



AUDIO & VIDEO POST PRODUCTION AN INDUSTRY STUDY

Things you will learn from this whitepaper:

1. What are the basic sectors of the post production industry?
2. How does the advancement of technology affect audio & video post production?
3. What are the current challenges facing the audio & video industry?
4. What are some of the most common valuation issues of the audio & video post production industry?

This whitepaper will have special interest to:

1. Attorneys consulting with audio & video production businesses considering mergers & acquisitions.
2. Judges presiding over business & corporate litigation cases.
3. Business mediators & arbitrators.
4. Financial & income tax advisors.

Notice & Disclaimer

In a forensic accounting setting, the purpose of an industry analysis is to allow a comparison of the subject company to its industry. This comparison is vital to assess the strengths and weaknesses of the subject company, as well as its industry and company specific risks.

The following study contains a brief, selected analysis of the specified industry. It is based upon a review of current economic statistics, articles in the financial press, reviews found in current business periodicals and information posted on numerous internet sites. It does not purport to be all-inclusive or to contain all of the information which a prospective investor or lender may require. Projections and opinions are based upon information provided by third parties. We make no representations or assurances that this information is complete or accurate. Neither Mark S. Gottlieb, CPA, PC nor any of its officers, employees, or representatives make any representation as to the accuracy of completeness of this report or its contents, nor shall any of the foregoing have any liability resulting from the use of the information contained herein or otherwise supplied.

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Industry Overview

The audio and video post production industry comprises establishments engaged in providing post production and other services to the motion picture, television and video game industries. These services include specialized motion picture or video post production services, such as editing, film and tape transfers, subtitling, credits, closed captioning, computer-produced graphics, animation and special effects, and developing and processing motion picture film.

Motion picture production in particular is a highly complex business involving the interplay of commercial and creative considerations. These considerations dictate a sequence of interrelated activities, commonly broken down into the continuum of development, preproduction, production, and finally, post production.

Audio and video post production industry players may be broadly divided into three basic sectors:

- *Sound Recording Studios* - This sector is comprised of establishments providing facilities and technical expertise for studio sound recording. Establishments in this industry provide audio production or post-production services for master recordings, and audio services for film, television and video production. The primary services in this industry include: album/CD production, original music production, audio post production, demo production, mastering services, commercial spot productions, duplication services, video production, audio format conversion, and live recording services; and
- *Motion Picture and Video Production* - This sector is comprised of establishments engaged in producing and distributing motion pictures, video television programs, or television and video commercials; and
- *Post production Services and Other Motion Picture and Video* - This sector is comprised of establishments providing post production services and other services primarily to the motion picture industry, including specialized motion picture or video post production services, such as motion picture film processing, visual and compositing effects, linear and non-linear audio/video editing, graphics and animation, audio post production, and all other post production services.

The audio and video post production industries, coming off a slight stagnation around the start of the 21st century, have seen a recent upward turn in revenues and are evolving rapidly as new uses for services within the aforementioned sectors arise. The popularity of MP3 players, cell phones, PDAs, and portable computers are just a few examples of the increased need for audio and video post production services and technology. Expanding the market further, these services are employed with growing frequency in the development of interactive gaming and gambling systems.

Competitive Landscape

The audio and video post production industry is highly fragmented, though it has begun to consolidate of late. In the late 1990s, as major movie studios began facilitating post production services “on site”, many post production firms, nervous about decreasing demand, began marketing themselves as attractive buys to studios. Disney and 20th Century Fox instigated a trend toward purchasing post



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production firms closely allied with their operations, in attempt to streamline overall production while limiting expenses.

Typically, independent firms focus on a specialized operation, contracting services to movie producers and distributors. As small, relatively unleveraged firms, these contractors compete with each other on pricing in order to attract motion picture studios. Some post production firms work almost exclusively with independent filmmakers, a sometimes difficult niche as independents often work within tight budgets. Because trends in the post production industry are driven by the macroeconomics of the film industry at large, post production companies search for ways to reduce labor and capital costs. Minimizing expenses for consumables and recurring costs also enhances competitive viability.

