there are two categories of 'new' platforms:

- **Old World Devices, New World Applications:** Extension of conventional television, specialty-TV channels, pay-TV and pay-per-view (PPV) to subscription on-demand (SVOD) and VOD services that are delivered on the BDU infrastructure (via cable, DTH, and the more recent entry of IPTV and to a limited extent fixed wireless.
- **New World Devices:** Emergence of the broadband Internet infrastructure where content can be downloaded for subsequent play, or watched live through digital signals "streamed" to the user online. The Internet platform is provided by Internet Service Providers (ISPs), which can deliver to fixed locations (over copper, fiber, and twisted pair copper, as well as fixed wireless), and to the

[43] Broderick, Peter, "Welcome to the new world of distribution", indieWire, September 2008.

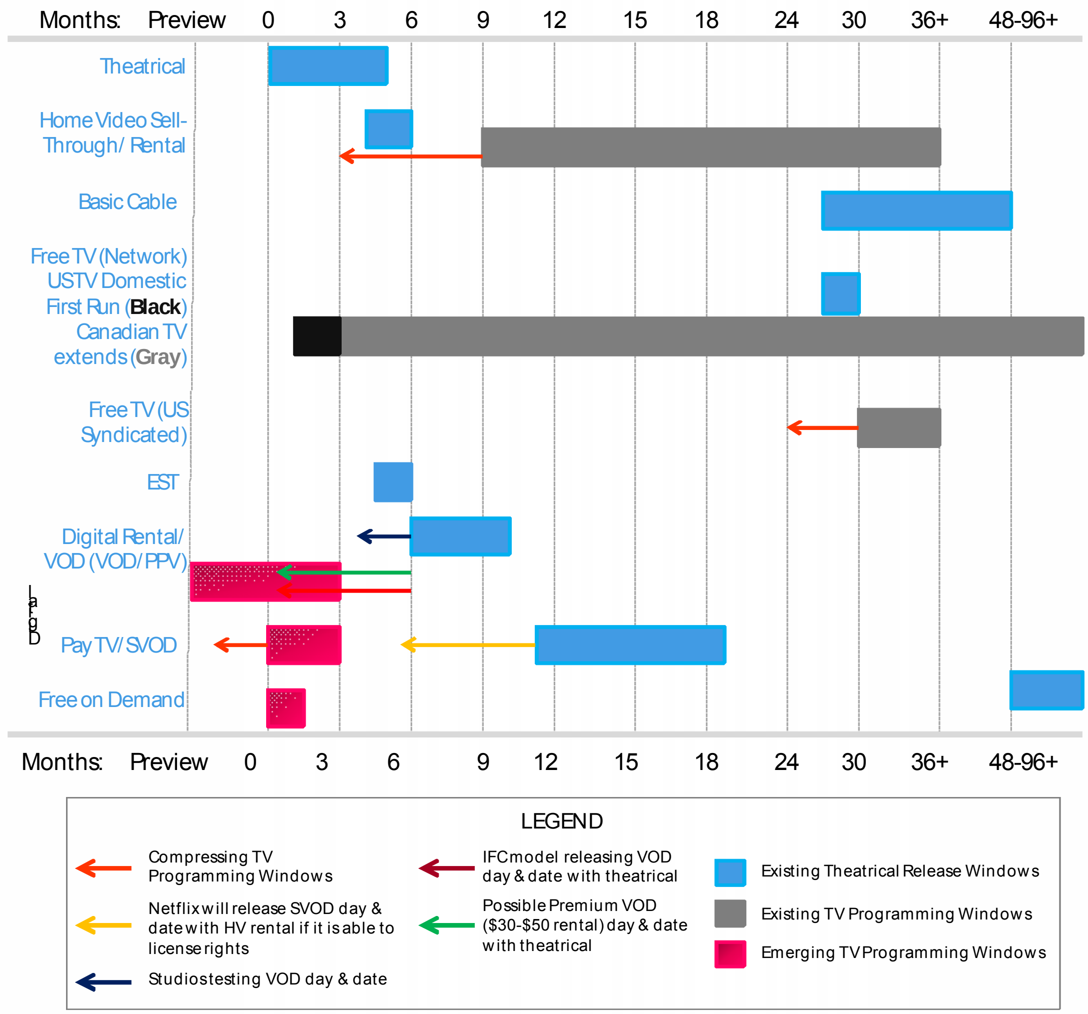
extent of their bandwidth capabilities to mobile platforms (smart phones, tablets and other smaller screen sizes).

One of the challenges in the industry is the lack of consistent definitions for any of these new platforms. One highly experienced TV executive jokes, “The nature of the rights you are buying has changed. You need an AV dictionary to keep up.” As such, the industry would likely benefit from a common, consensus-developed taxonomy for digital forms of distribution. For example, VOD is both a form of service (the platform-agnostic ability to view or order a video at will), and it is also commonly used to denote the VOD service available from digital cable TV providers (e.g., Rogers on Demand). Such distinctions can have profound impacts on how potential services and revenue sources are viewed and reported. In this instance, because the term first arose from the digital cable TV industry, it commonly refers to the narrower TV definition, but is equally applicable to other on-demand video delivered on the Internet (web) and mobile devices (e.g. smartphone).

Even within the BDU component of the TV environment, cable and IPTV providers have developed varied meanings for VOD. Indeed, a particular channel may have a dedicated VOD option (usually without incremental purchase costs). In other cases, TV service providers have dedicated VOD options (which are usually offered on an *à la carte* basis). Titles are available either free (Free-on–Demand or FOD) or for a fee, T-VOD (Transactional VOD) or *à la carte* VOD. Understanding the various meanings of VOD is a critical first step to understanding how to exploit IP using that “window”. In short, while the concept of video-on-demand is relatively simple, the term can take on numerous meanings depending on the context of its use.

The following graphic, reproduced from the study, *Towards a Framework for Digital Rights*, depicts the dynamics of the evolving windows of distribution, including new platforms such as video-on-demand, subscription video-on-demand and electronic sell-through (which is itself called by different terms, e.g. “download to own”). Note that in Figure 16 the arrows indicate the observed pressure to change the duration of the exhibition windows.

Figure 15 Dynamics of current and evolving windows for theatrical and television releases[44]



A consequence of these pressures is the need to "manage windows of exploitation in an orderly fashion and to discourage certain players (new or incumbent) from cannibalizing potential revenue streams in an attempt to grab or hang on to market share."[45]

The compression of release windows and the drive to cannibalize markets have had a major impact on distribution. For example, the theatrical window no longer enjoys total exclusivity ahead of the TV, on-demand and online distribution windows. One example of this challenge is the film of the bestselling book *Freakonomics*, which was available to download on iTunes one month ahead of its wider theatrical release. Similarly, the popular UK cinema chain Odeon declined to screen Tim Burton's 3D *Alice in Wonderland* when Disney (the studio producer and distributor) demanded a shorter period of

[44] CFTPA|ACPFT, *Towards a Framework for Digital Rights*, June 2010.
[45] CFTPA|ACPFT, *Towards a Framework for Digital Rights*, June 2010.

exclusivity for the cinema exhibition window – 12 weeks instead of the usual 17.[46] Disney wanted to advance more quickly to home entertainment, taking a major risk that the shortened theatrical boost –which is typically a major indicator of a production's downstream commercial success – would be adequate, advancing to a profitable window more quickly.

Likewise, in October 2010 Mongrel Media announced a deal with Netflix whereby Mongrel would release nine films to appear simultaneously in theatres and online in the Canadian market, and just a week later on DVD and Superchannel – a strategy based in part on the audiences sought and partly on economics. Film critic Liam Lacey posits that "art films rely on reviews, not advertising. With individual print costs of up to $4,000 for a European subtitled film, and publicity costs running much higher, it is just not profitable to screen these niche films in many theatres."[47] Distributors are also experimenting with releases for established blockbusters. In 2011, the film *The Social Network* returned to 600 North American theatres on January 7, just four days before its scheduled DVD launch. Admittedly, this move by worldwide distributor Sony Pictures Releasing (Columbia Pictures in the US) was perceived as a tactic to enhance the film's chances in the Hollywood awards season. Nonetheless, viewers are becoming more accustomed to non-traditional and non-linear releases for feature films.[48] For distributors, alternative strategies may not prove to be effective revenue generators, but the results of the experimentation will be revealing and offer firms an opportunity to embrace the changing dynamics of "New World" distribution.

5.3 Changing Industry Structure: New Platforms, Distribution Arrangements and Value

The table below presents a summary of the definitions and business models of new digital platforms, as derived from a combination of expert insight, interviews, and the CFTPA's on digital rights.

Table 8: Most common windows of exploitation for digital rights

Name	Definition[49]	Business Model for Distribution
Electronic Sell Through (EST) (sometimes known as "Download to Own" or DTO)	A sale. The digital sale of a program that can be accessed on demand via the Internet, mobile and cable in perpetuity for unlimited viewing in exchange for a transactional fee. It is most commonly described as an extension of the home video or DVD window and as such, EST revenue potential can be	**Pay model**: The consumer pays an incremental charge to view a program, for a pre-determined amount of time (e.g., 48 hours). The charge is added to customers' cable TV or credit card bill. **Revenue Share:** The Digital Service Provider (DSP) generally takes between 30-50% - e.g. Apple's revenue share terms are generally 30:70, in favour of the content owner/distributor; however, most independents are required to go through a third party aggregator to get on to iTunes. The Apple aggregator (in Canada could be: E1, Mongrel, Maple, Warner, Vivendi, etc.) takes a cut ranging from 15%

[46] BBC.co.uk, "Alice in Wonderland will not be shown in Odeon cinemas", Feb. 24, 2010.
[47] Lacey, Liam, "The web is the new art-house cinema", *The Globe and Mail*, Oct. 21, 2010.
[48] Egan, John, "The Social Network Coming Back to Theaters on Jan. 7", *Technocrati*, Jan. 5, 2011.
[49] CFTPA|ACPFT, *Towards a Framework for Digital Rights*, June 2010, p.8.

