

INVESTORS' CIRCLE



Venture Capital for a Sustainable Future

The Double Bottom Line (DBL) Media Industry *An Analysis of Investment Opportunities*

A Report by the Investors' Circle Foundation

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This report represents a two-year collaboration of an array of interested institutions and individuals. Chief among these are Investors' Circle (IC), the Ford Foundation and the Calvert Social Investment Foundation.

For the past 13 years, one of IC's primary missions has been to foster best practices in social entrepreneurship. Through a network of socially minded investors and funders, IC serves as a platform for providing "patient capital" in a range of sectors. Its focus on media here reflects its realization that a vibrant and diverse media are central to a sustainable democracy. Dominic Careri Kulik, IC Director and chief author of this report, has been central to IC's emergent DBL Media Project.

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Finally, we note that much of the data in this report is as much as more than a year old. This project began with the passionate entrepreneurial initiative in 2002 of IC Member, Carol Atwood. The protracted timeline is due in large measure to the constraints of a novel research and network-building project like this one. While we anticipate that some data will have

changed significantly since we circulated the first draft of this report last fall, we are confident that the report's central points and conclusions remain accurate and, we hope, inspire action.

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EXECUTIVE SUMMARY

The DBL Media Industry's Capitalization Gap

The mass media market is a growing business sector that has a profound impact on all aspects of our lives. From broadcast television to newspaper publishing, magazines to video games, mass media influence our perceptions of the local, regional and global communities of which we are a part. The media companies that reach the most people have significant global scale and scope, and operate within an intensely competitive and often lucrative business climate. This mainstream market dictates that most media companies prioritize maximization of short-term profits over concern for social responsibility and the needs of “non-mainstream” segments of the population. It is no surprise, therefore, that their primary concern is to stay ahead of the competition and to keep shareholders satisfied.

Many investors and interested observers, however, are wary of the long-term effects that such fundamental market conditions have on our communities and culture irrespective of profit. In this context, some philanthropic organizations and private companies are increasingly paying attention to media companies that attend to their social impact *as well as* their financial bottom line. We call these organizations “double bottom-line” (DBL) media companies.

Recently, some of these DBL media companies have had notable financial success and have helped to illustrate that the competitive business climate does not foreclose the possibility for social responsibility. In most cases, however, DBL media companies are trapped in a cycle of undercapitalization that limits their scale and growth. For these underresourced companies, the traditional sources of philanthropic funding are vital but insufficient to compete with conventionally financed and more mature for-profit companies. DBL media companies nevertheless have not yet fully exhausted the various innovative equity and debt financial tools used by other financial market entities. We believe that these untapped and underdeveloped investment resources can close the capitalization gap that occurs at the essential early stages of business development. Supporting the growth of an efficient capital market is essential to making the DBL media industry more effective, vibrant and self-sustaining.

Mindful of this present climate, in the fall of 2004, Investors' Circle's research team completed the first draft of this report with sponsorship from the Ford Foundation and in collaboration with the Calvert Social Investment Foundation. The report intends to provide preliminary insights into DBL media companies as well as DBL media funders and investors. We found a significant number of DBL media companies across every industry sub-segment. Many of these companies, however, do not have the necessary access to capital to grow or be self-sustaining. We found that many investors perceive additional risk in this kind of venture. But our research of investors and funders helped us to identify the affirmative ways in which foundations and investors can meet the capital needs of DBL media companies and manage this risk appropriately. We believe this report addresses perceptions of risk by providing details underlying the following three chief conclusions:

1. The so-called “DBL media industry” represents a rich collection of niche areas with strong opportunities for growth within the larger generalized “media industry”;
2. To achieve long-term sustainability, DBL media companies can (and perhaps must) continue to rely on philanthropic grant-making, but, more pertinently, must begin to look and prepare themselves for market-oriented financing, including debt and equity financing; and
3. To achieve social impact and long-term viability, the DBL media industry requires basic “rationalization” to improve its information and capital efficiencies. Significant capital and infrastructural gaps need to be filled in order for the most promising DBL media companies to be able to grow effectively and reach financial and social success.

The report ultimately advocates a substantial long-term initiative to help build a viable DBL media market. This initiative will require the collaboration of interested investors, funders, trade groups and entrepreneurs. The report is based on the lessons learned from our preliminary case studies, surveys and interviews with knowledgeable entrepreneurs, funds and foundations. In its conclusion, the report enumerates a set of specific next steps and reflects on factors critical to the success of DBL media investment and growth.

Identifying DBL Media Companies

For the purposes of this report, DBL media companies have the following three broad characteristics, which are distinct but sometimes overlapping: **minority-oriented, independent, or social mission-focused media**. Each characteristic is framed and measured separately:

Minority-oriented media companies have as their central mission the representation, support and targeting of a particular ethnic or other demographic minority group. We look to the composition of audiences, ownership, management and editorial/creative staff, as well as content to determine whether a company’s focus falls into this category.

Independent media companies do not allow a profit motive to subordinate their creative or production processes. For this category, we evaluate the composition of ownership, management and focus of the creative (i.e., editorial and programming) staffs to determine whether a company falls into this category.

Social mission media companies focus primarily and often explicitly on the achievement of specific social, political or cultural goals unrelated to profit. For this category, we look to the company’s mission, attention to financial returns, and philosophy of management, as well as content.

All three types of companies are alike in that they seek, fundamentally, to have a positive social impact in ways that mainstream media do not. Of course, each individual entrepreneur and investor determines for himself or herself whether a particular company is socially valuable. In addition, while the content focus of many of the companies that we observed have a

progressive political perspective, we believe that a company's underlying mission and value characteristics – not its political orientation – are essential to the development of a vibrant DBL media market.

For the purposes of this report, and in keeping with many other media industry analyses, we have divided the industry into the following 11 consumer- and advertising-driven segments: broadcast, cable and satellite television; broadcast and satellite radio; film, DVD, video and video game entertainment; newspaper, magazine and book publishing; the Internet; and one specialty market segment central to all other media segments -- advertising services. In 2003, these segments together represented about \$405 billion out of \$648.3 billion in total media industry revenues. The three categories of DBL media we identify above are active in all segments.

Media Segment Highlights

The report explains that there are DBL media companies in every segment of the industry. Some preliminary insights relating to those segments addressed in the report are the following:

- The television segment is consolidated and, for smaller DBL companies, difficult to penetrate. Investments in infrastructure or programming need to be substantial. Public television and radio distribute a great deal of social mission programming, but very few of these succeed commercially after initial distribution. For example, the report briefly features **Urban TV Networks**, a media production company that produces and distributes African-American-focused content. The content currently reaches 22 million urban households via 77 affiliate stations and is already coming close to breaking even.
- The radio segment and small local broadcast stations, in particular, offer lower cost structures than television. Examples featured in the report are **Air America Radio (AAR)**, a recently established progressive talk radio network that provides an alternative to conservative talk radio through syndication and affiliation content deals across the country, and the **Spanish Broadcasting System (SBS)** which owns 19 stations and, thus, is the largest Latino radio broadcasting company in the United States. Low-power FM radio stations also offer micro-financing opportunities, but are limited to non-profit ownership.
- Publishing has lower cost structures for production and distribution than television or radio. This segment is one of the most promising for successful DBL investment, especially for aggregation plays of content and distribution. The report cites several notable companies as examples, including: **Publishers Group West (PGW)**, one of the largest marketing and distributing companies in North America for independent book publishers, generated about \$165 million in revenue in 2000, and **Media Properties**, an African-American company that owns and operates community newspapers for African-American and Latino communities in the Los Angeles area that has generated between \$4 million and \$5 million a year in revenues over the past several years.
- The entertainment segment is competitive and driven by individual “hits.” It remains one of the riskiest segments for investment even as independent film may have matured

enough for a portfolio approach. **Participant Productions**, a social mission film production company founded with significant capital resources and mature distribution relations, stands out as a notable exception in this space.

- The Internet segment has the lowest content creation and distribution costs of any media segment. However, in general, revenues do not yet cover sales and marketing costs. DBL investors should remain mindful that new technologies in this segment could help create new models of distribution and marketing. One company featured in the report is **Globalvision Media**, a recently created global news service that purchases and aggregates print and broadcast content from more than 350 local news organizations in 125 countries to deliver diverse and unique news and information.

Research: Surveys and Interviews with DBL Media

The lack of comprehensive investment research into the DBL media industry makes it difficult to develop an accurate portrait of, let alone draw firm conclusions about, the landscape of early-stage, privately held companies that might attract investors. Thus, we began to develop and distribute nationally across the industry admittedly unscientific surveys designed to elicit preliminary demographic and financial information about such companies.

The primary survey targeted 5,907 DBL media companies through 13 trade groups including, for example, the Association of Hispanic Advertising Associations, the Independent Press Association, the National Black Programming Consortium, and New America Media (formerly New California Media). The survey generated more than 641 responses nationally (an 11% response rate) from trade groups across every industry area. We also conducted surveys and interviews with DBL media leaders, fund managers and investors and completed three case studies on investment models in current use. While more careful analyses are needed for a complete understanding of DBL media companies, the report makes several preliminary conclusions, including the following:

- DBL media companies are predominantly small companies, as measured by employees and revenues;
- they are highly motivated by their social missions;
- 88% were for-profits and 12% were non-profits;
- 65% were either breaking even or profitable;
- 75% have an interest in outside financing;
- 40% have a three- or five-year financial model;
- one-third are willing to consider selling their company; and most content producers are decisively committed to maintaining creative control.

The report reviews the tools and structures available to DBL media companies to make recommendations about how best to fill the capitalization gap.

Financing DBL Media Companies

We learned from our research that, traditionally, DBL media companies have looked to philanthropic as well as informal investment sectors for financing. As the entire media market

continues to become more competitive and actively financed through investment capital, philanthropic sources of funding are simply not sufficient to sustain DBL media. The report explains that, in this climate, both private, for-profit sources of innovative equity and debt financing, as well as non-conventional deployment of debt- and equity-like grant instruments are critical to achieving long-term sustainability of DBL media in the private market. Indeed, the present state of affairs is not merely a function of DBL media companies' (im)maturity, but also a reflection of the paucity of capital investors and instruments especially attuned to the capital needs and limitations of emergent media companies that are themselves unsure about next steps.

Private Equity – A Good Vehicle but Limited in Volume

Private equity firms and funds generally invest in companies at all stages of development if they have stable underlying assets and intellectual property, or high-growth potential. Private equity finance sources include strategic large media corporations, general buy-out firms, specialty media buy-out firms, venture capital firms, and angel investors. All of these entities generally consider the financial bottom line paramount in making investments.

Nevertheless, some angel investors and equity funds have begun to make specific investments in social mission media companies. Known social mission angel investors represent approximately 1% of all angel investors and invest infrequently in the media industry. (Investors' Circle, the sponsoring organization of the report, is a network of such angel investors focused exclusively on social mission companies.) The Columbia Business School's RISE Capital Market Report was able to survey approximately \$1.9 billion of capital invested in 2002, in social and environmental deals, or about .6% of capital invested by venture capital funds. Further, RISE found that the total number of deals completed by DBL funds represented about 6.2% of venture capital (VC) deals, signifying an orientation toward a greater number of smaller deals. These DBL funds include the following four types: mainstream VC funds that have devoted some portion of its capital to DBL deals; highly focused DBL industry niche funds that focus on specific issues such as charter schools or alternative energy; funds that emphasize increasing opportunities of ownership/management of underrepresented groups; and funds or fund activities embedded within philanthropic foundations and public charities. Researchers have estimated that these equity fund investors have between \$2 billion and \$6 billion available for investing in DBL companies, a small portion of which will be media.

Debt Markets: A Good Vehicle with Significant Hurdles

The average debt-to-equity ratio for all publicly traded media companies (.61) is significantly lower than that for the entire "services" industry (.82) and even lower than the average debt-to-equity ratio across *all* industry sectors (.89). The mass media tend to be much more cash-flow-oriented than asset-backed. This makes lending difficult since debt investors generally perceive risk in lending to enterprises that have limited hard assets. As a result, media companies need to obtain adequate equity in order to gain investor confidence. What is more, most emergent DBL companies rarely have sufficient assets to gain the access to the same sources of debt financing to which mainstream media companies do. DBL media companies accordingly have looked to two specialized sources of financing: revolving loan funds (RLFs)

and program-related investments (PRIs). RLFs are exclusively debt instruments, but PRIs can be structured either as debt or equity.