The hottest sector of the industry in the early 21st century was video post production of special effects and animation. The consistent success and proliferation of films and movies featuring computer-generated effects led to a rapid expansion and enhancement of these technologies. Film studios, engaged in competition to woo audiences with cutting-edge visuals, drove demand for all post production services and increased the vitality of the industry.

Products & Operations

In audio and video post production, the product is edited into its final form when music, dialogue, and sound effects are synchronized with the picture, and special effects are completed. At this point, the post production firm holds a “negative” from which "release prints" may be extracted for distribution. These prints may then be further edited into movie trailers, subtitled, etc.

Editing equipment and services are essential to the post production process. Editing involves joining disparate pieces of film shot by the cinematographer into a digestible narrative. For some films, the editor and director work closely in selecting each shot and determining where to cut, splice, and edit. Some directors shoot a large quantity of footage, allowing the editor a great deal of choice; other directors shoot less footage, providing the editor with less production autonomy.

It is common in this fragmented industry for editing equipment, editing services, and editing personnel to be provided by three different groups of organizations. There are more than 50 editing equipment firms, the majority of which are located in Los Angeles and New York. More than 100 firms, represented equally between New York and Los Angeles, provide film editing services.

According to the *Encyclopedia of American Industries*, other major post production operations include:

- *Cutting room work* - completed in specially designed facilities equipped with editing equipment where the editor and assistants can put the final film together; and
- *Film processing and preservation* - when the film is actually developed into a negative and subsequently processed, copied, and preserved; especially Technicolor, which was an industry leader for this service; and
- *Music libraries and cutting services* - sound and recording services, including the process of recording sound during production and subsequent editing and adding sound to the final product. This segment of the industry also is highly fragmented, with more than 100 firms engaged in



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music cutting and music libraries and more than 100 firms providing sound and recording services. Sound technicians include production mixers who are responsible for sound equipment and recording on set; boom operators who operate the microphones to pick up actor's dialogue; re-recording mixers engaged in combining sound in the studio; and sound effects mixers, responsible for sound effects both on the set and in the studio; and

- *Special effect services* - include a wide variety of creative photographic and sound effects. There are more than 50 special effects firms, which operate primarily in Los Angeles and New York, but are also in locations such as Las Vegas, San Francisco, and Orlando. Prominent firms include Buena Vista Visual Effects Group in Burbank, California; Lucasfilm, Ltd., in San Francisco; and Walt Disney/MGM Studios in Orlando; and
- *Subtitle services* - which provide translated dialogue appearing at the bottom of the screen of foreign language films or to narrative titles in silent films.

Research & Technology

The most significant technological developments in the film industry in the 1990s occurred in the special effects sector, as computer-generated images became prevalent in major studio offerings. Post production firms saw a strong upswing in demand for video special effects services in particular, and scrambled to win lucrative contracts. The 1997 academy award winning film Titanic featured a special effects budget of \$40 million, and its commercial success was a boon for the post production industry.

Computer-generated images have been available to feature films for over two decades, but only recently has the technology been affordable enough to be incorporated into a high percentage of feature films. By the late 1990s, cheap, powerful workstations and a wide range of software made computer graphics a palatable alternative to older models traditionally used for special effects. The widespread transfer of high-end digital production to computer platforms, which offer tremendous cost benefits, allowed major studios to invest in attracting top graphic artists, and to cut costs on expensive equipment.

The film industry also made aggressive moves toward the use of digital cinema as a replacement for film, a move anticipated in the industry for a decade or more. In 2005 the major studios agreed on technical standards and began negotiating how to finance the conversion of more than 36,000 screens across the nation to the digital format. This decision drove demand for audio and video post production services even higher.

Finally, industry observers note that digital technology has reached a point where the implementation of virtual actors into major motion pictures has become imminent. Such an option will utterly change filmmaking protocol, as the option to create any number of actors from the ground up will soon exist, thereby giving directors immeasurable latitude in the physical action of films. The development of virtual actors is certain to add emphasis to all production aspects of the filmmaking process.