Name	Definition[49]	Business Model for Distribution
	cannibalized if the same title is offered on free online platforms, typically illegally.	and up. The filmmaker or 3rd party distributor receives the balance after costs. **Example:** The upfront cost per new unit on iTunes can range from approximately $800-$1,000. Based on a selling price of $9.99, the distributor needs around 150-200 units sold via iTunes to break-even (depending on the retail price and revenue share split).
Electronic Rental/Video-on-Demand (VOD)	A rental. The digital rental of a program that can be accessed via the Internet, mobile and cable on demand for a limited period of time in exchange for a transactional fee.	**Revenue Share**: As above, but the typical split with Canadian cable and IPTV VOD providers is 50:50. The distributor or aggregator takes its fee. And the balance flows back to either the filmmaker or smaller distributor who has contracted with a bigger distributor as aggregator to the BDUs. **Example:** If a movie rents for $4.99, then the BDU retains $2.50 and the distributor or rights holder gets $2.49. The split may vary depending on the content, overall deal and who covers the cost of encoding the film. Hollywood studios might command better revenue share deals than other rights holders.
Subscription Video-on-Demand (SVOD)	A subscription. Gives digital access on-demand to a variety of programs for which the viewer pays a periodic subscription fee rather than a per transaction fee. Shaw Cable's SVOD, Netflix's "Watch Now" and 3UK are cable, Internet and mobile examples of SVOD.	The monthly SVOD service, or subscription, can be a consumer pay service, or provided free by the Digital Service Provider (i.e. either the ISP or the BDU), where it has acquired unlimited viewing rights to the programs. In Canada, SVOD is most commonly offered as a benefit of a premium movie subscription (e.g. TMN or MovieCentral). **Revenue share:** The monthly subscription fee is commonly split between content provider and the digital service provider. In the USA, where ad-supported models are more common, either the ad revenues generated are split with the distributor or the distributor is given a percentage of the inventory to generate sponsorship or advertising revenues. Where an offering makes up several content providers, allocation of the SVOD revenues is generally allocated based on a proportion of inventory that each content provider makes up as a part of the overall offering. **License fee:** In this model, the digital service provider pays the content provider a flat license fee for unlimited viewing of the program with their SVOD service for a predetermined period of time (the term), and within specific geographical boundaries (the territory).
Free-on-Demand (FOD)	Provides on-demand access to programs at no cost to the viewer. Most FOD services are advertiser supported. Hulu (USA) and Shaw's Free Zone are two examples.	Customers have access to a number of film and television programs to view on-demand at no charge to them and can be referred to as Ad Video-on-Demand (A-VOD). In Canada, the CRTC has restricted ad-supported VOD.

It is currently very difficult to obtain precise data on the value of the new digital platforms. Canadian feature film distributors, for instance, typically assign digital revenues to existing business product lines, such as the home entertainment stream, or the television markets. Until the revenues from these platforms become more substantial, distributors have little incentive to separate them out into the detailed categories depicted above.[50] One large distributor, for example, categorizes both VOD and online revenues as TV Home Entertainment; while another distributor allocates all non-traditional revenues into the "television" revenue category, while deeming electronic-sell-through delivered via iTunes to be "DVD" revenues. One large distributor explained that in recent years, the business has wasted time creating revenue categories for platforms that never became material to the business. While electronic and digital sales are growing rapidly, as yet they are still too small to bridge the gap created by an overall decline in physical copy sales.

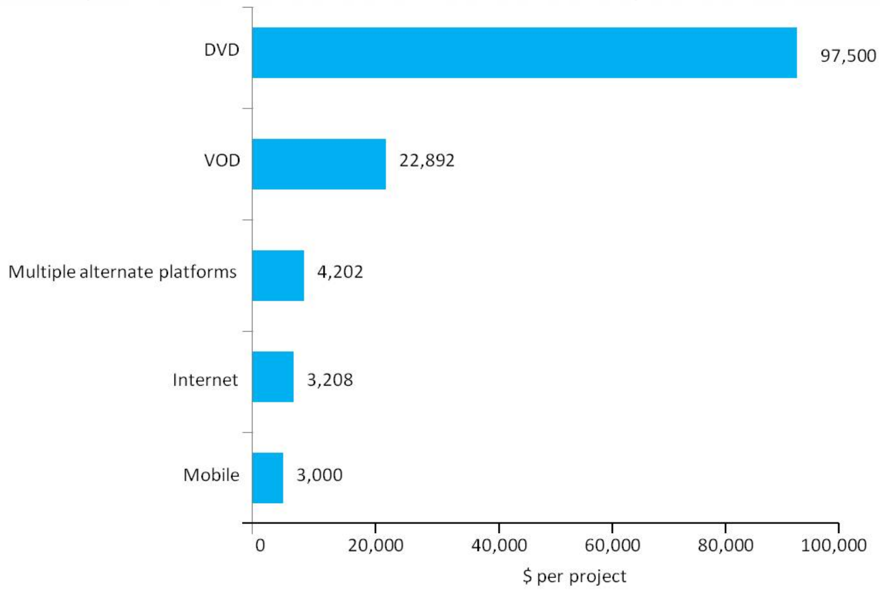
Yet there are indications that the revenue potential is not trivial. One broadcaster representative confirmed that online streaming profitability is growing and that it "has more demand than they can handle" when it comes to advertisers' appetite for online ad-buys in episode streaming. The broadcaster is reluctant to offer content to Netflix, where the episodes will be available without commercials, explaining, "We don't want to start competing against ourselves." Similarly, the broadcaster must balance the content it offers to iTunes, with what is available via its on-demand partnerships with BDUs such as Rogers.

More than one Canadian television producer expressed frustration at both broadcaster and distributor claims to have 1) expertise in online platform distribution, and 2) expertise in interactive digital content. Producers report that they receive little data or performance measures to back these assertions.

Recent data from the CTF (depicted in the chart below) provide some useful indicators for the current value of new digital platforms for TV programming (on a per project basis). While the license fees for alternate platforms can vary widely, CTF statistics point to very low averages for digital platforms, including the Internet and mobile. DVD and (to a lesser extent) VOD remain more important than other newer platforms. These figures also indicate very little premium for a multiple-platform license.

[50] For example, one medium-sized distributor estimated that digital revenues of all categories were only 2% of current business.

Figure 16 Average license fees for alternate broadcast rights, 2009-10

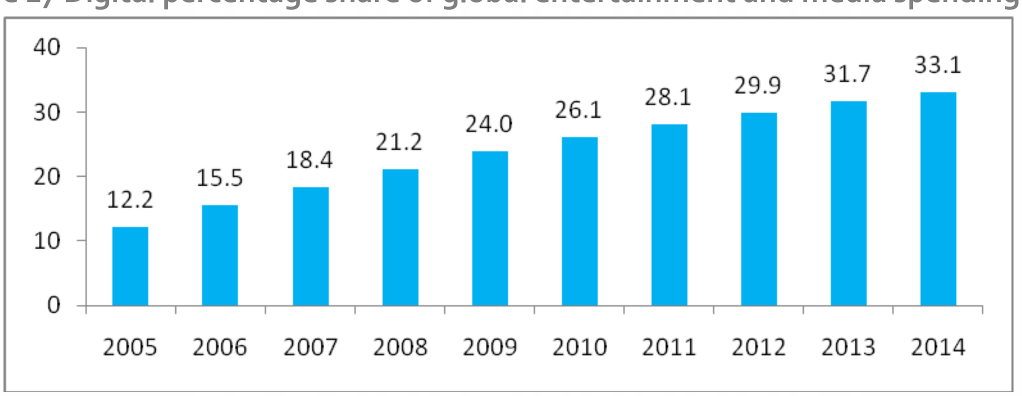


Source: Canadian Television Fund (graphic is from *Profile 2010: An Economic Report on the Canadian Screen-based Production Industry*)

Note: These amounts only account for explicit upfront license fees paid to producers; they exclude the value of revenue-sharing arrangements or other forms of rights compensation. Alternate platform licensing and rights data were reported on a voluntary basis and therefore may under-report actual alternative platform activity among CTF-supported projects.

While the value of digital markets is not yet large, digital content forecasts show that it is projected to grow at a rapid pace. According to PricewaterhouseCoopers' *Global entertainment and media outlook 2010-2014*, in 2009 digital platforms spending accounted for 24% of all entertainment and media spending, up from 21% the previous year. This share is forecasted to continue to rise, reaching 33% by 2014, which constitutes a projected compound annual growth rate of 12.1%.

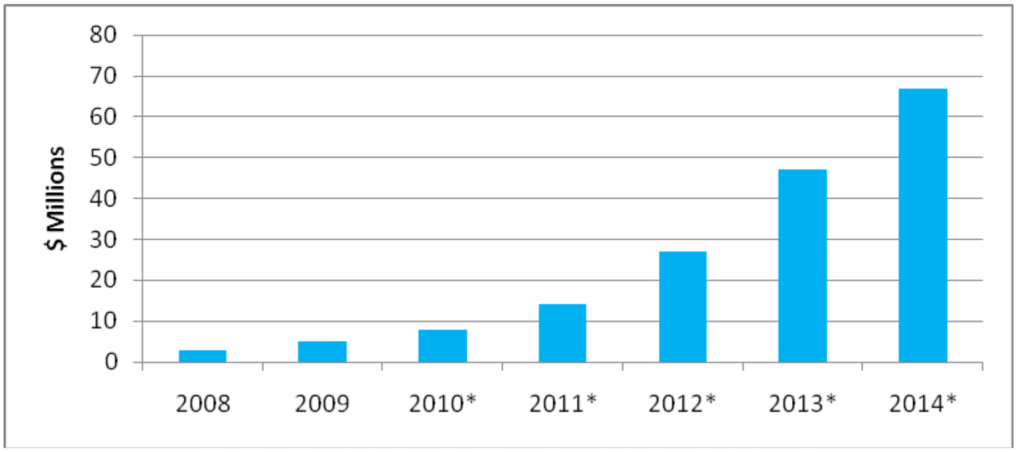
Figure 17 Digital percentage share of global entertainment and media spending



Source: PwC *Global entertainment and media outlook: 2010-2014*

Similarly, PwC forecasts strong growth for the future of paid digital downloads in Canada:

Figure 18 Paid Digital Downloads in Canada, 2008-2014



Source: The Globe and Mail, based on PricewaterhouseCoopers' data
* forecasted;
N.B. does not include streaming