Revolving Loan Funds and Program-Related Investments: Specialized Vehicles with Promise

Revolving Loan Funds (RLFs) are debt vehicles that loan an amount, recoup that amount with interest over a short period of time, and then re-lend those funds going forward. They have historically been non-profit organizations with specific social missions that essentially act as intermediaries for investors or donors wishing to reach enterprises' capital needs in a sustainable manner. Two DBL media debt funds, the Independent Press Development Fund (IPDF) and the Media Development Loan Fund (MDLF), are organizations that successfully operate such funds.

Program-Related Investments (PRIs) are investments made by public charities or foundations to support activities which align with their own grant-making priorities and from which they expect a below-market return of capital within a certain period. PRIs include financing instruments commonly associated with banks or other private investors, such as loans to non-profit organizations as well as loans and equity investments in mission-related for-profit organizations. Foundations commonly make PRIs to supplement their existing grant programs, many of which focus on the very social concerns addressed by DBL media. The U.S. Internal Revenue Service has sanctioned PRIs as a specific means of stimulating investing in social enterprises that exist in the private market, but which could not obtain capital investment from conventional sources. While PRI program activity has been on the rise, it has not increased significantly for media directly. Yet, the scale of the capital gap, and the substance of the social mission of many DBL media companies appear to line up significantly with the strategic goals of PRI programs of many foundations. In an emerging market that requires innovative leadership, such PRI financing can provide an essential element to a more efficient and effective capital market for DBL media.

Market Infrastructure: Fragile and Fragmented

The capital market for DBL media companies is represented by only a few important, but mostly fragile emerging trade groups and even fewer financial intermediaries. Most of these intermediaries have limited financial service offerings if any at all. Trade associations, particularly in publishing, are attempting to address market inefficiencies in distribution and financing. But they have limited resources to do so. The community of independent DBL investors is also in the early stages of development and its support organizations have limited resources.

Recommendations: Rationalizing the DBL Media Industry

Investors interested in DBL media companies generally want to support specific social agendas across several media segments. Almost all such investors wish to invest in companies that are likely to survive, grow and achieve some level of financial returns. Our research leads

us to make the following generalizations about the investors that may have an interest in DBL media:

- Most institutional investors with an interest in the DBL media industry invest in larger companies, particularly in emergent ethnic minority broadcast television;
- Pension funds, banks and government funds have invested in minority-focused media funds in increments of \$1 million to \$5 million. These minority-focused funds tend to invest in high-return, expansion stage (often larger) media companies rather than smaller, high-risk DBL media companies. These funds and their institutional limited partners often do not self-identify as DBL investors, even though they recognize the added social value to certain profit-centered investment areas, including media;
- Most DBL media investors are individuals and foundation PRI programs set to invest between \$100,000 and \$2 million per deal directly or through media funds;
- Most DBL media investors are particularly motivated by important social issues and, therefore, this group of investors is unique in the investment community;
- DBL media investors recognize that their investments are intended for stable, long-term revenue and profit growth, with an understanding that this includes lower to medium growth over time. While the community has no real DBL performance benchmark as guidance, it appears more “patient” and accepting of below-market rates of return;
- Lack of collateral on the balance sheets makes equity investments, rather than debt, the appropriate (and exclusive, if not lead) instrument for growth and expansion finance for DBL companies in most cases;
- Debt instruments are a good investment tool for DBL media companies in two cases: first, when a company needs to launch sales and marketing campaigns for reliable, subscriber-based cash flows; and, second, when a company requires completion gap financing for a creative product that is near completion and that has secured distribution; and
- DBL media investors understand that they are financing, in part, the development of a unique market. Since DBL media companies go public or get acquired at a lower rate than industry average, such investors must be willing to tie up capital for longer periods of time.

On the basis of these assumptions, the report finds that a necessary financial planning exercise for the DBL investor is to create an explicit set of performance expectations – including reasonable expectations for financial return – for their investments in DBL media. The report recommends seven basic guidelines to help generate a worthwhile financial return, mitigate risk, and help to expand the DBL media market:

1. Distribute Investment Risk: Invest in funds or other similar vehicles that apportion risk across multiple DBL media companies and that emphasize diversification of businesses and follow-on investment. This is particularly necessary for investors participating in fragmented, undeveloped markets such as the DBL media industry.

2. Insist on Business Fundamentals: Investors should choose DBL media companies that employ standard business fundamentals to drive their businesses. Unique DBL characteristics, in and of themselves, are not sufficient investment criteria.
3. Design for Scale: Investors should consider DBL companies with clear opportunities to scale revenues and market share.
4. Aggregate: As in Recommendation Three above, invest in the aggregation of several DBL companies into a larger business platform that can benefit from scale but still protect the mission focus.
5. Leverage Dominant Players: Consider companies that have a proven track record in establishing deals for distribution or production, including strategic partnerships with the larger players.
6. Plan for Exit: Most investors with long-term horizons (i.e., “patient investors”) must consider exit strategies. Therefore, it is important to screen for DBL companies that have a credible plan for and demonstrated ability to manage, for example, a private sale, recapitalization during an expansion round or an initial public offering.
7. Provide Technical Assistance & Support Capital Market Intermediaries: Infrastructure needs to be built to offer services for both institutional and individual investors who wish to invest in DBL media. Infrastructure entities also will assist DBL media companies to secure capital. Creating a series of linked capital market intermediaries and syndicate networks of investors can facilitate the financing of a range of mission-based media projects.

The report recommends that proponents of this market collaborate to develop financial service intermediaries to help with the following: create important information and transactional efficiencies through ongoing research and education, as well as network exchanges; produce industry financial reporting and deal services; and create DBL investment vehicles for pooling capital under management. Investment vehicles and intermediaries that allow for more aggressive and integrated social mission priorities will help to “rationalize” an industry that appears in desperate need of it. At this stage, collaborative thinking among potential funders and investors will be crucial in growing a commercially sustainable DBL media market.

The DBL Media Report’s Contents

The report that follows is in three parts:

Part One of this report is an overview of the **DBL media industry**, and contains three sections. In the first section, we examine the landscape for double bottom-line investing, define and identify what we mean by “social mission” or “double bottom-line” media companies, and share the results of our research into the needs and status of these companies. In the second section of Part One, we explore the financing options available to DBL media companies and analyze the overall health of the financial marketplace. The third section contains highlights of the DBL media industry by sub-segment, indicating trend factors, DBL opportunities and

examples of DBL companies. Together, these sections offer a comprehensive introductory report unto themselves. This section may be enough for those readers who are more interested in the cursory concepts and bottom-line recommendations. However, for those who wish to explore more of the finance-oriented discussion and case study, they may want to proceed to Part Two.

Part Two of the report explores **financing options** with greater industry detail and through four sections. The first section documents the media industry's historic reliance on debt and equity funding. The second section describes the use of different kinds of debt and equity in different subsets of the industry. Third, Part Two analyzes specialized fund vehicles that have been used to invest in DBL media, including foundation PRIs, as well as three detailed case studies on existing funds in the space: the Independent Press Development Fund, the Media Development Fund and the Lowell, Blake and Associates' Film Partnership.

Part Three of the report is a forward-looking set of **concrete recommendations** for investors interested in supporting the future development of DBL media. It outlines guidelines for investors and includes an overall strategy of specific, forward-looking actions.

In addition, there is an appendix to the report that includes more detail on our national survey (summarized in Part One), as well as case studies of organizations discussed in the report.

The executive summary of this report may be downloaded free of charge from Investors' Circle's Web site at the following link: www.investorscircle.net/ic/dblmediafinance. Access to the rest of the report requires registration with Investors' Circle.

PART ONE:

OVERVIEW OF THE DBL MEDIA INDUSTRY

A. INTRODUCTION

As of the third quarter of 2004, the media industry had a total market capitalization of more than \$900 billion dollars, including, specifically, publicly traded media companies and related subsidiaries.¹ This market's ubiquity and impact on global culture make it attractive to investors and financial and cultural analysts.

Today, even as the media landscape changes and media ownership continues to consolidate in four or five major media companies, market demand continues to fluctuate and fragment. One result of this market growth is the increase in demand for media products that represent a diversity of independent voices and "niche" demographic interests. For those who wish to invest in financially viable media companies that also have explicit social-minded objectives, however, investment choices are not as clear.

This report, commissioned by the Ford Foundation, represents the first two phases of an effort to identify and analyze such companies' financial structures and needs.² We conducted primary research, including in-depth analyses of industry sub-segments and interviews with fund managers, company executives and trade group representatives. We also developed and administered two unscientific national surveys, one of which was sent to almost 6,000 social mission media companies. We sent the second survey to more than 1,000 financial advisors and fund managers.

Our results were interesting and gratifying. We found hundreds of DBL media companies with clear and compelling objectives: from small, foreign-language minority-focused newspapers to television programs aimed at changing public environmental policy. At the core of the majority of these companies is a heartfelt desire to achieve change, to promote diversity in the industry, and to ensure that positive social values are not supplanted by a preoccupation with profitability. While these companies' respective financial growth and returns are not as high as traditional fund manager's might expect, many of these companies are self-sustaining and growing. More pertinently, they are seeking to have a positive social impact along with their financial one. We also found a few outlying opportunities that are demonstrating highly competitive rates of financial returns, while addressing an under-served social need.

We believe that pioneering investors and fund managers can invest in a broad array of high social return opportunities in media while credibly mitigating financial risk. Most will likely not be high return investments. However, over the medium- to long-term, we believe that many of these companies will do a great deal of social good and perform reasonably well financially to justify debt and equity investments in them.

B. MEDIA AS A VEHICLE FOR SOCIAL IMPACT

The Impact of the Media Industry

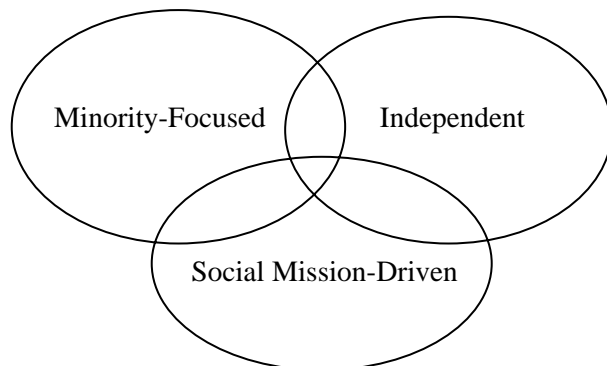
Many observers interested in social mission companies have come to pay particular attention to the mass media because of its central role in mobilizing the public as consumers and citizens. The media help to drive the public to shop (through advertising) as much as they make the public aware of otherwise unnoticed pressing social issues and problems. In today's "information society," the media are a central defining social force that reflects and helps constitute reality. Thomas Carlyle's 19th century observation that the press in revolutionary France was the "Fourth Estate," "a power, a branch of government with inalienable weight in law-making, in all acts of authority" rings true even today around the world.

At the same time, however, the media industry is managed generally as any other industry sector: Companies seek to maximize revenue, grow earnings and profits over time, and beat the competition. And there is a lot of money to be made. In 2004, the industry had a total public market capitalization of more than \$900 billion. As the seventh largest economic sector in this country at the time, overall revenues in the media industry were \$648.3 billion in 2003.³ The growth rate (CAGR) for the industry between 1998 and 2003 was 4.8%, which is slightly greater than the 4.7% rate of growth in GDP over the same period. Veronis Suhler Stevenson's 2004 annual industry report forecasted that the industry would grow at 6.4% from 2002 to 2007, again exceeding projected GDP growth of 6.0%.⁴ Today, in the fall of 2005, VSS projects that communications is expected to be the fourth fastest growing sector of the U.S. economy in the period from 2004 to 2009, expanding at a compound annual rate of 6.7%.⁵ Growth in 2004 was 7.3% and is forecast to be 6.8% in 2005. VSS expects that the sector will reach \$1.1 trillion in 2009. While VSS attributes these impressive growth rates to increases in institutional spending on media,⁶ they also expect that new media will drive advertising growth during the forecast period. In any event, as there are companies across all segments within the industry that incorporate social impact as a core business objective, the mass media seem to be an ideal subject for any DBL investing strategy.

Methodology: Identifying DBL Media Companies

Traditional investors generally employ a set of well-defined tools – from profit/loss statements to cash-flow analyses – in order to evaluate a company's financial strength. The capital markets, however, do not have a shared method of measuring social impact, particularly with regards to the media industry. While this report does not identify any particular tool set for measuring social impact, it tentatively provides a simple framework of analytical screening criteria that interested funders and investors might consider useful in beginning to look at this market more closely.