Workforce



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Broadly defined, the post production industry workforce is comprised of composers, audio and video equipment operators, and recording engineers. Strong computer skills are mandatory for most jobs. Few industry wide standards exist, so companies often look for people adept in the hardware or software they are currently using. Continuing professional education is extremely important; however, this is typically learned on the job or undertaken independently by workers.

In order to attract and/or retain employees, post production companies must pay relatively high salaries. In 2004, median hourly wages for film and video editors were \$21.50; equipment operators earned \$16.19. Because post production is a part of the entertainment industry, unionization is prevalent. Compared to the entertainment industry at large, however, audio and video post production are distinguished by a heavy reliance on subcontracting and freelance talent. Building and maintaining relationships with qualified freelance personnel is a key issue for firms.

Industry Concerns

Most concerns endemic to the audio and video post production industries are typical to other service businesses. In many regards, these issues do not exact undue stress on post production at large, and in periods of high demand most of the following are diminished even further:

Dependence on Economic Trends

Because demand for audio and video post production services is dictated by macro trends in the motion picture industry (which in turn is dependent on overall U.S. economic conditions) post production companies have few options in economically recessed periods.

Industry Consolidation

The attempt by many motion picture studios to move more and more production “on site” has affected the overall number of contracts awarded annually, and forced some post production firms to seek out new markets or attempt to sell themselves directly to studios.

Equipment Expenses

Because demand for state-of-the-art special effects is high, and because new equipment and engineering technologies allow for leaps in production capabilities, audio and digital post production firms must constantly invest in new equipment. As the largest component of operating costs, equipment expenses must be monitored closely and equipment utility must be maximized.

Ability To Find & Train Qualified Employees

Since up to 50 percent of industry workers operate on a freelance or subcontracted basis, hiring is an ongoing activity for many firms. Talented personnel may prove difficult to keep, as many jobs are done on a contract basis. Heavy investment in the training of personnel is uncommon, as many technicians move transiently to the highest bidder.

Contract Work



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Post production firms rarely enjoy gross percentages from films and continuously jump from one short-term contract to the next. As a result, firms are usually in poor bargaining position with studios, a feature exacerbated by the highly fragmented nature of the industry. Most firms monitor competitor contracts in an effort to out-price other bidders, thereby attracting studios.

Runaway Production

Competition from international firms, particularly Canadian companies, has taken market share from the U.S. post production industry. Seeking to capitalize on favorable exchange rates, studios increased out of country production by 500 percent from 1990 to 1998, costing the U.S. economy roughly \$10 billion. State and city sponsored legislation providing tax breaks for studios realizing production and post production within the U.S. has provided some relief. Congress has also considered legislation offering tax incentives for movie studios commissioning services within the U.S.

Industry Outlook

Like all firms engaged in services allied to the motion production industry, post production firms are inextricably tied to the success of the film industry as a whole. Domestic sales (box office receipts) grew from \$7.7 billion in 2000 to \$9.54 billion in 2004. International box office revenues and DVD sales surpassed these numbers in 2004, with DVD retail sales ballooning to \$15.5 billion and overseas ticket sales rising 44 percent to \$15.7 billion. These trends, with no end in sight, have been very good news for the audio and video post production industries.

During the early 21st century, films using animation and special effects were extremely successful at the box office, a particularly profitable area of video post production. A record year for visual effects came in 2002, when the second Lord of the Rings installment, Star Wars: Episode II, and Spiderman averaged \$347 million at the box office. Animated films earned new recognition from the industry's Academy Awards, which introduced the category of Best Animated Feature Film. The 2004 nominees in that category: The Incredibles, Shrek 2, and Shark Tale, claimed combined earnings of \$851 million.

As the industry continues to consolidate, operations will streamline and contract bidding should simplify. If incentives remain for post production to be realized within the U.S., the co-opting of some services by major motion picture studios should be offset by an increasing demand for services. Industry analysts feel that with the proliferation of the entertainment business as a whole (video games, cell phones, PDAs, et al.), and the increasing availability of powerful, affordable technology, the post production industry stands poised for growth well into the foreseeable future.





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