While digital platforms will grow in terms of their value as markets, there is also an exponential growth of AV content available – both legally and illegally. One effect of this flood of content is the lack of revenue and business performance predictability. There is some evidence that – because of this unpredictability – many producers and distributors in Canada are reluctant to "do deals", and it is at times easier not to do deals (and thus avoid the risk of making a "mistake"). This reluctance may also stem from having been trapped in unfavourable new platform and online deals in the early 2000s. Perhaps the best recent example of a deal struck hastily, and now regretted, is the 2008 agreement between the retailer Netflix and Starz allowing Netflix to stream movies from Sony and Disney. Netflix paid an estimated $25 million annually for the streaming rights to the films -- a tiny fraction of what cable and satellite companies pay Starz for the same content. As Starz and Netflix re-enter negotiations this year, analysts predict the content's value to be some ten times what it was in 2008.[51] In effect, Netflix's move to incorporate more online streaming into its business model, and thereby placing additional pressure on the DVD market, was not anticipated by content rights holders. Neither did cable companies foresee how a strong Netflix enables some viewers to 'cut-the-cord' more easily. The new reality, as Time Warner chief executive Jeffrey L. Bewkes explains is that, "Once you put [content] on Netflix, you can't really sell it anywhere else."[52]

Given the above-mentioned caution, one might conclude that Canada's smaller market and its history of greater reliance on support mechanisms have created a risk-averse

[51] Adegoke, Yinka, "Starz talks with Netflix weekly, no rush for new deal", *Reuters*, Jan. 5, 2010.
[52] Arango, Tim, "Time Warner Views Netflix as a Fading Star", *New York Times*, Dec. 12, 2010.

culture as compared to the US. Such cautiousness could hinder the growth and maturation of the Canadian AV market, perhaps leading to the continued ascent of US online retailers adding Canadian rights to their offerings and bypassing Canadian distributors by entering Canada electronically.

5.4 New Actors: The Rise of the Integrated Media/Communications Companies

In the new digital media landscape, the line between broadcasters and telecommunications companies (i.e. ISPs/BDUs) is blurring as market consolidation occurs. First, consolidation among broadcasting licensees in Canada has led to the greater involvement of broadcaster groups in exploiting content across their various TV outlets (conventional and specialty-TV services). It is a natural extension for broadcaster groups to control and exploit online platforms for the TV programming content they acquire.

Second, the major communications companies in Canada, which were commonly founded as cable or phone carriers, tend to own Internet, broadcast distribution and (increasingly) mobile infrastructure. Furthermore, the recent acquisition of the two major private broadcasting groups in the English-language market by Shaw and BCE has greatly increased vertical integration of broadcasting and communications. Such firms are becoming integrated media and communications companies, not defined by any single platform, type of content or delivery mechanism. Indeed, one could make the argument that Canada is rapidly becoming one of the most vertically-integrated countries in the developed world with respect to broadcasting and communications, ahead of comparative jurisdictions such as the US, UK and Australia.[53]

These vertically-integrated companies vie for consumer loyalty and attention by making their content offerings available on as many platforms as possible. As such, subscribers to a package of TV channels via cable, for example, are also offered access to content online and via mobile – as well as VOD. Rogers' coverage of the 2010 Vancouver Winter Olympics Games provides a good example of this type of multiplatform content offering. The operational objective is to maintain a relationship with the subscriber, and to extend that relationship across all platforms. Though they are few and of significant scale, Canada's vertically-integrated media companies face competition both from other integrated media/communications companies, and also from over-the-top (OTT) device and service providers.[54] These OTT competitors include iTunes, Netflix, and other services by which viewers acquire content; they also reach the consumer via broadband Internet.

Apart from appealing to subscribers' loyalty by providing *access* to content across multiple platforms, integrated media companies have begun to acquire rights to media

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[53] Nordicity, "Telus: Study of International Practices in Safeguarding Against Anti-Competitive Practices in Broadcast Distribution", 2010.

[54] Over-the-top television is television programming, movies, and video clips delivered to the consumer via the internet (broadband), bypassing traditional cable and satellite providers (CRTC, *Navigating Convergence*, February 2010). One exception in the communications landscape is Telus, which has no major content affiliations; as such, Telus argues for open platforms for accessing the content services over broadband.

content – whether directly for VOD, or for online distribution. In this way, they are now competing against the remaining traditional broadcasters.

Within these integrated enterprises, questions are being raised about whether the proper priorities for rights acquisition are in place. For example, David Purdy, Vice President and General Manager at Rogers Communications, acknowledged that Rogers was spending 92% of its programming/content budgets on linear television, and only 8% (roughly) for online, VOD and other content accessed on demand, i.e. non-linear platforms. As Canadians increasingly spend more time online, Mr. Purdy suggested that a realignment of Rogers' content acquisition priorities might be appropriate to match the offerings with the audience demand. From his perspective, the OTT competition was seeking to leapfrog over the regulated part of the content distribution (physical distribution) system, so it would be wise for an integrated BDU like Rogers to acquire more rights directly.

While mobile distribution for content is less well-developed and has some form factor limitations (e.g. smaller sized screens), it plays an increasingly important role in content marketing and distribution. For example, as part of the growing role of social media in the marketing and promotion of content, Twitter is emerging as the top referral method for content to friends, and mobile has a growing market share of Twitter traffic. YouTube is a core application on every smartphone and highly-integrated with social media. Additionally, all major TV programming brands are promoting themselves on Facebook and thus driving audiences, while Warner Bros. has announced it will begin testing movie rentals in the US through film Facebook fanpages.[55]

Impact on AV distribution

"We have no choice but to go digital," explained a small, Montreal-based distributor. However, what is meant by "going digital" remains unclear. How, for instance, should Canadian distributors work with the integrated media/communications companies and their OTT competitors?

Relationships with new AV distribution entities can be complementary and collaborative, as well as highly competitive. Speaking in October 2010 at MIPCOM (an industry forum), Lionsgate executive, Jon Feltheimer, counseled that creating "a patchwork quilt" of deals across a range of platforms is one way to unlock the elusive digital dollar. To that end, Feltheimer encouraged television representatives to form "sustainable partnerships with new media players like Microsoft and Amazon", in *addition* to retaining existing relationships with traditional players, saying: "We need to create relationships with people who install telephone lines and build mobile networks, relationships with people like billionaire Mark Zuckerberg who connects millions of people through bits and bytes."[56] One television and interactive content producer-distributor believes innovative, cross-sectoral partnerships are vital to success in the

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[55] Kroll, Justin, "Facebook friends Hollywood", www.variety.com, March 9, 2011.
[56] Clarke, Steve, "Feltheimer embraces the new at Mipcom", www.variety.com, October 5, 2010.

new distribution world, "I'm not saying we are going to become a toy company, games manufacturer or a book publisher, but I'm certainly going to talk to all of them."

In Canada, the vertically-integrated market leaders are (or will be) Rogers, Bell, Shaw and Videotron – although the latter two are more concentrated in specific regions (Western Canada and Québec respectively). As one small distributor commented, "We love our 'monopolies' in this country", and as such he stressed the importance of developing stronger relationships with content aggregators to access the VOD window in the hopes of gaining access to the growth area of distribution platforms. It is not clear, however, whether rights owners/producers would simply bypass the traditional distributor to make arrangements with the aggregator. In fact, this small distributor suggested that Rogers and Shaw are currently vying to be the leading brokers of exhibition and distribution in Canada and noticed that they are already referring to themselves as "distributors of content" in recent press releases.

With respect to feature films, integrated media/communications companies and their OTT competitors, such as iTunes and Netflix, are now acquiring product through Canadian feature film distributors. It remains, however, an open question as to how long this arrangement will last as aggregators become the new distributors and the primary focal point for distribution.

5.5 New Actors: The Changing Role of the Broadcaster

In this context, broadcasters typically seek to acquire all platform rights for original TV programming that they commission from independent producers. The CRTC has determined that broadcasters seeking to have their licenses renewed must first have in place a terms of trade agreement with Canadian independent producers. Digital platform rights are a chief point of negotiation; however, pending any such agreement, broadcasters are becoming *de facto* distributors for the digital platform exploitation of Canadian TV programming.

Some producers argue that broadcasters have not yet performed well in exploiting digital rights, and that some are "non-distributors" – they take no steps to exploit the digital rights once acquired. In remarks to a recent Toronto New Media "Zeros to Heroes" seminar, the executive director of the Bell New Media Fund, Andra Sheffer expressed some disappointment in the relatively low-level of digital rights exploitation with respect to the interactive component(s) of specific TV program projects. This disappointment was echoed by numerous Canadian producers.

The future of broadcasters as distributors is unclear as well, especially with respect to the imported US product. At present, Canadian broadcasters are either being denied the digital rights, or they are asked to pay premium prices for them. Indeed, it remains unclear whether US studio distributors will seek to optimize the value of their content by limiting Canadian broadcasters to linear broadcast rights.

Any weakening of value of the US programming would seem to benefit Canadian producers as broadcasters can acquire both linear and digital rights for Canadian content. Indeed, interviews reveal that where once Canadian broadcasters were uninterested in the "home entertainment" window for television programming, they are now almost seamlessly moving into that space as they regularly acquire ancillary online exploitation rights from TV producers. However, any weakening of the broadcaster position in the marketplace would ultimately limit their ability to pay the prices that they now do for Canadian programming licenses.

Globally, independent distributors (in other words non-studio distributors) account for 28% of the total $54 billion market, a significant market opportunity.[57] Further, some suggest that the global distribution market can expect to see enhanced growth of 3% to 4% per year through 2012, as "high definition DVD and video-on-demand full roll out bring (sic) some dynamism back to the home entertainment and TV-related markets."[58] This boost to the market may not be quite as evident for Canadian distributors, as we already have widespread HD VOD and pay-TV, but nonetheless there is the potential for a positive influence on profitability.

5.6 New Actors: "Over-the-Top" Online Services

In Canada, the integrated media/communications companies face increasing competition from (largely American) OTT service providers, including iTunes and Netflix, with the possibility of future competition from Hulu and Amazon (not yet available in Canada). These OTT providers compete with traditional distributors by accessing the customer through in-home devices, such as video game consoles, that can act as a gateway to the purchase of online products.

Netflix: Bringing Content Directly to Audiences

Generally speaking, Canada trails the US with respect to the introduction of new online digital services. That said, the US-based mail and online video content retailer Netflix has recently become available to Canadians, and theatre chain Cineplex announced a digital service that allows consumers to download movies from the Cineplex website directly to their PCs or Xbox 360 gaming consoles.[59] Among the online services for consumers in the US, Netflix leads the pack with over 12 million subscribers. It has extended its reach online through arrangements with cable operators' set-top boxes as well as media devices from Xbox 360, PS3, Wii, TiVO, selected TV sets, iPad and more.