Although there are many different methods to measure social impact and social returns,⁷ here, we



identify three broad characteristics of DBL media companies: **minority-focused, independent, and social mission-focused**. For the purposes of this report, a DBL company may have one or several of these characteristics. All such companies, moreover, must have a “positive social value.” We define these categories in more detail below. First, however, we provide a brief word here on the contemporary social and cultural circumstances that guide our focus.

These categories essentially signify two central points of interest: (1) supporting the essential role that media has in informing and developing a vibrant and healthy civil society in today’s world, and (2) mitigating the inauspicious consequences that consolidation trends in the media industry may have on our democracy in general and the availability of distribution channels and diversity of content in particular.

Consider, for example, the trend in television that has unfolded since the enactment of the Telecommunications Act of 1996. Between 1995 and 2003, 10 of the largest television station owners went from owning 104 stations with \$5.9 billion in revenue to owning 299 stations with \$11.8 billion in revenue.⁸ This horizontal consolidation of ownership creates scale and, with scale, comes market power. This report does not attempt to offer any in-depth analysis of the overall effects of consolidation trends. Indeed, we acknowledge that such trends are not necessarily antithetical to democracy. However, we are equally sure that the founding principles of our country underscore the essential need for an informed and active citizenry. This report represents a deep faith in developing new *market-oriented* insights in order to promote the media’s historical role in supporting effective democracy. We believe that the conceptual framework of this media report and the work of the underlying IC project not only help address this social and cultural need in general, but also advance the possibility of working successfully within the private market.

It is our belief that DBL investors will be interested in minority-focused and independent media in particular because trends in ownership will affect which companies get to “air” or publish their content to large swaths of the consuming public. (We already know that these ownership trends have affected the programming that companies can compel distributors to purchase.) As minority-focused media historically have not had the access to distribution channels and capital in the way that mainstream media have, any effort to enhance their capacity to reach audiences is consistent with diversifying ownership in the industry as well as the composition of content. We perceive any effort that accomplishes this to have a positive social impact. We, like most DBL investors, see ethnic diversity in media as an end in itself. Similarly, we anticipate that the lack of content diversity in the mainstream media will marginalize “alternative” social mission focused-media to the point that the latter will not reach interested niche audiences.

Nor, in today’s commercial media environment, will the smaller social mission-focused media companies be able to reach otherwise new audiences. We believe, like many DBL investors, that supporting social mission-focused media that would otherwise never be seen, read, or heard is an end in itself. We will now define in greater depth the three categories of DBL media companies – minority-focused, independent and social mission-focused – as follows:

Minority-Focused Media

A media company whose central mission is to represent, support and target a particular demographic minority group (i.e., African-Americans, Latinos, Asian-Americans, Jewish-Americans, GLBT and the deaf) is, for the purposes of this report, “minority focused.” More specifically, a DBL media company is “minority focused” if it satisfies three of the following criteria:

- Audience: The company specifically targets an ethnic or other minority group through a significant percentage of its programming, production, advertising or distribution;
- Ownership: A majority of the company’s shareholders are members of an ethnic or other minority demographic group even if the company’s programming does not target a minority audience;
- Management: The company’s management consists predominately of a specific ethnic or other minority demographic group even if the programming, production and distribution does not target that specific group;
- Creative: The creative team, including writers, editors, actors and producers, are predominately from an ethnic or other minority demographic group; and
- Content: Most of the content that the company sells contains themes and portrayals particular to an ethnic or other minority group.

Independent Media

An independent media company generally does not allow profit maximization alone to govern its creative processes. At best, the business model for independent companies requires a kind of symbiosis between profit and the creative processes. Indeed, sustainability of the business model requires such a relationship. For these reasons, a DBL media company is “independent” for the purposes of this report if it meets at least three of the following criteria:

- Audience: The company specifically targets individuals who prioritize media that provide unique and creative points of view that are otherwise not provided by the more popular media;
- Ownership: The ownership of the principal entity is not controlled by a mainstream media company and, just as importantly, sees sustainable independence as an essential element of the creative editorial process;
- Management: The company’s management sees independence as an essential element of the creative editorial process and explicitly supports and protects the creative independence of the editorial process; and
- Content Creativity: Content creators do not attend particularly to mainstream or popular perspectives. Although their product may indeed achieve popularity and

commercial success, independent creators emphasize unique message, original voice and influential craft skill as primary criteria.

Social Mission-Focused Media

A media company that includes, as part of its core charter or mission, the achievement of a specific social, political or cultural goal has a “social mission” for the purposes of this report. Although this is broadly true of a variety of media companies (after all, many very commercially successful media companies purport to have some social mission when they assert that they seek, for example, to be “fair and balanced”), we classify companies that meet the following criteria as a “social mission-focused” DBL media company:

- Audience: The company specifically targets individuals who seek out or have an affinity for media that address particular social issues;
- Core Mission: The company’s social agenda is equally important to or more important than its financial objectives;
- Management: The company’s management personally supports the social agenda of the company; and
- Content: The company’s media content consistently promotes its perspective, even if – and often especially because – such views are underrepresented in the mainstream media.

A Note on “Positive Social Value”

As we explain above, no matter which of the three categories to which a company belongs, all DBL companies share a fourth characteristic: They have positive social or cultural value. Value, in this case, is admittedly more ambiguous because it is a matter of judgment. We make our assumptions transparent here without engaging in a debate about the variety of relevant values at stake.

Positive social value has a particular meaning for the authors and funders of this report. Although we are not formally aligned with any particular political party or social organization, the DBL media companies we monitor and discuss here have a predominantly progressive orientation. Examples of positive social values that, for the purpose of this report, might be present in DBL media companies include the following:

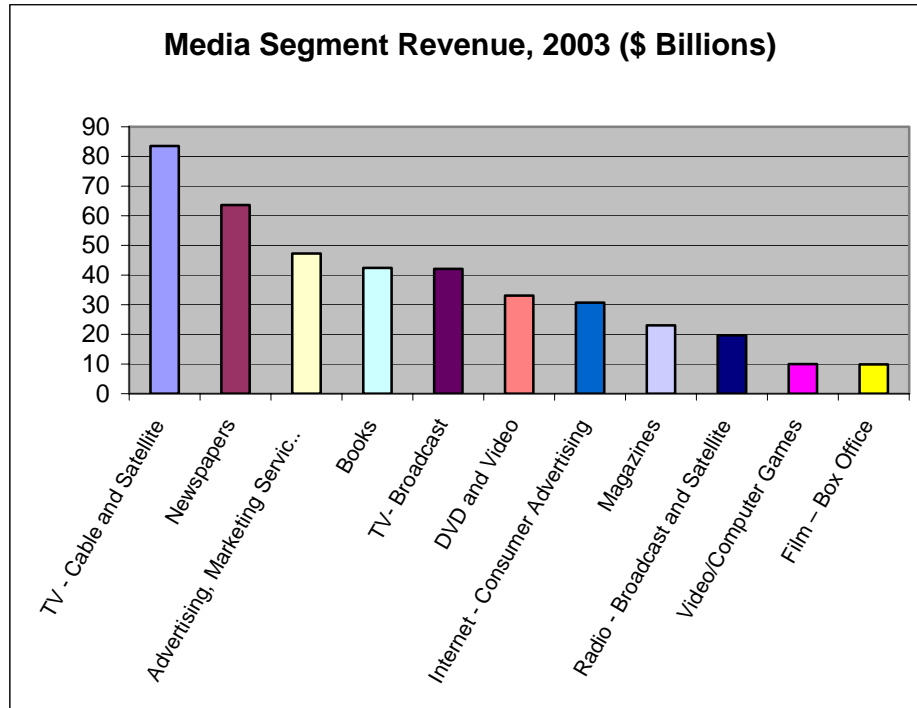
- Environment: Promoting the protection of the natural world, conserving its resources, and promoting sustainable consumer, industrial and development practices;
- Human Rights: Promoting the protection of equal rights for all human beings including such basic rights as freedom of speech and due process; and
- Social Justice: Promoting the essential elements of life in civil society, including shelter, food, education, due process of law and freedom of speech.

Below, we evaluate companies to determine whether they meet the criteria of a DBL company defined above. Although there is no hard-and-fast rule for most of these criteria, we try to be consistent within our own framework. That said, it is practically self-evident that each individual investor will determine for himself or herself whether the agenda and values of a particular media organization meet his or her personal objectives. It is our hope, however, that a well-structured project can devise unimpeachable measures of positive social impact to which a diverse array of investors and grant-makers can agree.

Finally, we recognize that many mainstream media companies may own or manage subsidiaries or divisions that resemble DBL companies we will discuss here. Consider, for example, two divisions of prominent media companies: Logo, a new cable network owned by Viacom with programming that addresses and celebrates gays and lesbians, and Telemundo, a Spanish-language broadcast network owned by NBC Universal (which is owned, in turn, by General Electric) that actively seeks out a Latino audience. Although these corporate divisions have significant DBL characteristics, they are not DBL media companies in the context of this report for two reasons: first, one can not invest into these subsidiaries directly, but rather only the larger holding company; and, second, the major media companies — including those that own DBL-oriented media subsidiaries — consider profits and competitive return on investments fundamentally more important than any other bottom line held by one of their divisions. These holding companies reserve the right – and, in fact, contend that it is their legal and fiduciary responsibility – to subordinate any of the DBL goals and objectives of a media property to optimize profits if necessary.

Defining and Sizing Media Industry Segments

Comprehensive analytical reports on the media industry generally divide the industry into various distinct segments. For the purposes of this report, we will focus on 11 consumer- and advertising-driven media segments identified by Veronis Suhler Stevenson, including the specialty media segment of advertising. Together, in 2003, these represented \$405.27 billion out of \$648.3 billion in total media industry revenues.⁹ Following the strong industry growth of the past couple years, Veronis Suhler Stevenson forecasts that total communications spending in 2005 will be more than \$857 billion, with strong performance coming from advertising spending at about \$200 billion. As of October 2005, consumer spending will be more than \$252 billion in 2005.¹⁰ The two charts below identify the industry segments on which this report focuses. Categories that contribute to VSS's calculation of total media industries but that are not included here are business-to-business media and professional and business information services.



Segment	2003 Revenue
TELEVISION	
Broadcast	42.1
Cable and Satellite	83.5
RADIO	
Broadcast and Satellite	19.7
ENTERTAINMENT	
Film - Box Office	9.9
DVD and Video	33.1
Video/Computer Games	10.0
PUBLISHING	
Newspaper	63.6
Magazines	23.02
Books	42.4
INTERNET	
Consumer Internet	30.70
ADVERTISING	
Advertising, Marketing Services & Specialty Media (not ad spending)	47.25
Total	405.27

Despite the established and significant scale of these revenue figures, the media industry is transforming rapidly. A recent report by Columbia University on the State of the News,¹¹ for example, notes that the following forces are causing a major redistribution of value within the industry across segments:

- Mainstream media companies continue to chase relatively static or even shrinking audiences. For these companies, their general audiences are growing in the Internet, minority-focused (particularly Spanish-language), and “alternative” media. (This supports this report’s narrower underlying assumptions.)
- Much of the new investment today is in the distribution of media, not in collecting or creating it.
- Online media is converging with traditional media and adding to the creation of large media conglomerates (e.g., Time Warner).
- The creators of media programming are gaining power in the value chain as an increasing number of distributors compete for content.

National Survey Findings and Conclusions

At the outset of this project, we found no comprehensive research focused on investing in the DBL media industry. This general lack of relevant or recent primary data makes it difficult to draw conclusions about privately held, emergent DBL media companies. Accordingly, we designed a field questionnaire to identify and survey DBL media companies about themselves. Preliminary analysis of the results from this survey was a significant asset in gaining greater understanding of the DBL media industry. Although we have not had the resources to study this data in any depth, several of our initial findings provide context for this report. The reader may turn to Appendix A for a more complete summary of the survey findings.

Survey Process

Our research team distributed one standard voluntary convenience questionnaire with 48 questions to 5,907 companies. These questions were designed to elicit basic managerial, demographic, organizational and financial information about respondents. The targeted companies were all members or associates of 12 national media trade associations. We culled these specific trade groups from a larger screening effort of more than 20 media trade associations. Each of these 12 groups self-identified as membership or trade organizations that support DBL media companies as a primary or at least significant part of their mission. Once selected, these associations assisted in the distribution of the DBL Media surveys (see chart below).¹² Respondents submitted their answers to the surveys online. There were no sampling or other statistical controls on either the survey content itself or the survey population. The collected data, therefore, does not necessarily reflect the broader universe of DBL media companies.