On the distribution side, in the US, Netflix is working with studios to develop a new approach to distribution that is, in chief content officer Ted Sarandos' words, "win-win". In exchange for the expanded licenses and library access necessary to reach its customers online, Netflix has agreed to a 28-day window during which new release titles will only be available to download-to-own, not rent. This arrangement effectively drives sell-through potential for new release DVDs and Blu-Ray titles. As of April 2010,

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[57] Oliver & Ohlbaum, "From Middlemen to Mini Majors Prospects for global, independent film distribution to 2012", 2008.
[58] Ibid.
[59] Krashinsky, Susan, "Cineplex to unveil movie download service", *The Globe and Mail*, November 8, 2010

this window arrangement was in effect with Warner Bros., Universal Studios, and Twentieth Century Fox.[60]

In 2010, Netflix entered the Canadian market in a more limited way, by introducing online streaming of largely older library material. As yet, Netflix is not competing directly in Canada with theatres, home video, VOD, or pay-TV. Indeed, Netflix's activities may be helpful to its Canadian counterpart, Zip.ca (which has a modest subscriber base). Zip.ca's CEO, Rob Hall, explains that Netflix will help his firm "educate the market about why brick and mortar is dying in the US and why it will follow suit here in Canada, and we're the only game in Canada right now for mail... Netflix is going to introduce Canadians to streaming with the old movies, and we're going to be there to offer them the new ones." The new release market is the most competitive between Zip.ca, iTunes video-on-demand services offered by cable and telecom companies.[61] One could counter that it is likely that Netflix will not remain a library product service forever, as evidenced by recent deals with CBC, Cookie Jar and FremantleMedia Enterprises and deal extensions with New Video, Maple Pictures and Sony.

Theatrical exhibitors point out that, at this time, Netflix is currently concentrating on the "post-pay window", which they do not see as competitive with their lines of business. The "out-of-home experience," according to one major exhibitor, "continues to be the delivery system of choice for the majority of movie goers" in Canada. Yet, the Cineplex digital store will, like iTunes, sell movies that are downloaded and stored permanently on the user's computer and will also allow users to rent films for limited periods of time. Cineplex may target new releases primarily, effectively leveraging its brand as an exhibitor or it may also acquire rights to, and offer, library titles as well. Regardless, that an exhibitor is now embracing an OTT distribution play speaks to the dynamism of the markets, and level of experimentation taking place as the industry develops more ways to reach customers.

Canadian Distributor Relationships with OTT Distribution

To date, distributors are reacting positively to the advance of Netflix and iTunes into the Canadian market, at least in one significant respect. These international firms tend to deal directly through Canada's key distribution and media companies and not directly with individual independent producers. Logically, these large online service providers would prefer to deal with fewer distributors, in possession of larger libraries (i.e. aggregators), rather than myriad individual production companies. iTunes has established, for example, a list of preferred distributors from whom it will buy (including large content holders, such as the CBC). In addition, iTunes will only accept files sent through one of just three or four iTunes-approved encoding houses in Canada. This arrangement does, however, pose a barrier for some small producers and distributors and creates a small market for larger distributors or media companies to aggregate and distribute for third parties who cannot access iTunes themselves. Of course, content

[60] www.netflix.mediaroom.com

[61] "Bring it on, says Canada's Zip", National Post, September 22, 2010

providers have to abide by the terms set by Netflix and iTunes, as they have considerable market power.

One large distributor interviewed sees online services as a major threat to the pay-TV channels (e.g., Astral's *Super Ecran* and *The Movie Network*), though not to distributors. The biggest movie aggregators are foreign-owned, and could be displacing revenue flow from Canadian pay-TV services. Thus, broadcasters and BDUs, not to mention (mostly Canadian-owned) movie theatres, share some concern about this new form of competition.

Indeed, Shaw Communications executives recently appealed to the CRTC to regulate parts of the Internet alleging that online movie providers, such as Netflix, could undermine Canadian broadcasters' ability to pay for domestic content. As the *Globe and Mail* points out, "Netflix, Hulu, Google TV and others can distribute similar programming without any responsibilities to generate Canadian content, or pay into the fund that supports Canadian producers, actors, writers and directors."[62] The results of this debate have yet to be concluded, but will have a significant impact on the market for both Canadian distributors, and consumers.

So far, ISPs have charged extra for high bandwidth Internet accounts with larger downloading limits. As such, the real cost to consumers of streaming large amounts of content using Netflix, for example, may be much higher than the monthly $8 charge for the Netflix subscription and the cost of *à-la-carte* download purchases on iTunes.

The Particular Role of Apple's iTunes and Electronic Sell Through

In the OTT context, Apple's iTunes plays a particularly important role. One small distributor who has a relationship with iTunes is slowly making content available on the site. He explains that as the cost per unit for gaining access to iTunes is roughly $800, and iTunes takes between 30 and 40% of the retail rental price (which is typically set at $5). Therefore, this particular distributor's break-even point was the rental of approximately 275 units. The distributor is testing different films in different genres and audiences to educate himself about what works on the platform. Until he evaluates the return, he cannot say how important iTunes is to his business.

Producers, distributors and media companies agree that there is a lack of a widely competitive marketplace given iTunes' dominance. This lack of an alternative is a major threat to distributor revenues as they begin to see a decline in traditional home entertainment revenues (i.e. DVD sales). Without viable alternatives in electronic rental and sell-through, the losses in home entertainment are unlikely to be recovered from online platforms for some time.

Furthermore, the business models that will support online digital distribution remain unclear. One large distributor, for example, admitted to having chosen the "spaghetti on the wall approach" with regards to new digital distribution channels, and expressed

[62] The Canadian Press, "Companies like Netflix should be regulated by CRTC: Shaw", *The Globe and Mail*, Dec. 2, 2010.

a willingness to experiment with any reasonable market access point. A major broadcaster interviewed, on the other hand, believes it has moved beyond the experimentation phase and is now investing in the infrastructure to track and analyze performance across digital platforms more effectively. This broadcaster sees tracking of audience viewing and purchasing habits as a value add for independent producers who may not have access to the same data sources. Indeed, a lack of consistent reporting and analytics from broadcasters and distributors is a persistent frustration for many producers.

Another obstacle to success in digital sell-through is the 'warehouse effect'. Seemingly unlimited shelf space for video online, for example in the iTunes store, requires, "improving 'discoverability' tactics, better promotion, better search functions for video, more sophisticated ways to achieve visibility, and making video platforms more user-friendly."[63] While iTunes has a Canadian storefront, and carries French-language content, it has yet to develop a store-front explicitly for Canadian Francophones.

As digital innovation continues, the overall effect from the changing consumption habits remains uncertain. The appetite for media is not likely to decline; however, the firms that create, aggregate and/or deliver content to the consumer will face a significant change, with new entrants assuming (often new) gatekeeper roles, and traditional roles eroded. Taking advantage of digital platforms appears to be ever more critical for smaller distributors in order to remain viable. Finally, while some niche opportunities may be available to digital distributors to reach audiences and markets that would otherwise not be economically viable, such outcomes are not yet very common.

5.7 Key Issue: The Rights Race

In many respects, rights negotiations for new digital platforms have moved past their infancy and are mired in their tumultuous adolescent years. Prices and expected returns are unpredictable, the life span of new start-ups is uncertain and robust monetization remains the exception rather than the rule. In this environment, the distributor's risk mitigation strategy is to obtain all available rights, which holds especially true for digital rights. Indeed, one large distributor explained that it will not license a product without acquiring 100% of Canadian rights, saying: "We're paying the advance against *all* revenues; why would we pay for split rights?" Another large distributor concurred, explaining that "all rights" is the strategy. There are exceptions, but for today, 100% rights acquisition is the dominant strategy for large distributors in Canada.

Producers – particularly newer, smaller producers – believe they are at a disadvantage because distributors do not necessarily pay any more for a bundle that includes new platforms that the distributors may not be actively exploiting. That said, Canada's most established feature film producers are not quite as anxious about how distributors exploit digital rights, as their focus remains success in the theatrical window (ignoring digital pennies for analog dollars).

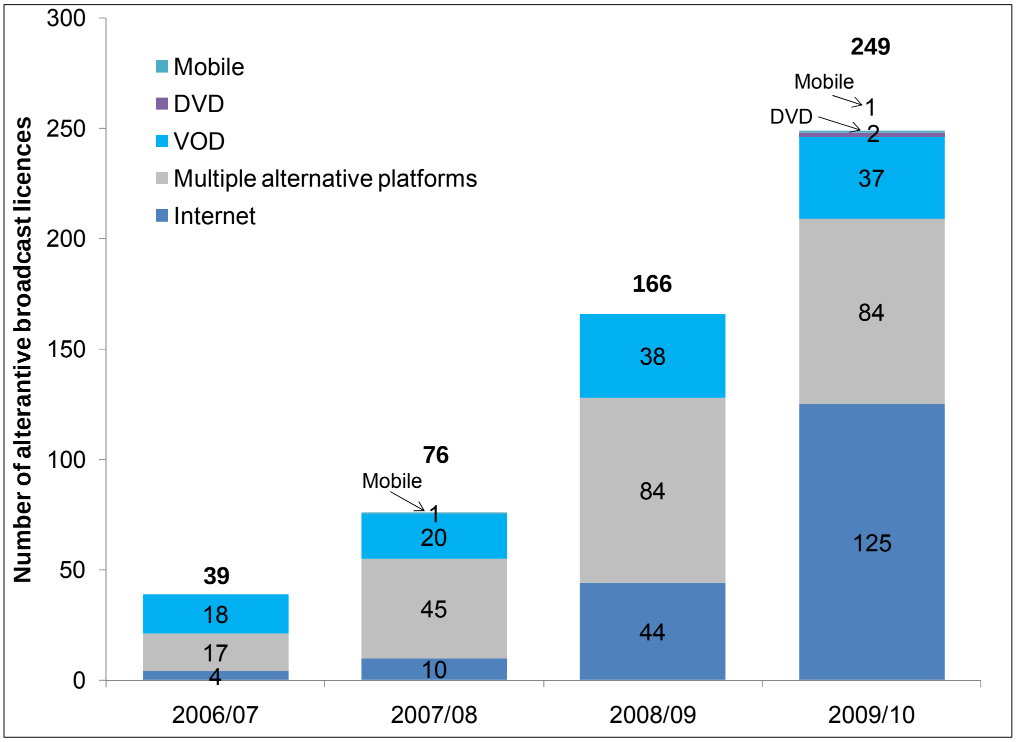
[63] CFTPA|ACPFT, *Towards a Framework for Digital Rights*, June 2010.

As online, mobile and on-demand technology improves, contracts are being re-written to reflect the changing nature of distribution and revenues. Producers want to see their content exploited skillfully across multiple platforms. They are often bound, however, by contracts that cover revenues generated by their content on all platforms, present and future, in all territories. Producers may want to hold back (some) digital rights from distributors; however, they may find they lack the bargaining leverage to do so. One large distributor confirms that the company is revisiting existing contracts to assert their claim to digital rights.

With respect to television, broadcasters typically have a relationship with producers of TV programming that mirrors the producer-distributor relationship in the feature film market. When broadcasters are able to acquire and exploit all rights (whether buying from the content creator or the distributor), it allows them to extend content beyond the traditional linear broadcast (i.e. from wireless, mobile applications and the website, but also to syndicated third party platforms, digital signage networks, cable distributors, broadband portals, etc.). For the rights holder, the issue may not be purely about revenues. Particularly for television content that may have a multi-year lifetime, there are other tradeoffs, including enhanced brand recognitions and the ability to reach a new demographic on their preferred platform of consumption.

CMF data indicates the growing importance accorded non-traditional rights markets. As the graphic below indicates, between 2006-07 and 2009-10, the number of alternative broadcast rights sought by Canadian distributors of CMF-supported programming increased from 39 to 249. Most of the growth in alternative broadcast rights concerned Internet distribution, but multiple platform distribution was also very common: about one-third of alternative broadcast licenses granted covered multiple-platform distribution.

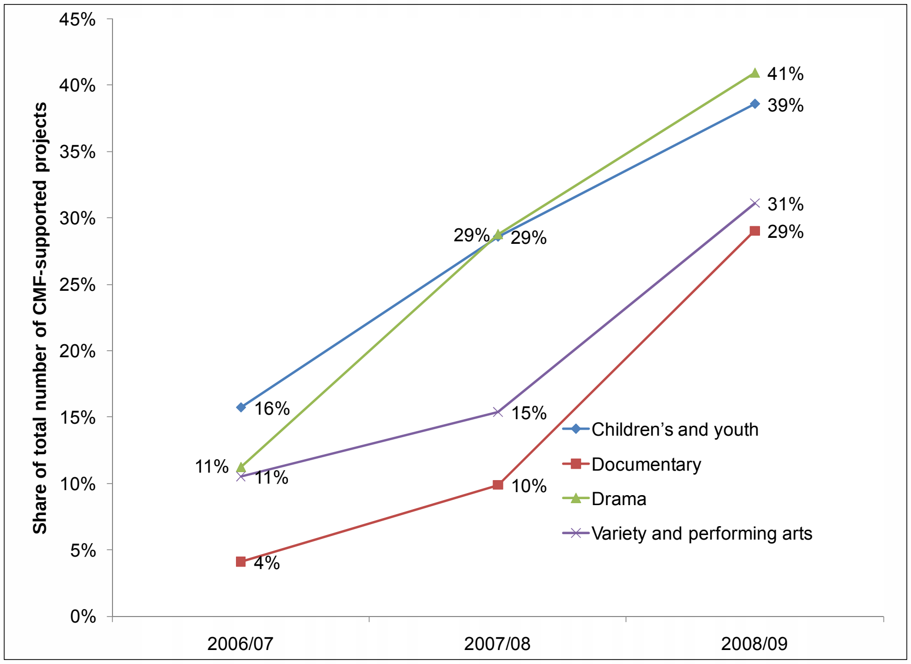
Figure 19 Number of projects with alternate broadcast rights, by type of platform



Source: Canadian Television Fund (graphic is from Profile 2010: An Economic Report on the Canadian Screen-based Production Industry)
Note: Alternate platform licensing and rights data were reported on a voluntary basis and therefore may under-report actual alternative-platform activity among CMF-supported projects.

As illustrated by the following graphic, CMF data show that the proportion of projects with an alternative broadcast license is growing across all priority genres. In the drama category, for example, the proportion of projects with at least one alternative broadcast license – whether Internet, multiple platform, VOD or other – grew from 11% in 2006-07 to 41% in 2008-09. Producers, broadcasters and distributors of children's and youth programming are also active in adopting alternative platforms. The adoption of alternative platform broadcast rights was slightly slower in the documentary, and variety and performing arts genres, but still strong.

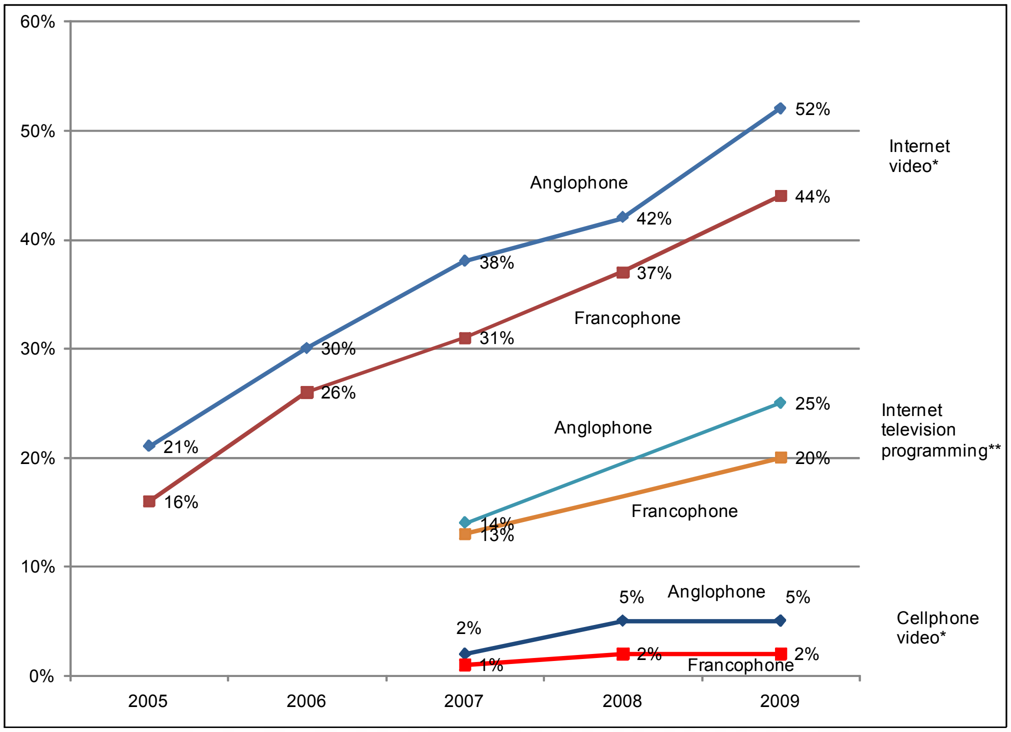
Figure 20 Share of CMF-supported projects with an alternative platform broadcast license



Source: Canada Media Fund (graphic is from Profile 2010: An Economic Report on the Canadian Screen-based Production Industry)
Note: Alternative platform licensing and rights data were reported on a voluntary basis and therefore may under-report actual alternative-platform activity among CMF-supported projects.

There are some differences between French- and English-language programming in terms of adoption rates for different platforms. As shown on the following graphic, the trend line is similar, but the French-language market lags the English-language adoption rates for Internet video (YouTube, etc.), Internet TV programming, and mobile viewing.

Figure 21 Adoption rates for Internet video, Internet television and cell phone video



Source: Media Technology Monitor 2009 (graphic is from Profile 2010: An Economic Report on the Canadian Screen-based Production Industry)
*Used in the past month
** Watched a TV program or clip from a TV program available on the Internet

At present, the beneficiary of the new platform rights seems to be the broadcasters who have been able to draw audiences to, and sell advertising on, their electronic streaming channels. For this reason, independent producers consider a robust terms of trade agreement with private and public broadcasters to be important. The denouement of terms of trade negotiations will become more apparent over the next few years in the context of license renewal hearings, and the possible CRTC stipulation that terms of trade agreements would be a necessary outcome of renewed licenses.

Broadcasters' benefits may be short term in some respects. If, for example, non-linear programming is captured by the BDUs or the OTT services, broadcasters will lose a portion of their market share. AV distributors are also vulnerable to being bypassed as producers increasingly attempt to reach viewers directly through online channels, and directly through BDUs. In 2006, Rogers caused a ripple of worry when it signed a deal with CBS to buy VOD rights for episodes of the hit show *Survivor* for its paid video-on-demand channel. The agreement, according to *The Globe and Mail*, "was the first deal of its kind in Canada, and could serve as a blueprint for the distributors to go around the networks to secure content."[64]

[64] Robertson, Grant, "Internet won't kill the TV star, but it could cause disruptions", *The Globe and Mail*, June 6, 2007

If BDUs or the OTT services retain digital streaming rights, then it will be their brands/web sites which will be the locus for consumer interest. All the broadcasters have "catch-up" online services for their programming, but so do cable. As such, the battle for viewer loyalty remains hotly contested – and digital rights are the weapons of choice.

5.8 Key Issue: Social Media Marketing

High expectations have been placed on social media and online marketing as cost-effective (and generally effective) means to promote films. Myriad promotional opportunities exist online with the dramatic increase in the reach of social networks, such as Facebook, and Twitter, YouTube and blogs, but, as a recent *Variety* article characterizes it, "despite its soaring cool factor, it is rare that social network marketing can, by itself, make a movie a big hit… But no film marketer dare go without it." [65]

Interviews and research confirm that while the marketing mix may be changing because of new platforms, overall marketing budgets are the same, or growing slightly. Medium and large distributors in particular, described online and social media efforts as one piece of the puzzle and best used to complement mainstream campaigns that include trailers and TV advertising (seen as essential) to reach critical mass. In fact, interviews with producers and distributors suggest that the power of a great quality trailer is still a vital force in the marketing of feature films, particularly as it is so easily distributed and consumed online in the digital age.