Organization	Description	# Members	# Responses	% Responses
Asian American Advertising Federation	Asian-American advertising industry trade group	30	11	2%
Association of Hispanic Advertising Associations	Hispanic advertising industry trade group; also organizes pro bono	70	4	

	advertising campaigns for the Hispanic population			1%
IFP/New York	New York chapter of a national independent film trade group	180	14	2%
Independent Press Association	Independent newspaper and magazine publishing trade group	457	156	24%
Independent Television Service	Grant-giving organization that funds independent television programming for under-served audiences, primarily for public television	50	5	1%
National Asian American Telecommunications Association	NAATA a non-profit national media arts organization that funds, produces, distributes and exhibits films, videos and new media relating to the Asian Pacific American experience	400	40	6%
National Black Programming Consortium	NBPC is a non-profit national media arts organization committed to the presentation, funding, promotion, distribution of diverse images of African American & African diaspora experiences.	80	7	1%
National Newspaper Publishing Association	Black newspaper publishing trade group	140	8	1%
New America Media (formerly New California Media)	Nationwide association of ethnic media organizations	700	45	7%
Publishers Marketing Association	Independent book, audio, and video publishing trade group	3800	355	55%
Total		5,907	641	100%

Survey Results

We received 641 individual responses from the pool of targeted companies. This 11% response rate yielded the following highlights:

- Approximately 88% of the participating organizations were for-profit companies and 12% were non-profit organizations.
- About 70% of the responses come from the publishing segment and, of these, 68% have a circulation of less than 300,000.
- 65% of respondents reported their income status as profitable or “break even.”
- 75% of respondents indicated an interest in outside financing.
- 60% of respondents indicated they have a written business plan, and 40% have a three- to five-year financial model.

Preliminary Findings - Overall

We found companies that shared various combinations of the three DBL characteristics. Yet, across the board, we found most DBL media companies share certain additional central business characteristics unrelated to their intent on fostering positive social value. In sum, the DBL media companies that we surveyed tend to be:

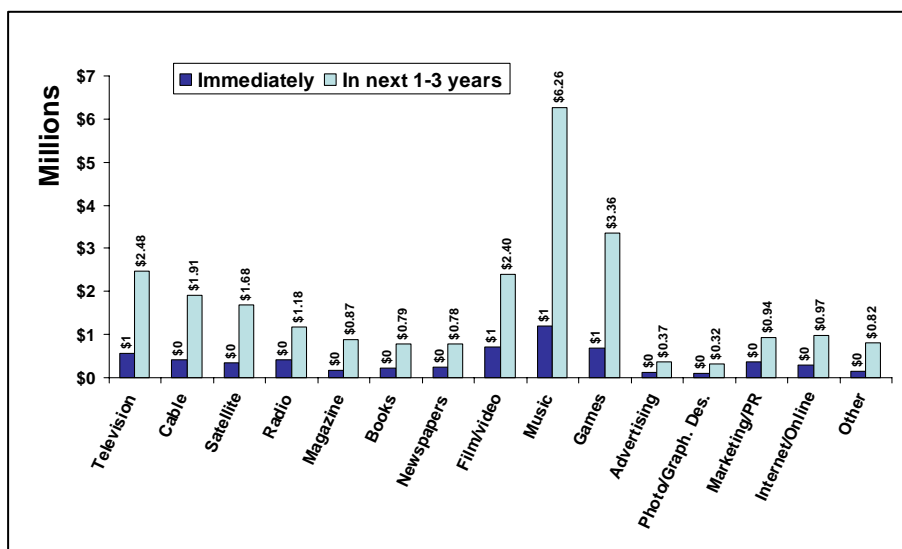
- small, as measured by number of employees and revenues;
- highly motivated by their social missions;
- equally committed to achieving both their economic and social missions; and
- generally high-risk investments with low financial returns.

We found, moreover, that many DBL media companies tend to:

- either “break even” or be profitable;
- want and seek some form of capital; and
- are decisively committed to maintaining creative control of their product (although one-third are willing to consider selling their company).

Not surprisingly, these companies are very interested in outside funding. More interesting, however, is the amount of funding that they seek. See the graph below.

Average capital sought by segment



In 2004, 224 respondents were seeking \$53.3 million, ranging from sums of \$5,000 to \$1 million. Over the next one to three years, 262 respondents are seeking \$209.2 million, from \$10,000 up to \$7 million. As approximately 10% of the associations’ members responded to the surveys, we expect that the total appetite for financing probably exceeds \$2 billion. Consider, moreover, that these groups are only a fraction of the overall DBL media industry.

After the Survey

We believe that more careful analysis will yield richer information about DBL media companies. Thus, we strongly recommend that the following additional analysis be done:

1. initiate more in-depth study of the data that we have already collected;

2. validate and extend the survey itself; and
3. broaden the recipient base for future surveys.

We anticipate that, with more data, investors will come closer to generating a concrete, baseline sense for how the DBL media industry looks.

Finally, the work we have done in this report will prove valuable in crafting a more scientifically valid survey that could be administered annually to track a more targeted set of variables. Indeed, through the administration of the survey, we built important relationships with national trade organizations in the DBL media space.

C. INVESTORS IN DBL MEDIA

The vast majority of investments made in the media industry are concerned only with the financial bottom line. Here, we present a very broad overview of this industry and comment on the investment possibilities in DBL media. We discuss these in more detail later in the report.

Types of Equity Investors in Media

Private equity firms and funds generally invest in high growth companies at all stages of development that have stable underlying assets or intellectual property. There are five categories of equity investors which have invested in the media industry:

1. Strategic Large Media Corporations

Adjusted total revenues for publicly traded reporting media companies rose 9.7% to \$361.2 billion in 2003, and grew at a compound annual rate of 9.3% from 1999 to 2003.¹³ Publicly traded companies, such as Viacom, Liberty and Comcast, generally seek transactions of at least \$1 billion to capture market share, expand economies of scale and consolidate competition.

2. General Buy-Out Firms

In the late 1990s, buy-out funds collectively raised as much as \$50 billion to \$60 billion per year. Yet, by the early 2000s, they were deploying only \$30 billion to \$40 billion per year.¹⁴ As of 2003, these funds have \$90 billion in uninvested, “overhanging” capital. However, since then private equity funds have continued to increase the total assets under management considerably. Many of these firms will do a couple of media industry investments per year, competing with specialty media buy-out firms and strategic investors. During the past three years, these funds typically engaged in transactions that have a 3:1 debt-to-equity ratio.

3. Specialty Buy-Out Firms

Examples of some of the best known buy-out firms that specialize in media are Abry Partners, Boston Ventures, Providence, Quadrangle Group, Spectrum Equity Investors, Veronis Suhler Stevenson, and the Wicks Group. These funds of \$1 billion to \$3 billion focus on late stage leveraged buy-out (LBO) transactions across all media segments, deploying \$20 million to \$150 million per deal.¹⁵

4. Venture Capital Firms

Between 1998 and 2003, investors committed \$244 billion into venture capital (VC) funds and, as of 2003, approximately \$50 billion of these commitments were uninvested. Approximately 9%, moreover, target the “retail and media industries.” The average deal in the industry was approximately \$6 million in 2003.¹⁶

5. Angel Investors

Industry observers increasingly recognize that angel investors (“angels”) comprise an “informal venture capital” sector of accredited investors who make investments of \$100,000 to \$2 million. Consider the fact that more than 150,000 angels invested \$15.7 billion into 36,000 companies in 2002.¹⁷ Indeed, angels invest in a greater number of deals and at a smaller average transaction size than conventional VC firms. Angels tend to focus predominantly on similar industry areas as the VC firms.

The financial bottom line is paramount for all of these equity investment categories. While corporations and specialty buy-out firms offer a potentially positive “exit strategy” for a profitable DBL company (e.g., NBC Universal’s acquisition of Telemundo or Leonard Green & Partners’ acquisition of the community newspaper aggregator Liberty Publishing), social mission generally becomes subordinated by such investors.

Types of Debt Investors in Media

The media industry often secures finance in the form of debt. The following two categories of debt investors invest in media across segments.

1. Commercial Banks

Commercial banks lend to media firms with established track records. The debt-to-equity ratio of 0.61 in publicly traded media companies is lower than both the overall 0.82 debt-to-equity ratio for the services sector (in which the media industry is generally included) and the average market capitalization debt-to-equity ratio of 0.89 for *all* sectors. (The latter excludes the financial services sector to which this ratio is not applicable). Lack of collateral on the balance sheets – which describes most media companies – is, right or wrong, considered high risk to most of these commercial lending institutions.¹⁸

2. Bond Markets

Traditional media have tapped bond markets for capital. Most DBL companies, however, are below “investment grade” (e.g., BBB or lower) of rating agencies and/or unqualified for rating for the bond market because most often lack audits, business plans and scale.

Debt has the potential to increase greatly the leveraged impact of the media sector, but often is either (a) not possible without an increase in equity or grants to support it, or (b) is more readily available to expansion stage or maturing enterprises than other types of capital. While debt is generally inappropriate for very early stage ventures because of the credit risk, later-stage or large-scale market rate transactions have access to traditional sources of debt. Caught in the lurch is a critical middle layer of strong social purpose enterprises (and the intermediaries that serve them) for which there is considerable need for DBL debt, but little access to it.

Double Bottom-Line Investing

Many investors today are becoming more attentive to social as well as financial returns. That is to say that, while most market activity focuses solely on profitability, some investors are beginning to recognize that non-financial goals are appropriate criteria for investing. As Stanford Graduate School of Business lecturer Jed Emerson has explained, all commercial activity “is embedded with economic, social, natural, and cultural capital.” In his book, *The Blended Value Map: Tracking the Intersects and Opportunities of Economic, Social, and Environmental Value Creation*, Emerson outlines an approach to investing that rejects the notion that there is “a real separation in the notions of value.”¹⁹ “Blended value investing,” a synonymous if not more expansive phrase for “Double Bottom-Line” investing, attempts to account for all capital that creates all value, particularly social value.

The Social Investment Forum (SIF), a research and trade group for mutual fund managers and financial advisors who focus on socially responsible investing (SRI), historically has represented investments in publicly traded companies and, according to SIF, now represents \$2.1 trillion of investment involving social screens, socially focused shareholder advocacy or community investments. However, DBL investments refer to private equity investments more narrowly, and debt related activity into privately held companies. This is a considerably narrower slice of the finance pie, but one in which investors maintain the essential focus on early to expansion stage companies. In other words, by investing in publicly traded SRI portfolios, investors can arguably minimize the negative impact of larger corporations, including media conglomerates. By investing in privately held companies, including social enterprises and DBL companies, an investor has an opportunity both to help forge a positive social agenda during the formation of a company, as well as exert a proportionally higher impact at this stage of a company’s growth than in the public markets.

Private equity investors and early/mezzanine debt investors, philanthropists and non-profit organizations, researchers, and academics are all intensifying their attention to DBL investing. Some non-governmental organizations which are interested in fostering blended value investment approaches, such as the World Economic Forum, the Rockefeller Foundation, and the International Finance Corporation, have adopted “blended value” and DBL investing approaches. Additional trade groups that focus on various segments of the DBL market are gradually emerging, developing conceptual frameworks and helping organize an informal marketplace. Workshops on private investing for social goals and their venture fairs, involve a broad range of attendees, including institutional and retail investors, venture capitalists, banks, fund managers, asset managers, institutional philanthropists, development finance agencies, and social entrepreneurs. For their part, many non-profit organizations are beginning to recognize that some time-tested business practices can help to create economic value for even them and, in turn, help to achieve the social missions of their respective grant programs.

Thus, to all parties involved, an attempt to find a way to federate social purpose and profitability, and thus produce investments in DBL companies, is welcome. Indeed, it is more than welcome; it is imperative because the alternatives are not sustainable. We now turn our attention to a more in-depth exploration of the universe of DBL investors.

Specialized DBL Investors

There are four kinds of investor that have begun to make specific investments in DBL companies: DBL equity funds, DBL angels, revolving loan funds (RLFs), and Program-Related Investment (PRI) funders (which include a broad range of foundation types).

1. DBL Equity Funds

An estimated \$2 billion to \$6 billion of the private equity and non-profit capital market is available for investing in companies with social (i.e., not financial) missions.²⁰ Four types of funds comprise this market: VC funds “with a conscience” (i.e., mainstream funds that have devoted some portion of its capital to DBL deals); change-focused VC funds (i.e., funds that are particularly focused on certain issues, such as charter schools or alternative energy); leadership- or development-focused VC funds (i.e., is, funds that emphasize increasing opportunities of ownership and/or management of underrepresented groups, such as women and ethnic minorities); and non-profit social investment funds (i.e., funds or fund activities embedded within philanthropic foundations and public charities, and which employ PRIs as near-equity instruments).