Canadian distributors are experimenting and investing in social media marketing. Most Canadian distributors have active Twitter, YouTube and Facebook accounts and frequently run competitions to win tickets to advance screenings, film paraphernalia, or offer the latest awards news and opportunities to see special, unreleased footage. Online marketing efforts may also be particularly effective at driving electronic-rental and sell-through, examined in the following section. A brief look at Canadian distributors' presence in social media platforms is shown in Table 10.

Table 9 Evidence of presence of Canadian distributors on select online platforms (Dec 2010)

	Alliance	Viva-film	E1	KFilms Amer.	Maple	Mongrel	Kino-smith
YouTube Broadcast Yourself	√		√		√	√	√
twitter	√	√	√		√	√	√
facebook	√	√	√	√	√	√	√
Available on the iPhone App Store					√		

[65] Friedman, David, "Social media gains virility: Facebook, Twitter add to marketers' arsenal", *Variety.com*, October 5, 2010

Source: www.youtube.com, twitter.com, www.facebook.com, www.itunes.com/ca

Table 10 shows corporate social networking accounts, but distributors can choose to run social media from their own branded accounts, or create entire campaigns based on the brand of a specific film or film franchise. As in book publishing and music distribution, the distributor is rarely the brand the consumer is connecting with, more often it is the director or star (author, lead singer) that draws audiences to the theatres. Nevertheless, it is telling that today distributors want to build and nurture more direct relationships with the films ultimate consumer. One large distributor described the "instantaneous feedback" one receives in the online marketing world, be it advertising or social networking, as enormously important to both individual marketing campaigns and overall institutional learning. Resource allocation for social media varies from distributor to distributor. One of Canada's smaller distributors, for example, has a dedicated digital marketing expert on staff, while a larger distributor spreads online marketing responsibilities across the marketing division.

5.9 Key Issue: Piracy

Piracy continues to be a major issue for all rights holders around the world – and one without any simple solutions. In 2010, The Canadian Motion Picture Distributors Association (CMPDA – "The Voice and Advocate" for the major international producers and distributors in Canada such as Walt Disney and Twentieth Century Fox) estimated that the Canadian economy lost $1.8 billion in Gross Output as a result of piracy.[66] While critics call this figure inflated, we are nonetheless dealing with a significant loss of revenue to piracy. A brief search on popular bit torrent and streaming websites quickly reveals the popularity of Canadian productions from *Degrassi: The Next Generation* and *Being Erica* to *Passchendaele* for illegal downloading. Due to what some refer to as a more difficult legal environment in which to protect copyright, Canada is home to some of the world's most active illegitimate downloading Internet sites. IsoHunt, for example, receives 5.1 million visitors a month and is based in Vancouver, with servers in Toronto. Torrentz receives 2.5 million visitors every month and is based in Laval, while BT Junkie (2.4 million visitors) is purported to be a collaborative effort from Canada and Sweden.

In March of 2011, IsoHunt became the target of legal action by Canadian sound recording labels under Canada's current copyright legislation. Some commentors, such as Michael Geist, have argued that such legal action indicates that the current copyright legislation is equipped to address piracy issues.[67] Others may argue that the lack of swift court action to bring down the illicit site, may show the weakness of the existing legislation.|

[66] CMPDA, News Release: "IPSOS/Oxford Economics Study Reveals $1.8 Billion in Losses Across the Canadian Economy Due to Movie Piracy", February 17, 2011, states: "12,600 Full-Time Equivalent (FTE) jobs were forgone across the entire economy, including over 4,900 forgone directly by the movie industry and retailers. Tax losses are estimated at $294 million. Direct consumer spending losses to the movie industry, i.e. cinema owners, distributors, producers and retailers, were $895 million."

[67] http://www.michaelgeist.ca/content/view/5668/125/. Accessed March 30, 2011

While the latter point of view is developed from the perspective of the US integrated studios and distributors, the impact of piracy is real. Any copyright reform approach that is similar to the now defunct Bill C-32 would not likely stamp out these practices, but could have the potential to provide stakeholders with more effective mechanisms to contain the growth of piracy. One goal is to make legitimate online services more palatable than illegal downloading options. The lack of a comprehensive legal framework may indeed contribute to lack of development of legitimate online consumer alternatives (as compared to the US or the UK, for example). In those jurisdictions, there are more legal means for consumers to acquire viewing, copying, or ownership rights to feature films or other programming online.[68]

Peer-to-Peer and Streaming Theft

Peer-to-Peer (P2P) file sharing theft operates through networks such as BitTorrent and enables users to make, search and transfer exact file copies from one computer to another. P2P is not in itself illegal but is commonly exploited to exchange copyrighted material on the Internet. As a downloader of movies on P2P sites, one is required to also be a participant, uploading and thus distributing illegal copies to other "peers" in the network. Streaming theft (also called hosting and leeching) occurs on sites that provide users the ability to watch illegal copies of productions without first installing a program or downloading a file. Content is streamed to computers instantaneously. This method was not nearly as viable just a few years ago, when slow bandwidth speed made streaming a far less attractive way of accessing illegal content.

Large-scale piracy disrupts the already high-risk business model of distributors by substituting some theatrical and home entertainment platform revenues. Distributors, while anxious about piracy, do not believe there is much they can do at the organizational level. They call on government to strengthen punishments for piracy infractions, and on the ISPs to identify and penalize their worst-offending patrons. It is not clear, however, if legal action alone will be sufficient to curb users' piratical tendencies. Copyright legislation and reform is a complex area without simple solutions, but it is clear that some action must be taken if the AV distribution sector is to take full advantage of the opportunities presented by digital platforms.

5.10 Findings: Overall Impact on Distributors

Distribution market structures are evolving to accommodate new platforms and windows of exhibition while, simultaneously, relationships and deal structures are evolving to accommodate new actors such as OTT content providers Netflix and iTunes. Key issues such as piracy, the opportunities of social marketing and the race to acquire all rights will also play a role in the evolution from "Old World" to "New World" distribution.

The broad impact of the trends in the growth of new platforms on Canadian distributors can be summarized as follows:

[68] Barrie McKenna relates the lack of copyright protection to the paucity of downloading and streaming sites in an article: "Don't care about copyright? You should", *The Globe and Mail*, Dec. 6, 2010

1. Distributors are marketing to new platforms, and the businesses operating these new platforms want to deal with distributors rather than individual rights holders; however, some investment is needed by distributors to position them in the business, as the revenues will remain low until the volume picks up.
2. BDUs, which are also broadcasting entities, are beginning to acquire and exploit VOD and online rights in competition with traditional broadcasters and other vertically-integrated media companies.
3. Foreign aggregators or distributors may use OTT platforms to reach Canadian consumers directly by reserving the digital rights for content, thus shoving aside domestic distributors, broadcasters and BDUs.
4. So, while Canadian distributors can expect to benefit from the growth of new distribution platforms, such growth will come as a result of a decline in traditional platforms like home video. And they are in danger of being squeezed by BDUs, broadcasters, and foreign distributors and retailers.

Clearly, though exciting, the new platform era will challenge today's distributors to transform themselves in the face of new competitors to maintain their critical role in AV distribution.

6. AV Distribution Market Analysis

In this section, we summarize the market position of Canadian distributors, drawing on material covered in previous sections. We then point out key strengths, weaknesses, opportunities, and threats of this market position.

6.1 Overview Market Position of Canadian Distributors

As detailed in Section 2, federal and provincial governments have long encouraged the development of a Canadian-owned distribution sector. To summarize the evolution of these policies:

- Policies and programs were created in the 1980s to encourage access for Canadian distributors to independently produced (non-proprietary) international product and Canadian feature films for the Canadian market. The motivation for this was based on the pragmatic necessity of allowing the US studios full access to the Canadian market for projects they produced and to which they held North American rights. This approach, however, also reinforced a separate Canadian rights market for film and television distribution.
- The Canadian-owned distribution sector has been supported by various specific policy decisions and program requirements, including the Investment Canada Policy on Foreign Investment in the Film Distribution Sector (limiting new start-ups to proprietary product only); direct funding support programs (Telefilm's distribution funding); and select federal and provincial tax credit policies, which require the use of Canadian distributors for projects to be deemed eligible.

- Since the 1990s, the Canadian-owned sector slowly increased its overall domestic market share; while it has stabilized in recent years, there is no growth trend in market share.

In recent years, changing US studios' distribution and financing strategies have resulted in their taking on fewer pictures each year and financing them in different ways. As a result, more non-proprietary products have become available to Canadian distributors, thereby allowing them access to commercially successful projects. As the international market – and its sources of financing – has become more important to the studios, Canadian rights are now often available separately for many mini-studio projects. As the industry has matured internationally, key relationships have developed between some major independent studios (e.g. Focus Pictures, Miramax, New Line and Summit Entertainment), and substantial output deals have been negotiated with Canadian distributors which has helped provide a strong slate of projects on an annual basis.

At the same time, the Canadian theatrical distribution market has been highly competitive and remains dominated by major US studio productions with large production and promotion budgets. The release dates of studio productions have been the foundation of the Canadian exhibition industry and have determined the release dates for all other films. Canadian distributors have competed for audiences by being targeted in their acquisitions, and by working closely with exhibitors to design effective release strategies and promotional campaigns that maximize audiences. At the same time, distributors have always balanced the costs of acquisition and promotion with the realities of returns from the Canadian theatrical market.

The commercial model that has evolved has provided the Canadian distributor/rights holder with the ability to exploit the production across other platforms (or exhibition windows): DVD, pay-per-view, video-on-demand, specialty cable and conventional television, over a pre-determined length of time. Revenues from these ancillary markets have often determined if the production will be profitable, and given changing viewing habits (as detailed in previous sections), these ancillary markets are likely to be even more important.

Consolidation and integration within the entertainment industry has resulted in the integration of the domestic distribution sector into corporate structures with varied interests, including international distribution, television production and distribution, digital media production and other creative endeavors. These integrated firms include Lionsgate – which spun off its Canadian distribution operations, E1 Entertainment, Alliance, TVA and Remstar. There has also been some integration within the television distribution sector, creating some major new international television distribution groups, with TVA Films, a division of Groupe TVA Inc., an affiliate of Québecor Media Inc., as a good example. Finally, some larger Canadian-owned distribution companies (e.g. E1) have recently emerged, operating on revenue models based increasingly on the global market – and with the required scale to negotiate advantageous deals in that market.

6.2 AV Distribution Sector SWOT Analysis

An AV distribution sector SWOT summary is available in Figure 24 with full analysis beginning in the following section.

Figure 22 SWOT Summary

Strengths	Weaknesses
▪ Well-capitalized and experienced, adept at handling major releases ▪ Québec-produced French-language films market share as high as 27% in the French-language market ▪ Strong producer-distributor relationships ▪ Content access: many distributors have access to significant libraries ▪ Seizing opportunities in social media marketing ▪ Policy support and public-funding environment ▪ Broadcasting regulations that support Canadian content ▪ Québec: star system, publicity and marketing environment – strong theatrical performance ▪ Significant barriers to non-Canadian entrants	▪ Stagnant, almost no growth between 2003-2009 (see Appendix A) ▪ New platform revenues not categorized /reported separately ▪ Outside of Québec: absent star system and seemingly little public appetite for Canadian stars, stories ▪ Largely untapped foreign market for feature film distributors (producers are exploiting)
Opportunities	**Threats**
▪ Continued strength of theatrical window ▪ New business lines: e.g. further expansion into foreign markets ▪ Active experimentation with new alliances, distribution strategies and windows ▪ VOD holds some promise for English-language Canadian films ▪ Continued pursuit of "all available Canadian rights" strategy may offer some long-term protection ▪ iTunes and other online retailers desire to work through an aggregator ▪ Further output and aggregator deals with US classics departments and mini-majors	▪ Decline in physical home entertainment sales and rental, not yet made up through digital sales and rental ▪ Growing power of BDU/ISPs, leading to distributor bypass ▪ High (and growing) risk exposure as acquisition and marketing budgets grow ▪ OTT distributors bypass the AV distribution regulatory framework ▪ Decline in value of simultaneous substitution for commercial broadcasters ▪ Revenue loss due to piracy – and little (current) legal framework to curb illegal file sharing ▪ Lack of understanding of new digital formats and interactive content

6.2.1 Strengths of the Canadian Distribution Sector

Several Canadian distributors seem sufficiently well capitalized to be capable of major exhibition and promotional campaigns -- and to have well established relationships with exhibitors and other market outlets. The leading companies in terms of scope and scale of operations, notably E1 and Alliance, are increasingly able to function like mini-majors in the domestic and international market with coordinated release and financing strategies. In some respects, their size and scope represent a significant structural change in the industry.

A core of experienced senior distribution executives has emerged over the past two decades, well connected to the international market. Network building is critical in an industry of global relationships, cemented over the years through attendance at a network of major international markets and festivals, and helps distributors access desirable films. This expertise and adroit acquisitions in TV production and distribution, by E1 for example, has also led to their entry into the large scale TV coproduction business.

The long and stronger tradition of feature film production and distribution in Québec has led to a French-language market share as high as 27% for feature films. The stronger tradition of Québec firms, abetted by the *Cinema Act*, concerning the restriction on distributing films not owned by studios, has helped develop the AV distribution sector in Québec. Most importantly, there is a healthy, symbiotic relationship between production and distribution in Québec, where distributors depend more on Canadian films because French-language films are generally more successful in the domestic market. As well, the independent cinemas and chains enjoy more success with domestic French-language feature films, which means they are more receptive to distributors seeking cinema access. Greater exposure through talk shows, magazine and print media, and French-language Internet-generated buzz facilitates the marketing of productions, and stars are often willing to go on regional promotion tours, with a dramatic effect on increasing local media exposure.

In contrast, English-language Canadian films are generally seen as challenging and require careful release strategies. Finding proper release dates for independent films has always been problematic. Canadian distributors generate most of their revenues from foreign titles; in fact, their lack of reliance on Canadian productions could be viewed as supporting the overall viability of the Canadian distribution sector (but not necessarily the Canadian film sector). To Canadian distributors, a continuous supply of good foreign independent and mini-studio product, where Canadian distributors can, in some cases, outperform their American counterparts, is critical. The Film Distribution Policy protects distributors by restricting the establishment of foreign distribution firms, unless they distribute only proprietary films, which further lends strength to the Canadian AV distribution sector in terms of revenues from the distribution of foreign films.

Beyond the Investment Canada Policy on Foreign Investment in the Canadian Film Distribution Sector, there are two public policy mechanisms that lend further strength to Canadian distributors. First, Telefilm's feature film funding support is a catalyst for at least some Canadian productions to access distribution in the Canadian market. Second, the Canadian production tax credit program (CPTC) requires a Canadian distributor or broadcaster involvement for program eligibility. As well, there remains CRTC regulation with respect to TV broadcasting, VOD and pay-TV.

Several larger distribution companies have acquired substantial libraries (through acquisitions and integration) of films to which they hold distribution rights (Lionsgate – outside Canada – E1 and Alliance in particular). A library of titles has always been one of the major assets of a distribution company and can provide an ongoing revenue stream for investors/shareholders and improve access to future financing. It is also seen as a major asset for the VOD and other new markets as they grow in importance.

Finally, there are two economic conditions which should be considered as strengths for Canadian distributors. First, be it through their cautious accounting or risk-averseness, or simply the nature of the Canadian theatrical market, Canadian distributors have weathered the economic recession to this point and are not suffering badly in its shadow. Second, with respect to the future, Canadian distributors have had, as one distributor described it, a "stay of execution" on the decline of the home video market. This market lag provides Canadian distributors with a slightly bigger buffer to transition to electronic sell-through markets as they eventually mature and begin to pick up the revenue slack.

6.2.2 Weaknesses of the Canadian Distribution Sector

Access to screens is still determined largely by release schedules of the major studios. It remains challenging to establish proper screen access and appropriate promotional campaigns for effective release of films into the Canadian market, especially the English-language market.

Traditional release strategies are under pressure from a changing consumer market: the traditional pattern of providing a 3-6 month theatrical release window before allowing DVD sales and rentals, and pay-per-view has been put under huge pressure by the softening physical home entertainment market. The percentage return to distributors from DVD sales has traditionally been much higher than theatrical margins, so the current shaky nature of DVD sales is seen as a serious issue. There is also steadily increasing pressure from cable carriers and online retailers to shorten theatrical release dates and provide quicker access to films through the increasingly profitable VOD window. Inspired by the examples of IFC and Magnolia Films in the States, Mongrel Media has recently started experimenting with simultaneous releases of subtitled art films to theaters (so far only the Bell Lightbox operated by the Toronto Film Festival Group has played these films theatrically), pay-TV (Superchannel) and VOD on the same date. This weakness may be particularly pertinent for Québec, where many films go directly to DVD so as to secure a return on the MG and to cut the cost of exhibition in many theatres. Québec's distributors may be even more exposed in this area as a result.

The theatrical distribution market has typically demanded high risk tolerance and significant institutional and financial capital. Therefore, there are considerable barriers for new entrants unless they are well capitalized with access to a supply of films and to domestic and, in some cases, international markets. The value of libraries, often seen as the backbone of a strong distributor who can continue to monetize films long after they have earned-out their initial investment, is in jeopardy, in large part due to declining DVD sales. Specialty channels are also investing more in their own programming such as mini-series, rather than buying films, new or old. In this time of flux, business models are susceptible to changing revenue stream patterns from different windows and larger players like BDUs changing the market model completely.

Recently, there has been a major crossover of film talent to TV, and similarly a major appetite for television series content on pay and specialty channels formerly dominated by feature film (e.g. *TMN*). Conventional TV and specialty TV networks are both increasingly creating and finding audiences for long-form drama. If the total revenues generated from feature-length films on these post-theatrical platforms decline, it may have a domino effect on the value chain and diminish the ability of distributors to acquire and promote productions (both foreign and Canadian). While integrated distributors like E1 can transition in part to this market, most film distributors do not have the infrastructure or international networks to take advantage of the major TV series business.

In fact, the lack of international sales agents or foreign distributor infrastructure is a weakness for the production sector, if not ultimately the distribution sector in Canada. Without more companies (other than E1) with international sales and distribution capabilities, it will be difficult to gain substantially from international markets.

While Telefilm financing is critical to Canadian cinema, it does not have the capacity to be a major financing partner in the $20-50 million, or "mid range", films. Increasingly, films in that budget range, such as the recent *Barney's Version*, must rely on the pooled resources that coproduction structures bring to the table. Telefilm has expressed a desire to encourage more such activity as a means of raising budget levels, and has also identified the need to update the 49 coproduction treaties (with 53 partners) currently in place, so as to include issues like digital media production.

Even combined with SODEC in Québec, some argue that budget levels for French-language films are too small to take full advantage of the production capability and market enthusiasm for Québécois films. Therefore, low-budget productions do not generate significant interest as they are unlikely to be sold, and higher-budget productions are perceived as too risky to attain the sales necessary to warrant such a high up-front investment.

6.2.3 Opportunities for the Canadian Distribution Sector

There have been major advances in 3D technology in theatres, but also in television and online. Experts believe the appetite for 3D television is considerable and will grow as prices drop and level out.[69] 3D in theatres translates into higher ticket prices and so can hold higher revenue potential for Canadian distributors. While 3D tends to be dominated by the studios, Canadian distributors must treat all new theatrical technology as an opportunity and an area for growth. As more content is made available in 3D format, they will have the opportunity to take on and understand the dynamics of 3D distribution, and benefit from its greater revenue potential for distributors.

The growing importance of non-theatrical release windows and wireless applications, such as the iPad, for consuming content can provide entirely new revenue streams for rights holders. Social networking and gaming networks are also already providing

[69] Digital Hollywood, May 2010.

opportunities to promote and market productions alongside other more traditional platforms. New distribution platforms largely built on a VOD model working with major BDUs (e.g., Rogers), as well as Microsoft and Apple, hold promise. That said, to sustain their current business, and remain profitable, these new revenue sources need to at least match the revenues currently obtained through home video.

VOD is also seen as a viable opportunity to grow audiences for niche independent films which, if exploited effectively, could bode well for Canadian productions.

The disruptions in US distribution over the past two years (e.g. the financial perils, bankruptcies and consolidations at New Line, Miramax, Warner Independent, Thinkfilm, Apparition, Overture and even MGM) may be changing the game for Canadian distributors. Some traditional relationships are being challenged and may be lost (leading to loss of substantial output deals), but may also create opportunities for others through innovative collaborations.