The “leadership- or development-focused VC funds” are minority business-oriented, which is to say that they seek to develop entrepreneurial leadership in ethnic and racial minority communities. These arguably have the longest DBL equity history of the four types mentioned above, dating back to the 1960s. There are essentially two types: minority enterprise or specialized small business investment companies (MESBICs and SSBICs) backed by the U.S. Small Business Administration, as well as the member firms from the National Association of Investment Companies (NAIC). As of 2004, NAIC member companies have invested more than \$2.5 billion in more than 20,000 businesses, and represent more than \$4 billion in capital under management. NAIC member managers have invested a significant fraction of this capital into funds with an exclusive focus on direct investments into minority-oriented businesses. This fraction represents at least \$1.33 billion raised since 1989, and \$250 million invested between then and 2000. Most pertinently, 48.7% of these minority-oriented investment dollars went into the media industry during that period.²¹ This ratio is largely attributed to federal regulations relating to minority ownership of broadcast and other media properties.

Excluding the VC funds from the NAIC/SSBIC groups, less than 10% of other DBL funds – comprising less than 1% of all survey DBL fund assets – are interested in the media industry.²²

Furthermore, for the most part, DBL VC funds operate like typical small- to medium-sized VC funds and consider financial performance of primary importance and only secondarily consider the social mission issues.²³

2. DBL Angel Investors

Known DBL angels represent approximately less than 1% of all angels and invest infrequently in the media industry. Investors' Circle, the sponsoring organization conducting this report, is a network of investors focused exclusively on DBL companies. To illustrate, Investors' Circle members have invested more than \$100 million in 160 deals over the past decade. Only 4% of this investment, however, has been in DBL media companies. Additionally, 77% of these angels expect an internal rate of return (IRR) of more than 10%, even though 64% have invested in deals that are expected to generate below market returns in return for "high social impact."²⁴

3. Revolving Loan Funds

RLF's are debt vehicles that loan an amount, recoup that amount with interest over a short period of time, and then re-lend those funds going forward. These vehicles have emerged within the community investment debt sector. As measured by assets invested in community development financial institutions of all types, the market totaled \$14 billion in 2003 with a compound annual growth rate of 23% annually over the last six years. What is more, growth has been *accelerating* at 36% over the last two years.

RLF's act as intermediaries for investors or donors wishing to reach enterprises' capital needs in a sustainable manner. They are historically non-profits with specific social missions. Originally, they were created to support low-income housing and community development loans. RLF's perform substantial due diligence before making a loan, thereby decreasing risk of default on repayment. However, they do accept below-market rates of returns. The overall capitalization of such loan funds is \$3.6 billion as of the end of 2003. Virtually none of these, however, specifically focus on DBL media companies, although many anecdotally lend to small media enterprises much as they would to any small enterprise. The only two DBL media debt funds are in fact RLF models, including the Independent Press Development Fund (IPDF) and Media Development Loan Fund (MDLF). These funds have \$500,000 and \$30 million in assets respectively. These funds are examined in detail within this report.

Although debt is often inappropriate for early stage ventures because of credit risk, intermediate stage companies may also have difficulties securing debt through traditional means – even if their risk profile is lower. We nevertheless believe that debt financing can be a reasonable, moderate-risk method of investing in DBL media companies. We discuss such a possibility in depth later in this report. (See the debt industry analysis below as well as the attached IPA case study for more information on debt financing in DBL media.)

4. Program-Related Investment Investors

Private or public foundations may use non-profit charitable funds – in the form of program related investments (PRIs) – to issue below-market rate debt and equity investments to support directly their own grant programs. The IRS stipulates three main criteria in order for a foundation to make such investment with its charitable funds. All such investments must:

1. Be consistent with the stated mission and goals of a philanthropic program of the foundations;
2. Represent not only a below-market rate of financial return but ensure that its primary objective is not profit-generation; and
3. Be offered to a socially focused company which other wise cannot procure such an investment from conventional financial sources.

Foundations make very few PRI grants in general, and very few PRIs to DBL media companies in particular. As of 2003, in the U.S., more than 61,000 active private and community foundations are making \$200 million in PRIs per year, or roughly 0.66% of \$30 billion in annual charitable distributions, and just 0.04% of total assets. According to the Foundation Center, in the U.S., foundations made more than \$350 million in PRIs in 2000-2001, of which the most was spent on program areas such as community development (24.5% of total PRI dollars), the environment (18.3 percent), and education (16.8%).²⁵ Foundations allocated 8.4% to “arts, media, and historic preservation” during the same period.

While these PRI figures are historically small, they also represent a significant potential growth area for DBL investing because of the unique alignment between social mission and performance objectives between such funders and recipient company. In addition, PRI instruments broaden the range of foundation participants in this market, including traditional, large foundations (e.g., Ford, MacArthur and Rockefeller); smaller family and community foundations; and individual donor advised funds (DAFs).

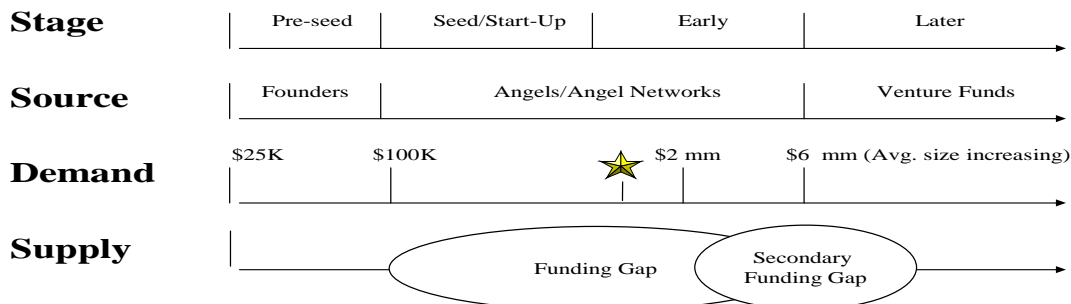
Capital Markets for DBL Media: Fragile and Fragmented

Capital and information inefficiencies plague the DBL investment market in general and the DBL media market in particular. DBL media companies are not established enough to attract conventional capital markets and their related services. In a few DBL segments, such as ethnic minority television broadcasting, the capital markets have indeed responded. But this is primarily because of regulatory motivations, the intrinsic financial characteristics of the players, and the promise of emergent ethnic minority markets. Consider, for example, Viacom’s acquisition in 2000 of Black Entertainment Television for about \$3 billion, Comcast’s acquisition/partnership with Radio One which owns and/or operates 69 radio stations located in 22 urban markets in the U.S., and General Electric’s acquisition of Telemundo for nearly \$2 billion in 2001. GE, the parent of NBC, outbid a very interested Viacom. Activity in ethnic minority media, however, is an exception.

The Capitalization Gap

There is a capitalization gap in the DBL media market that mirrors that of the general early-stage capital markets. The graph below illustrates the underlying financial needs of private companies through each of their major phases of development. There are two notable funding gaps for new and early-stage DBL media companies which fall in between the cracks of the larger market of financial investors in media. The first occurs when the first rounds of “founders, friends and family” funder runs out for most companies. As the average size of

venture capital funds has increased, so to have their average transaction size. This means that most start-up companies must typically seek investment from the far more diffuse and less efficient angel market in order to get enough capital to begin to prove their concept in the market. Furthermore, as the average transaction size of venture capital rose above \$6 million, it created a second capital gap since angels typically invest a range of \$100,000 to \$2 million. This means that even companies that have successfully proved their core business concept and are now looking to “roll out” and compete further, will most likely not find the needed capital for this expansion stage either.



This data is an integration of research insights from the University of New Hampshire’s Center of Venture Research (CVR), the National Association of Venture Capital Association (NVCA) and Columbia University’s RISE program. While CVR’s and NVCA’s data involves conventional markets and mainstream companies, RISE’s data involves DBL investors only. Interestingly, each of these broader research findings corresponds closely with the findings of our own survey: DBL media companies find a particular need for \$100,000 to under \$2 million from outside sources. More specifically, 44% of DBL companies seek \$1 million or less during the seed to early stages and face a critical shortage of investment sources to find this needed capital.

Intermediaries and Investment Services are Weak

Conventional media investors and companies alike have available to them a broad range of investment services – ranging, for example, from strategic industry analysis, company due diligence, finance transaction structuring, and deal syndication – provided by a broad range of intermediaries. The investment service sector of the mainstream market includes nearly 100 publicly traded companies (including the major giant corporations such as Morgan Stanley, Goldman Sachs, etc.) with a combined market capitalization of \$324.4 billion. This figure neither includes the myriad of private and boutique investment service providers nor those media

specialists within the group such as the merchant bank and research arms of Veronis Suhler Stevenson cited throughout this report.

In comparison, the DBL media market is represented by only a few important, but mostly fragile, emerging trade groups (many of which participated in the national surveys of this project) and even fewer financial intermediaries. Most of these intermediaries have limited financial service offerings, if any at all. An exceptional few organizations, especially in publishing (such as the Independent Press Association (IPA) discussed in Appendix B) are attempting to address market inefficiencies in distribution and finance. However, at present, almost all have limited resources to do so.

Independent DBL investors engage projects at the early stage of development and have limited resources. Investors' Circle, with nearly a \$1 million annual budget and the Calvert Social Investment Foundation with a \$2.25 million annual budget, are examples of organizations beginning to support equity and debt investments in DBL media companies. CleanTech and the Community Development Venture Capital Alliance (CDVCA) are specialist intermediaries which focus on vertical industry areas (energy and community development, respectively) and provide legislative, trade and investment services. However, an informal survey of all such known DBL investment intermediaries (including research and consulting firms active in this space) have less than \$20 million combined annual budget. Nevertheless, pursuant to the attention foundations and investors have paid to DBL investing in only the past two or so years, momentum is gaining. Organizations such as Social Venture Network (SVN) and Net Impact, and universities such as Columbia, Berkeley and Stanford, are providing intermediary training, education, competition for funding, and services to DBL companies.

Eliminating Inefficiencies: Aligning DBL Investor Motivations

At present, the DBL media marketplace is highly fragmented and requires rationalization. Financial service intermediaries can help to create important information and transactional efficiencies through offering network exchanges, industry financial reporting, deal services and assistance in pooling capital under management. Given, moreover, the focus of profit-imperative and credit-risk aversion of the private equity and debt investors described above, investment in DBL media companies requires investment vehicles and intermediaries that particularly appreciate DBL priorities.

Investors interested in DBL media companies most likely want to support specific social agendas across several media segments. All such investors wish to invest in companies that are likely to survive, grow, and achieve some financial returns. The solution for the DBL investor is to create an explicit set of concrete social impact performance expectations and measures, as well as reasonable expectations of financial return. We will return to this in Part Three of this report.

D. DBL MEDIA INDUSTRY: SEGMENT HIGHLIGHTS

As we explain above, we have divided the media industry into 11 segments for the purposes of this report. Below is a summary of those segments and the DBL activity within them. Here, we assume that the reader has some basic familiarity with the media industry. For more details on any one of the segments, please visit www.investorscircle.net to see the respective segment report drafted in conjunction with this project.

1. Broadcast, Cable and Satellite Television

More than 98% of the 108.4 million U.S. households own a television set. Nearly 75% own two or more. In 2003, the broadcast, cable and satellite industries earned combined revenues of \$125.6 billion. These segments have mature, consolidated markets. High infrastructure and programming costs create significant barriers to entry. With the possible exception of public television, most DBL investment opportunities in television are small scale, local, or niche market.

Highlights:

- Most DBL investments in the television segment are **high-risk with likely low financial returns**. Local cable franchises are the possible exception.
- Within the broadcast television sub-segment, **low-powered television (LPTV) provides notable opportunities for investment**. These stations are based in rural and under-served urban areas and target niche demographics groups. The cost of entry is low for LPTV stations as they use local advertisements to drive revenue. Although not highly profitable, many seem to break even. Risks are associated with, among other things, the limited broadcast range of LP technology, competitive pressures from high power stations and other local cable stations, and regulation (i.e., there is no “must carry” regulatory provision for LPTV yet). This is a low-return micro-investment, although LPTV station aggregation and local programming distribution partnerships may provide interesting options.
- Emerging digital technologies allow programmers to increase the number and quality of transmissions within a single channel (“multi-casting”). **DBL investors may consider investing in efforts to incorporate these new technologies for LPTV or small DBL television networks**. However, investments in the financing of such technology will only succeed if the stations can increase advertising revenues sufficiently to cover capital expenditures. Targeted production companies create and market content to local, cable and satellite stations. This is an expensive proposition given programming fees and shared advertising revenues. Predicting success for any given production, however, is almost impossible, making stand-alone projects extremely risky.
- The Public Broadcasting Service (PBS) is a highly sought-after means of distributing content that has significant social focus. Few television brand and license properties do well enough to drive strong financial returns for public television. **DBL companies focused solely on PBS for distribution are likely not a good area of financial investment; those that demonstrate evolved after-market and back-end strategies mitigate some of this high-risk proposition**.

- Cable infrastructure is prohibitively expensive for small DBL investors, but a scalable network that aggregates content with sales and marketing is a possible point of entry. **Ethnic minority demographic groups, for instance, are creating opportunities for “narrow-casting” cable programming**, but this area is becoming highly competitive.
- Another investment opportunity is to purchase a **local cable franchise in an urban market** and provide low-cost, targeted programming for under-served markets. This kind of investment requires more capital, which is somewhat mitigated by the underlying value of the asset.
- **Satellite feeds may offer opportunities** for DBL companies that wish to target individual communities, particularly immigrant second-generation communities with ties to culture around the world. This distribution method requires a sufficiently large audience in order to pay for satellite costs.

Sample DBL Companies

- **W48AY, Channel 48** is an LPTV broadcaster of foreign-language programming, primarily in Greek, for small neighborhood areas in Oldsmar, Florida. At the time of the original research for this report, this station typified a stand-alone LPTV business model: struggling to break even, but nonetheless serving an established under-served market.²⁶
- **Urban TV Networks** is a media production company that produces and distributes content for African-American audiences. In 2004, their network reached 22 million urban households via 77 affiliate stations. Launched with equity capital, this small network was coming close to breaking even.²⁷
- **Ethical Marketplace Television, Inc.** is an independent producer of programming about socially responsible business. They launched nationally through PBS and LinkTV in January 2005 and began airing its program on PBS in March. In order to cover the costs of production, EMT is attempting to establish international distribution licenses beyond the U.S.-based PBS market.²⁸
- **Television Korea (TVK24)** was the first digital 24-hour Korean language cable television network in the U.S. This private company recently struck a deal with the International Channel Networks (ICN), which is 90% controlled by Liberty Media. ICN will become a shareholder in Television Korea. ICN will distribute their programming to cable and satellite companies in North America. ICN will sell national airtime for the L.A.-based station, while TVK24 will handle sales in Korean communities.²⁹
- **Urban Communications, Inc.** is a local DSL franchiser in New York City, N.Y., that purchased a license from a large provider to deliver both customized broadband/TV programming as well as additional phone service to lower income areas.³⁰
- **Independent World Television** is in the throes of fundraising for a network launch in 2007. Based on the conviction that “infotainment” now defines the news media, IWT asserts that it will be an independent, non-profit broadcast service financed by (non-corporate) viewers across the globe. MacArthur, Ford, and the Phoebe Haas Trust, among others grant-makers, have supported a “planning study” after which IWTnews will build an online community necessary for fundraising.³¹

2. Broadcast and Satellite Radio

Radio is an established industry that earned \$19.7 billion in revenues in 2003. Its infrastructure and nationally distributed programming are consolidated. Today, five companies own approximately 30% of all radio stations in the U.S. Four of these companies produce two-thirds of all radio-news programming in the country. Lower cost structures in this segment allow small local players to compete as content producers, station owners, and even regional network owners. Investment in DBL radio-related businesses is predominantly high-risk. However, the risk can be mitigated in some cases by hard assets such as FCC licenses as well as smaller required investments, but, again, the capital barriers to entry, while lower than TV, are comparatively high.

Highlights

- **Small local broadcast stations may provide significant opportunities for DBL investors.** These companies have more mature cash flows (including predictable revenue streams), controllable costs, and high operating margins. The Federal Communications Commission grants licenses to a limited number of local stations so there is a restricted, but active market. There is a clear need for early stage private equity investment at moderate levels (ranging from \$1 million to \$20 million, depending on the size and number of stations involved) and for accompanying debt financing. **A few, large minority-focused DBL equity funds, including Quetzal JP Morgan and Fairview Capital Partners, have indicated that they might welcome co-investments from smaller DBL funds.**
- **Small DBL radio networks show some promise for investment.** Investment in both infrastructure and programming for radio is substantially less expensive than for television. Examples of DBL radio networks include Air America Radio and Spanish Broadcasting System, both described below. The preferred business model is to build content and a loyal base before investing substantially in expanding the radio network.
- **Low power FM (LPFM) stations**, also called community-based radio, are available solely to non-commercial, educational, public safety, and transportation organizations allowing these groups to broadcast up to 10-miles in diameter. Because of the short reach and restricted use of these licenses, LPFM stations are mostly a philanthropic funding opportunity. **Start-up costs can be as low as \$10,000, however, and there may be DBL micro-finance and service opportunities.**
- DBL radio companies need every technological edge they can get to compete with well-funded competition. As with television, there may be investment opportunities in financing technological enhancements. **However, such investments will only succeed if the stations can increase underwriting or advertising revenues sufficiently to cover capital expenditures.**

Sample DBL Companies

- **Air America Radio (AAR)** is a small, progressive talk radio network that provides an alternative to conservative talk radio. Formed in mid-2003, AAR is currently carried on 26 broadcast stations and both satellite stations (Sirius and XM) to reach 12.96% of the U.S. population. In comparison, the networks that carry programming by Rush Limbaugh and Bill O'Reilly reach 500 stations and 400 stations, respectively. AAR purchased the operations and some of the assets of New York City's

WLIB, a full-service production facility and a flagship broadcast station. AAR also established syndication and affiliation content deals across the country. AAR projects that it will grow 13 times its current \$4 million revenues within five years and demonstrate approximately 40% EBITA margins by 2009. In comparison, Cumulus and Entercom, two of the ten largest radio networks, have 34% and 33% operating margins in 2003, respectively. AAR was launched with just over \$11.5 million in private equity in 2003. With only \$2 million in debt in July 2004, AAR will rely on equity to fund operations until they break even, and ultimately provide dividends or an exit for investors.³²

- **Spanish Broadcasting System (SBS)**, with 20 stations, is the second largest Spanish-language (behind Univision Radio) and the largest Latino-controlled radio broadcasting company in the U.S. After establishing an audience and significant advertising, SBC received its first highly-leveraged investment to aggregate stations. In 1999, SBS went public. While the company recently had to sell some assets for cash flow, in 2003 it had about \$150 million in revenues, was experiencing 10% net revenue growth, and was profitable.³³
- **Blue Chip Broadcasting** was a radio network comprised of 19 stations in nine markets throughout the Midwest. It primarily focused on the African-American community. Unlike almost every other DBL media company, Blue Chip Broadcasting was in the enviable position of having an excellent financial position sufficient to attract traditional equity investment. In 2004, Blue Chip, then the third largest African-American radio network, was sold entirely for approximately \$190 million to Radio One, the largest such network. Blue Chip's growth was financed by a \$20 million investment from a private equity fund that invests exclusively in ethnic minority media businesses that meet traditional expectations for return on investment.³⁴
- **Inner City Broadcasting (ICB)** is a radio network with 17 stations in seven markets focused on the African-American community. ICB received a \$25 million investment from the equity fund described above that funded Blue Chip Broadcasting. The growth of ICB prompted a recapitalization within two years of ten times the initial investment.³⁵

3. Feature and Documentary Film

The film industry is consolidated at the top end and fragmented at the bottom end. In 2003, 500 feature films were distributed, 300 of which were independent, earning a total of \$9.9 billion in U.S. box office sales. Independent films represented 60% of the film titles distributed in the market, but only accounted for 10% of the revenue. In spite of significant improvements in the creative incubation, production, and distribution of independent films, they face great barriers in sales and distribution because of the increased saturation of marketing conducted by the major studios. Today, most films' revenues and profits come from video/DVD, cable, satellite, broadcast, and foreign markets. Within the film industry, independent film is the most compelling arena for creating social mission content that is not solely dependent on commercial success.

Highlights

- The one-time independent film production is the largest financial risk for any project, particularly one that has not secured distribution in advance. **Without a careful distribution strategy, such investments (including the “gap financing” discussed later in this report) are not financially advisable.**
- A tier of small independent production companies has emerged, some of which have garnered critical success and commercial track record and now produce two to five films per year. While these companies do not explicitly produce socially minded content, they are an active part of an independent sector that does produce a very high percentage of DBL films. Although producing multiple films distributes some risk, any one of these companies remains a high-risk investment. **One possible approach to this market is to create a film-focused fund that syndicates financing to a number of these established production houses while also partnering with distribution companies.**

Independent film distributors attempt to sell independent films to theaters. However, the most successful distributors also engage rights for video/DVD, cable, satellite, broadcast, and foreign markets. As with most companies in the independent film space, socially-relevant product is not their only focus. **Investment in an independent film distributor, rather than directly with an individual producer, may mitigate risk.**

Sample DBL Companies

- **Independent Digital Entertainment or InDigEnt Films** began in 1999 as a joint creation of independent producer/director Gary Winick, independent producer/attorney John Sloss, and IFC Productions. Each film production costs no more than \$300,000.³⁶
- **Progressive Pictures** is a start-up division of Robert Greenwald Productions (“RGP”) – a privately owned independent film and television production company. Progressive Pictures develops and produces independent, low-budget films for worldwide theatrical release, DVD/video distribution, and cable television acquisition. The content of the films focuses on dramatizing social and political issues to do the following: (a) attract mainstream audiences; (b) inspire activism; and (c) change the circumstances dramatized. RGP has brought more than 45 films to audiences worldwide. These films have garnered 25 Emmy nominations and numerous other awards. The total budget for each film is approximately \$3 million. Greenwald received significant media attention from his recent film

"OutFoxed," distributed with Moveon.org, a liberal political organization, and sold more than 100,000 DVDs.³⁷

- **Participant Productions** is an innovative media company that focuses on producing feature films and documentaries, as well as developing social action campaigns inspired by the films. Founded in January 2004 by CEO Jeff Skoll, the first President and employee of eBay, its mission is to be a financially sustainable social enterprise. Participant's first goal is to build a portfolio of films that fits the vision, is commercially viable, and acts as a catalyst for social change. The second goal is to use the awareness created by these films to effect enduring social change through action campaigns by partnering with social sector organizations, corporations and media companies. These campaigns reside on Participate.net, Participant's online community. Participant's films will be the primary driver of financial returns and the social action campaigns will be the primary driver of social returns. In 2005 Participant will have released three feature films: Good Night, and Good Luck, North Country, and Syriana. In addition to these three feature films, Participant invested in the release of the acclaimed documentary Murderball in July 2005. It has partnered with, among others, Warner Bros., Warner Independent, Section 8, 2929 Entertainment, IFC, THINKFilm and others to produce and distribute these and other features and documentaries.

4. DVD and Home Video

The DVD and video market generated \$33 billion in sales in the home video market, including DVD/video rentals, DVD/video sales, pay-per view, and video-on-demand. DVD sales alone have roughly equaled theatrical box office revenues for the past four years. This market segment is for all practical purposes a rapidly evolving distribution channel of the film industry. The easy recording, duplication and distribution of video make it attractive to independent producers. Consolidation of digital distributors could pose a risk to the currently growing independent distribution channel.

Highlights

- Successful DVD/video retailers such as Blockbuster and Netflix can influence both production and distribution patterns. Smaller players, such as GreenCine, can help affect even more narrowly focused niches in a similar manner. **They can also become interesting partners for well-organized or aggregated independent producers and/or distributors.**
- Although such companies do not exist today, it might be possible to establish a DVD/video distributor for social mission/independent films. **This would likely be an expensive and risky start-up investment in this space, but synergistic strategic investing could lower risk in other areas, such as investing in production.** A handful of small nonprofit video distributors have been foundation supported, but their impact in the larger commercial world of distribution has been limited.
- In the long-term, as video on demand (VOD) and digital video recording (DVR) become widely adopted commodities, they will have significant impact on the competitive dynamics of the DVD market.