The self-distribution model may allow distributors to build a brand directly with clients interested in accessing their libraries on many different platforms, as well as providing innovative ways to promote product on the Internet. Indeed, Facebook, Twitter and YouTube are already common promotional tools for distributors. This opportunity could easily be lost, however, as producers may believe they are in the best position to reach consumers directly with their productions. Accordingly, the opportunity will lie with the ability of distributors to add value in this relationship and act efficiently across a number of productions.

Financing for commercial productions, from SODEC, the Ontario Media Development Corporation (OMDC) and other provincial agencies, as well as Telefilm Canada, has bolstered revenues for the film and TV markets, and thereby helped distributors and producers. However, with limited international distribution capacity, most distributors will need to invest in sales infrastructure and increase their acquisition budgets to gain the advantages of the "export" markets.

6.2.4 Threats to the Canadian Distribution Sector

The self-distribution model outlined above could also be a major threat to the current economic model for distributors. Distributors of both English- and French-language films may need to look at other ways of providing value to the consumer in order to remain relevant in a direct distribution world. Furthermore, potential direct distribution from creator/producer/rights holders to consumers may bypass any traditional system of distribution by territory.

Additionally, new and more affordable production technology has provided producers with the ability to create high quality productions, and the Internet has created innovative ways of financing and promoting them. *Star Wars* creator George Lucas is quoted in the May 2010 *Screen International* as saying "the paradigm of how movies get made and how they get distributed is going away…. The consortium of rich corporations that used to control this entire medium are (sic) now doomed. The Internet has pretty much wiped out borders." Perhaps an overstatement, but clearly the world is changing, and younger consumers are watching and interacting with media in different ways.

Another threat for Canadian AV distributors is that new distribution networks from Apple and Google (the so-called OTT distributors) to Bell, Videotron, and Rogers will squeeze out most of the margin from the sale of product by electronic means. Savings in the cost of producing expensive physical film prints for theatrical exhibitors, for example, will all but be absorbed by the upcoming "Virtual Print Fee." The fee, already introduced in the US, is intended to help fund the theatres' conversion to digital. On the other hand, despite the fee, interviews suggest there is some defiance on the part of some exhibitors, particularly in Québec, to embrace digital. They feel that the independent movies they screen do not need this type of technology to be appreciated by moviegoers. If this resistance gathers momentum, it could force distributors of independent and Canadian cinema to straddle the digital and print divide and so will not be able to fully capture the benefits of digital distribution.

There is also an underlying threat to the large, established distributors in both the French- and English-language markets, as smaller distributors begin to claim expertise in distribution on new platforms. If larger firms are not able to exploit new platforms effectively and transition to digital, it may have a negative impact on the entire industry.

Possible changes in government policy to allow non-Canadians to start new distribution businesses could increase competition for incumbents and threaten both their access to viable films and their business models. Even without changes in policy, major media firms like Rogers, Shaw, TELUS and Québecor may consider expanding their current role in AV distribution, especially with the growing overlap between theatrical and VOD markets.

Piracy clearly remains a major issue for all rights holders and any change or relaxation of existing copyright provisions, particularly in the area of digital media and file sharing, could be devastating for the distribution sector. It may take more collaborative, cross-industry and government effort to fight piracy in the long-term.

6.3 Findings: Market Positioning and SWOT

While the success of the Canadian film distributors is not necessarily reliant on the success of Canadian productions, a look at the French-language market reveals that successful Canadian productions can benefit the industry as a whole, enhancing distributors' relationships, expertise and reputation. The broad impact of the opportunities and threats on Canadian distributors can be summarized as follows:

1. Despite some tumult at the firm-level, Canadian distributors have built expertise in the industry as well as having developed vital relationships to maintain their core business – domestic distribution of foreign feature film content.
2. One major advantage of the Canadian AV distribution sector is the regulatory protection it receives. Such protection includes The Investment Canada Policy

on Foreign Investment in the Canadian Film Distribution Sector which establishes an economic framework for the sector, such that market entry is regulated as well as CPTC stipulations that require the involvement of a Canadian distributor or broadcaster to access the credit.

3. While the need for the distributor role is relatively secure in feature film content across the theatrical, TV and home entertainment platforms, in domestic television production, the role continues to be marginal.
4. Economies of scale and risk-tolerance should help distributors develop and invest in the potential of volatile new markets and platforms in Canada and abroad. Future success may come to smaller, niche distributors that resist the desire to be too cautious (as in past decades) and go after new opportunities and roles, particularly in new platforms and technology. As they face the threat of possible disintermediation from self-distribution models and OTT competitors, Canadian-controlled distributors must ensure they remain relevant in the future multi-platform world.

7. Overall Conclusions

This study provides an historical and current portrait of the Canadian distribution sector, within the limits of available data, and outlines some recent trends in the continued development of the sector. It identifies some key issues through a SWOT analysis, and raises some questions for future policy consideration. In this section, we draw together some conclusions about the role, the achievements, and prospects of the AV distribution sector in Canada.

Policy and entrepreneurship have created a reasonably strong domestic distribution sector in Canada, at least for feature films.

- The various film and TV production policies and the feature film distribution policies have led to the development of a sizeable film/video distribution sector in Canada. Certainly, distributor entrepreneurs took advantage of the potential market opportunities created by the 1988 Film Distribution Policy, and lined up output deals with significant international production/distribution companies.
- Canadian-controlled distributors have grown their share of the total market for distribution of foreign and Canadian films, although have reached a plateau of about 25-30% over the last few years. There is a cadre of experienced executives in distribution and new entrants who bring new approaches to the marketplace.
- This market share for Canadian-controlled distributors has been achieved primarily by the success of domestic films in Québec, and access to a wide range of commercially successful foreign films in the domestic market in Canada.
- The barriers to entry to the Canadian distribution market are not inconsiderable. Building key relationships, developing credibility and investing in a library of content – all of these activities take time, capital for upfront investments and a high tolerance for risk.

- While more important in the early years before broadcaster consolidation in Canada, there has been a limited role for independent Canadian distributors of TV programming for the domestic market.
- While there is a need for sales agents and distributors to access foreign markets for TV and feature film programming, there are few Canadian companies engaged in such activities.

The creation of Canadian distributors has helped the growth of the French-language film sector, and offers English-language feature films a way to get to market.

- The policy objective of generating box office sales for Canadian feature films has been successful for French-language films. Although a product of several factors, the existence of a strong feature film distribution sector has been a key factor in achieving box office success in Québec.
- The same results have not been realized for English-language films, but the existence of a strong distribution sector has been essential for Canadian feature films to access movie theatres, home video and TV markets.
- While feature film producers have frustrations with their distributors the more experienced producers recognize the value, role and market limitations of distributors. This frustration is shared by producers in virtually every country.

Within the overall distributor level of success in revenues, there has been relative turmoil at the company level.

- A historical review of the distribution sector shows that many distribution firms enter and exit the market, though many veterans have stayed in the business in new formations, in some instances due to market consolidation. This turmoil seems to have been caused in part by an inability to adapt to technology changes in the market, e.g. the introduction of home video technology.
- Lower margins over the last few years were in part the reason for some consolidation of the sector, and put a premium on scope and scale economies.
- Historically, there has always been a tendency for distributors to take part in the production business, and for producers to create their own distribution arms. And there are periods when distributors disband their production business. These trends seem to be continuing, in part to better access foreign markets, and in part to get the right mix to match domestic and international market conditions.

While overall demand for content supplied on digital platforms is expected to be strong in the next several years, the uncertainty going forward inhibits distributors from seizing the new opportunities.

- Because of ease of access to content and low production costs for entry level content, there is a lot of product chasing existing and new markets. It has been described as an exponential growth of AV product available.

- The product availability and the development of new platforms mean that there is a lack of predictability in revenues and business performance. There is also uncertainty about business arrangements due to the destabilization of the traditional release windows market, traditional partners and customers, and the whole business model for AV distribution.
- This lack of predictability and stability has made many Canadian producers and distributors quite cautious about defining new business arrangements for fear of making mistakes. It feeds on the relatively largely risk averse culture in Canada, which is also the result of a small, fragmented market.

Canadian distributors will serve the new platforms, but the new sources of revenues will not make up for declines in current ones, and margins may remain low.

- Early indications are that new platforms and aggregator/retailers like Netflix and iTunes will turn to Canadian distributors to acquire their product. In fact, the proliferation of new platforms creates opportunities for Canadian distributors of film and the full range of AV product.
- Canadian distributors have experienced fewer market downdrafts in the market than their American counterparts, as the DVD market has not declined as rapidly and the theatrical release segment has been growing. However, TV markets are not as robust as in the past, and the new platforms are not creating the same level of revenue opportunities to replace the declines in the traditional markets.
- Home video and pay-TV (and other TV outlets) are very important contributors to the bottom lines of distributors. But there is less margin (at least at this point) from new platforms that price their product competitively to gain share and combat illegal free content. It is possible that at some point revenues will increase but the market is not there yet.

New forms of competition to distributors are emerging, and Canadian distributors will need to adapt.

- Upheavals are common in Canada's AV distribution history but while the firms may change, the professionals in the business seem to remain. Operating in a competitive landscape dominated by a small number of US majors, all distributors must be highly-adaptable to change.
- New technology is altering the way audiences consume film and television content. The viewers' "anywhere, anytime" content expectation disrupts the orderly, linear windows of exhibition that the AV distributor of feature films has experienced since the advent of television, pay-TV and home video. New competitors, online aggregators, off-shore OTT content providers and video-on-demand providers each jockey for position in the new distribution environment.
- In this time of flux, some security comes from expertise in exploiting all rights. Without knowing how the future of on-demand offerings, online pricing, piracy

and the possibility of a regulated internet, will unfold, the AV distributor must learn to work with the new platforms and new relationships in order to survive. History has shown that such adaptability has not always been among the Canadian-controlled AV distributor's strengths.

- One way to adapt is to "go global" – diversifying with new products, partnerships and markets in Canada and abroad. "Niche" distribution is also an alternative, as some small, savvy distributors market their new platform expertise to the larger firms and independent producers.
- Distributors will need to invest in new platforms of distribution even though there is no certainty in their future.

The advent of new platforms and technology constitute a seismic shift for the AV distribution sector in Canada. To fit into the new, complex value system, Canadian distributors must continue to add value to AV content by continually adapting and redefining their role.