Sample DBL Companies

- **Ventura Distribution** is an example of a distribution consolidator that offers independent content in more than 60 different film categories. This company has been in business since 1993.³⁸
- **The Film-Makers' Cooperative** is the largest archive and distributor of independent and avant-garde films in the world. It is a non-profit serving any film-maker online and will rent to any institution.³⁹
- **The Film Movement** is an online subscription service for independent film lovers. It rents DVDs of independent films and 10% of all gross profits go to filmmakers.⁴⁰
- **GreenCine** is a West Coast-based, online subscription service and direct seller of films. It offers DVD titles with a focus on indie/art house, classics, anime and Hong Kong Cinema. They also offer a video-on-demand service.⁴¹

5. Video and Computer Games

This report focuses on video console games – we do not address the PC-based game sub-segment here. There are 42.9 million active game consoles households in the U.S. (compared to 28.2 million online gamers in 2004). The video console game industry is a \$10 billion market with software accounting for \$5.8 billion and hardware \$4.2 billion. Software is very competitive. The hardware segment is consolidated. Like film, the game software industry is driven by hits. These require high investment in production and marketing. There are no established producers or platforms for production of DBL games.

Highlights

- Game hardware is dominated by Sony, Microsoft and Sega. Game software is developed by a very competitive market. Gaming is beginning to center around the PC rather than the game console.
- So-called “edutainment” titles, which blend fun with learning, often have a positive social agenda. These titles account for a sliver of the \$10 billion North American video game business.⁴² Educational PC software sales in the U.S. plunged to \$191 million in 2003, down from \$340 million.⁴³ Studios believe that putting that amount of effort into an educational game is simply too risky.
- Creating game software across numerous hardware platforms is prohibitively expensive for small investors. **Game software may be a point of entry for DBL businesses that can structure credible marketing and charitable partnerships to support such investment.** A typical game costs \$8 million to \$10 million to create. A hit game generates \$400 million to \$500 million in revenue.
- Investors should mitigate risk by **distributing investment across a number of titles.** Stand-alone efforts are notable stories, but are very risky even with creative partners, producers and distributors.

Sample DBL Companies

- **United Nation’s World Food Program** created a game for release in the first quarter of 2005 as part of a “UN Food Force” project with Creative Artists Agency and Microsoft developers. It is a mainstream action game with educational content on poverty and international food policy. The plan is to earn “donations” for the WFP, a non-profit organization.
- **The Markle Foundation** contracted with game producers in the mid-1990s to produce edutainment titles about political and public policy issues. These games were produced by Maxis, still a leading game developer, and Crossover Technologies, which has closed. The audience was small.

6. Newspaper Publishing

In 2003, the newspaper industry represented approximately \$63.6 billion in revenue, over 80% of which was from advertising. The rest was mostly from newsstand and subscriptions. Today, there are about 1,457 daily papers in circulation. This number has steadily dropped since 1990. In 2004, 22 companies (the largest of which are media conglomerates) owned 39% of newspapers in print and represented 70% of daily circulation (73% on Sundays). Profit margins averaged about 19% for the entire industry in 2003. For many large publishing companies, newspaper circulation has been declining steadily from a peak in 1950. Smaller independent newspapers, on the other hand, blanket the nation. Indeed, there are more than 10,000 community papers, and this area is ripe for DBL investment. Independent newspaper growth areas include the following markets: ethnic and other minority, urban-focused, and other social mission-related.

Highlights

- Most independent publishers are small family-owned businesses that require up to five years to break even. The range of circulation for the vast majority of such papers is from 5,000 to 100,000. (Circulation for the largest of these companies ranges from 250,000 to 2.2 million.)
- Independent newspapers published for foreign language minorities are the fastest growing publishing audience. The number of Spanish-language dailies, for instance, has more than doubled since 1990.
- **The cost of publishing independent newspapers is relatively small compared to other media. The economics of sustaining such a business, however, are hard.**
- Social mission and politically directed independent newspapers offer investment opportunities.
- Advertising placement services help to establish sustaining advertising bases for independent, ethnic minority, and social mission newspapers. **This kind of ad-buying aggregation offers a competitive service and may be a way of investing in a broad array of DBL newspapers at once.**
- Most independent weeklies are free to readers. For them, advertising is the only or primary source of revenue, supplemented frequently by revenue from sponsored events. Independent newspaper publishers have the difficult task of competing where corporate media is strongest — in advertising.
- **The most compelling potential in this segment involves companies that “roll-up” small, often community-based newspapers, especially African-American and non-English language newspapers, to generate economies of scale, production and distribution.** These could have significant social impact and generate moderate profitability over the medium term.

Sample DBL Companies

- **El Bohemio** is the largest Spanish-language newspaper in San Francisco. It has a circulation of about 60,000 and has no plans for printing in English in the near future. It is a free paper that gets almost all of its revenues from national and local advertising. Competitors include Knight Ridder's *Nuevo Mundo*, (circulation of 45,000) and the Chicago-based *La Raza* (circulation of 187,401).⁴⁴

- **Nguoi Viet Daily News** is a Vietnamese language daily paper that has published seven days a week since 1978 in Orange County, California. Today, there are about 140,000 Vietnamese living in Orange County, the largest concentration of Vietnamese outside of Vietnam. *Nguoi Viet* has leveraged the success of its daily paper – currently with a circulation of 18,000 – to acquire a radio station, a distribution company, two monthly magazines, and Vietnamese Yellow Pages.⁴⁵
- **Liberty**, owned by Leonard Green & Partners, a specialty leverage buy-out firm discussed later in this report, is a platform company that has aggregated 350 community newspapers to date. Its revenues are approximately \$50 million with approximately \$5 million to \$6 million in profits. Revenues are generated principally through advertising. While not a DBL media company itself, Liberty (not to be confused with the larger publicly traded media company) is an excellent model in an aggregation market that has no dominant player.
- **Media Properties** owns and operates African-American and Latino community newspapers in the Los Angeles area. The company has generated between \$4 million and \$5 million a year in revenues over the past several years. Since 2000, the company has been executing an aggressive roll-up strategy and, today, seeks to acquire additional newspapers and publications in the top 50 media markets in the U.S. It received \$1.5 million of convertible debt from a large, Fortune 100 corporation, \$2.0 million in direct equity investment from an angel investor, and \$4.2 million of debt financing from the Los Angeles Community Development Bank to initiate this strategy in Los Angeles.
- **New America Media (NAM, formerly New California Media)** is a membership organization of more than 700 ethnic minority media organizations across the publishing, radio, television and Internet industry segments. The majority of NAM members are in the print industry. Most members are small, with five to 20 staff members. NAM has already launched a rapidly growing advertising placement service discussed below, which is a possible target for revolving loan fund and direct investment.⁴⁶
- **National Newspaper Publishers Association (a.k.a. Black Press of America)** is a 62-year-old federation of more than 200 African-American community newspapers from across the U.S., reaching, together, more than 15 million readers. They seek national corporate advertising campaigns. In 2000, NNPA launched a print and web advertising placement service. Like NAM, this organization is a possible target for revolving loan fund and direct investment.⁴⁷

7. Magazine Publishing

There were 17,254 magazine titles in the U.S. in 2003, 6,234 of which were consumer titles. These publications generated \$23 billion in revenues, 56% of which were from advertising sales. Circulation revenues are comprised of subscription sales (86%) and single copy sales (14%). The top three magazine-holding media companies control 45% of revenues in the magazine sector, and the top ten control almost 75%. Some trade groups estimate that there are several thousand small independent and news-oriented magazines that have thrived by addressing specific “niche” audience needs. DBL investment opportunities include aggregation and distribution services for this fragmented and growing market.

Highlights

- As with independent newspapers, there is solid growth in demand for ethnic or other minority, social mission, political expression and “healthy lifestyle” magazines.
- There are about 45 Latino magazines in the U.S. Subscriptions increased 60% from 1992 to 2002.
- The economics of magazine publishing are similar to those of newspapers. They are inexpensive to start and are constrained by resources required for sales and marketing. The key is finding an under-served, identifiable and targetable audience.
- **As with newspapers, aggregation of independent, social mission magazines, or services to support them, may provide economies of scale, production, and distribution that could, in turn, generate moderate profitability over the medium term.** This kind of aggregation may provide investment opportunities in the DBL media space.
- Newsstand distribution services, like the advertising placement services for newspapers described above, offer important scaling efficiencies for small client companies. **Such services may be both a direct DBL investment opportunity and an indirect means of helping the DBL media industry finance its own growth.**

Sample DBL Companies

- **The Independent Press Association** is social enterprise that promotes alternative journalism and publishing in the U.S. Since 2001, the IPA has grown from 325 to about 600 members including, for example, 13 Spanish-language magazines (e.g. *El Sol de Mexico* with 10,000 in circulation; *El Special* with 10,000 in circulation) and 15 environmental magazines. Indy Press Newsstand Services (formerly BigTop Newsstand Services) is IPA’s distribution broker for its independent magazine members which typically lack competitive distribution services compared to the dominant players. The Newsstand Service has links to a variety of alternative and mainstream retailers, such as Barnes and Noble. Purchased by IPA in 2000, it currently handles 82 magazines in 21 categories and has grown from \$1.2 million in revenues in 2001 to \$2.8 million in 2003, and is seeking investment capital. IPA also manages the IPA Media Network (formerly AII CAS) ad placement service and the Independent Development Fund, both described later in the report.⁴⁸

- **Utne Magazine** is a 20-year-old social mission driven magazine with a circulation between 120,000 and 140,000, which creates original alternative political and social interest content, and syndicates content widely from more than 2,000 independent magazine, newspaper and Web sources. Utne has recently bifurcated its business model into a for-profit magazine and non-profit educational foundation as part of its preparation to raise equity and philanthropic capital, and increase self-sustaining profitability.⁴⁹

8. Book Publishing

Revenues for books sold through conventional book retail and library sales were \$27.8 billion in 2003. Revenues for books sold through special sales (i.e., corporate sales, direct sales, Internet sales, trade show sales) added at least \$14.6 billion (and up to, by certain estimates, \$34 billion) in 2003. We assume for the purposes of this report that the total book industry revenues in 2003 were \$42.4 billion. In the U.S., 73,000 out of 96,681 publishers, or 76%, are small, independent companies with fewer than 10 book titles. There has been an upsurge in growth of the smaller, independent publishers. Also, 90% of those monitored for the report are for-profit and 10% are non-profit. And 85% of these small independents make less than \$250,000 in revenues per year. While these companies are small, overall, book publishing represents an established media outlet for social mission authors. And as with other sub-segments in publishing, there may be opportunities here for DBL company roll-ups.

Highlights

- As in the independent film industry, passionate individuals generally start Independent book publishing companies. They are motivated (and often defined) by their first titles, but are often aggressive about selling future titles.
- The Independent book market is still underserved by independent book distributors. We noted a number of fast-growing distributors and suspect that there is real investment opportunity here.
- Publishing revenues are driven by consumer and trade purchases rather than advertising sales.
- Sales, marketing and access to growth capital are the principal challenges for these companies.

Sample DBL Companies

- **Chelsea Green Publishing** has \$2 million in revenue and focuses on environmental sustainability. They also provide distribution services for smaller, similar publishers who pay approximately 30% for this service. Expected growth in this business area is expected to be 40% by the end of 2005.⁵⁰
- **Berrett-Koehler Publishers** generates about \$5 million in revenue a year and focuses on progressive business practices.
- **Just Us Books** generates about \$750,000 in revenue and focuses on African-American children's books.
- **Publishers Group West (PGW)** is headquartered in Berkeley, California and has been around since 1976. It is one of the largest marketing and distributing companies in North America for independent publishers; it represents more than 150 and has a staff of more than 300. The company generated approximately \$165 million in revenue in 2000. Publishers distributing through them range in size from those that publish 60 books a year to those that publish just a few per year. These publishers specialize in nearly every subject category, including fiction, art, travel, health, children's books, African-American studies, business, gay and lesbian studies, drama, self-help, woodworking and

home-building, music and other nonfiction. Many of them are working to define emerging categories such as alternative healing, spoken word, popular culture, aging and Japanese manga.⁵¹

- **Biblio Distribution, Inc.**,⁵² is a sister company of **National Book Network, Inc. (NBN)**. NBN claims to be the second largest of the independent distribution companies with more than \$40 million in sales to book chains and independent bookstores.⁵³ NBN, in turn, is a sister company of **Rowman & Littlefield Publishers, Inc.**, an independent publishing company that has been around since 1949.⁵⁴
- **Independent Publishers Group (IPG)** was founded in 1971 and currently distributes for about 85 independent publishers. IPG supplies museum stores, computer stores, teacher supply stores, warehouse clubs, house wares outlets, and catalogs. In spring 2001, IPG acquired Paul & Company, an 11-year-old distributor of university and scholarly press titles. In 2003, the CEO of the company claimed that IPG had an annual growth rate of 30% per year for the previous 15 years and expected this trend to continue. The company claims to have a return rate average of about 20% and puts about 80% of this back into stock. The company also claims to have large cash reserves, no external debt, and an unused line of credit that could be drawn on in case of an emergency.⁵⁵
- **Consortium Book Sales & Distribution (CBSD)**, founded in 1985, is the distributor for 90 independent publishers from the United States, Canada, Europe, India and Australia. Books are distributed in the United States and Canada. In addition to sales and distribution services, they provide marketing, promotional and product development support.⁵⁶

9. The Internet

In 2003, the consumer Internet market generated \$30.7 billion in revenues: \$7.3 billion from advertising sales and \$23.4 billion from subscription and content fees. At that time, an estimated 128 million American adults (about 64%) and 19 million teens were Internet users. The Internet provides two main domains of activity: a media channel for distributing and marketing original content from all other media and a medium for myriad original economic and social activity. If one considers not just the Web but also other functions like e-mail, listservs, community boards and blogs, the Internet is perhaps the most inherently democratic media in the world. DBL independent content accordingly flourishes. The difficulties for the investor are in growing audience and reach through advertising and subscription revenues, and, as such, much DBL activity is small and unprofitable. There are, however, some opportunities to consolidate or deepen content and audience through newsfeeds and other means.

Highlights

- A few giant portals have come to dominate Web traffic patterns: Google, MSN, AOL and Yahoo. Two of these holding companies dominate Web news services.
- One of the earliest examples of a centralized Internet portal for social change is the site for the Institute for Global Communications.⁵⁷ Part of the international Association for Progressive Communications, IGC was one of the very first organizations to promote and make Internet use accessible for political organizations. Some well-known more recent examples include, Alternet, MediaChannel and Media Reform. Major portals exist on a wide range of social change and movement building issues, but few of them receive explicit funding. These recent examples have not been able to compete effectively, but are developing loyal followers while using hybrid for-profit/non-profit business models.
- Web site creation is more similar to publishing than to broadcast. The cost to produce a Web site is substantially lower than that of any other media. However, sales, marketing and operational costs are high. Substantial revenues are necessary to break even.
- Advertising consolidation is notable in this market. A recent PriceWaterhouse Coopers-Internet Advertising Bureau report shows that 50 companies today now control about 97% of media revenues on the Internet.⁵⁸
- Many Web sites republish content that has already been created for other media, providing leverage at a relatively low cost for a potentially new and broader audience.
- The Internet is the only part of mainstream news business that is generally seeing increased viewership. Even major newspaper companies, however, are uncertain as to which models are consistent and autonomous revenue generators. Notable recent efforts include those of the New York Times (which will make some of its features available only through subscription service).
- An estimated 2% of adult users maintain web logs ("blogs") and 11% read them regularly. Although commercialization of blogs is not yet widespread, it offers an opportunity.

- DBL capital needs to find media that scale to profitable sizes at reasonable costs. The Internet offers this potential, but there are few (if any at all) stand-alone DBL companies that have thrived.

Sample DBL Companies

- **Salon Media Group, Inc.**, an alternative news and opinion site, produces a network of 10 subject-specific Web sites, hosts two online subscription communities, and features Salon Premium, a paid subscription service. Salon has two online subscription communities, with approximately 70,000 paying subscribers. Founded in 1975, Salon showed \$5.6 million in losses against \$4.5 million in sales in 2003. The company generates revenue through advertising (39% of sales) and subscription fees. The company raised tens of millions of dollars before going public in 1999. But the company has reported losses of \$38.8 million over the last five years alone. John Warnock, Salon Director and founder of Adobe Systems, holds about 40% of the company's total voting securities.⁵⁹
- **Alternet.org** is a project of the Independent Media Institute, a non-profit organization supporting alternative journalism. The company publishes WireTap Magazine, an online magazine by and for socially conscious youth, and owns the Strategic Press Information Network, a non-profit public relations consulting organization providing media training to other non-profits. Since its inception in 1988, AlterNet has grown dramatically and now provides free online content to more than 1.8 million readers every month. The budget for Alternet is \$700,000. By comparison, its main competitor, Salon, spent an average of \$16 million over the same period. The economic model has been based on charitable grants, with increasing fee-for-service components. Alternet relies solely on word of mouth and viral marketing to users who demand reliable information.⁶⁰
- **Globalvision Media** is a global news service that delivers diverse and unique news and information around the world. Globalvision has licenses to print and broadcast content drawn from more than 350 local news organizations in 125 countries on all seven continents. Their content is often used by mainstream news and information outlets around the world. Globalvision is a hybrid business model, combining non-profit organizational and for-profit sub-contract production elements. Principals founded the business in 2001 and estimate that it will turn profitable in 2005.⁶¹
- **ManyOne.net** is an Internet content provider which is accessed through a proprietary browser and distributed to members of affiliate organizations. Partners can private-label the combined service to offer portals, complete with ISP services, email, trade, messaging, and subscription-based content. ManyOne's business model is not dependent on advertising. Instead, ManyOne divides gross margins from its subscription service on a 50/50 basis. Partners market subscriptions to their members, considerably reducing advertising and promotion costs. This approach is expected to significantly reduce the time it takes for ManyOne to reach profitability. This privately financed concern has used \$11 million over the past four years and was, at the time of this report's original research, seeking an additional \$10 million in private equity to complete its Q4, 2004 beta and 2005 launch.⁶²

10. Advertising and Marketing

As of the third quarter of 2004, publicly traded advertising companies represented \$53 billion in market capitalization. Advertisement buying and creative production in the U.S. comprised \$10.6 billion in 2003.⁶³ These companies serviced about \$471 billion in global advertising spending in 2003, 53% (\$250 billion) of which was spent in the U.S. Advertising income drives the majority of revenues for about six of the 11 media segments analyzed in this report: namely, newspapers, magazines, broadcast television, cable television, radio, and the Internet. In 2003, the top 10 advertising organizations claimed nearly 88% of the world's top 50 marketing organizations' revenues. The leading advertising companies bring in between 41% and 57% of their revenues in the U.S. alone. Revenues at the world's top 50 marketing organizations totaled about \$38.8 billion in 2003, or about 8% of total advertising expenditures, according to Advertising Age. Multinational conglomerates accounted for roughly 73% of revenues of the world's top 50 marketing organizations in 2003.

Highlights

- **Spending to target ethnic minority audiences in media is increasing at a rate much faster than general spending.** Put differently, the CGR for advertising spending on ethnic minority audiences from 1995 to 1998 was 16.2% compared to the overall general spending growth of 7.4%. Overall spending to target ethnic minority audiences, however, is still much less than those audiences' proportional representation in the total audience size, creating market opportunities.
- In our search, we found almost no social mission driven advertising agencies among the independent agencies.
- It might be possible to create or support agencies willing to incorporate a social mission as fundamental part of their focus. This would be an opportunity with a high level of risk given the competitive nature and low barriers to entry in the advertising market.
- Magazines and newspapers are particularly vital to any DBL media advertisement placement strategy.

Sample DBL Companies

- **Egg** is an advertising agency in Seattle that works exclusively with socially responsible businesses. It was originally bootstrapped by the founders for less than \$50,000 and is profitable today. The company continues to struggle over a perceived trade-off between social mission and the financial bottom line.⁶⁴ Egg's most visible pro bono work involves public service announcements for the Ad Council.
- **New America Media (NAM, formerly New California Media)** provides an advertising service that charges below market rates to encourage advertisement placement for ethnic minority media. NCM's advertising placement business has generated about \$7 million in gross billings.⁶⁵

- **Independent Press Association** (mentioned above in magazines) has an advertising service, IPA Media Network, serving the New York metropolitan area which generated about \$900,000 of gross billings in 2004.⁶⁶

Conclusions: Opportunities and Risks

There are DBL companies competing in almost every sub-segment of the media industry. The segment summaries above describe their broad range and diverse character. While each segment has its own idiosyncrasies, we draw the following general conclusions.

- The television segment is consolidated and, for smaller DBL media companies, difficult to penetrate. Investments in television infrastructure or national programming need to be substantial. Public television and radio distribute a great deal of social mission programming, but very few content properties succeed commercially after initial distribution on public television or radio.
- The entertainment segment is competitive and driven by individual “hits.” It remains one of the riskiest segments for investment even as independent film may have matured enough for a portfolio approach.
- The radio segment and small local broadcast stations in particular offer lower cost structures than television. Low-power FM radio stations may offer micro-financing opportunities, but are limited to non-profit ownership at this time.
- Publishing has lower cost structures for production and distribution than television or radio. This segment is one of the most promising for successful DBL investment, especially for aggregation plays of content and distribution.
- The Internet segment has the lowest content creation and distribution costs of any DBL media segment. However, in general, revenues do not yet cover sales and marketing costs. In conjunction with other media methods, Internet publishing promises economies of scale. DBL investors should remain mindful of this segment as new technologies help create new models of distribution, revenue generation, and marketing.
- Although there are not many specific examples, DBL advertisement placement services create marketing efficiencies and economies of scale for many small DBL media companies across the media segments. Investment in these kinds of companies may help grow the overall media market.
- In the cable, radio and newspaper sub-segments, there appear to be several DBL media companies which offer high returns on investment. These companies have attractive financials and market opportunities. In most cases, the cost of investment is on the order of \$5 to \$25 million – outside the range of most DBL investors, but well within the range of traditional investors.

PART TWO:
FINANCING TRENDS AND CASE STUDIES

A. THE BROAD ROLE OF EQUITY AND DEBT FINANCING

One means for reflecting upon the capital structure of the overall media sector and its component industries is the extent to which publicly traded media companies rely on debt and equity. The categories identified in the chart below summarize (as of the third quarter of 2004) the industry segments we identify in Part One, with the exception of the Internet.⁶⁷

Media Industries	Market Cap	Debt	Equity	Debt/Equity	ROE
Broadcasting & Cable TV	\$474B	\$164B	\$310B	0.53	2.7%
Printing & Publishing	\$211B	\$80B	\$131B	0.61	15.0%
Advertising	\$54B	\$29B	\$25B	1.20	8.5%
Motion Pictures	\$18B	\$8B	\$10B	0.78	4.3%
Totals or Weighted Avgs	\$757B	\$281B	\$476B	0.61	6.6%

The most notable statistic here is the .61 weighted average debt-to-equity ratio for publicly traded media companies. This is lower than both the overall 0.82 debt-to-equity ratio for the entire services sector (to which the media industry belongs) and the average market capitalization debt-to-equity ratio of 0.89 across *all* sectors (excluding financial services, for which this ratio is not applicable). This contrasts even more starkly to other industry sectors, like that of the auto and truck manufacturing industry which has an average debt-to-equity ratio of 6.69.

This disparity underscores an important and fundamental feature of the media industry in particular: *media companies tend to be much more cash-flow-oriented and less asset-backed*. In short, this suggests two central facets about the supply side of financing media in general. First, equity is an essential lead financial instrument for helping grow media companies and it remains a disproportionately weighted factor throughout each stage of financing media. Second, debt investors perceive an inherent risk in enterprises that have relatively few hard assets. Simply put, for investors, the risk profile of media companies does not invite large amounts of debt because of the relative lack of collateral.⁶⁸ This does not eliminate the role debt, which also remains an essential instrument, but merely qualifies the conditions under which such finance will occur. We now turn to trends in demand for finance within the media industry in general, and DBL media in particular.

B. CURRENT DBL MEDIA FINANCING USE AND APPETITE

As we explain above, in order to gain some primary data for analysis, we conducted an extensive national survey to learn more about DBL media enterprises.⁶⁹ Of the 12 trade groups with which we worked to reach individual media companies, members from 10 associations responded to the survey. Respondent enterprises financed their activities with \$16.35 million in debt and \$5.69 million in equity. Furthermore, 75% of 426 respondents are presently or will be actively searching for financial investment. In total, 224 respondents are seeking \$53.3 million, ranging from sums of \$5,000 to \$1 million. Over the next one to three years, 262 respondents will be seeking \$209.2 million, from \$10,000 up to \$7 million.

We found that 38% of more than 290 responding companies ranked equity as an “attractive” or “very attractive” investment instrument, and 26% of this group found equity as “not very attractive.” We found that 29% of 286 responding companies considered debt to be “attractive” or “very attractive,” and 35% deemed it “not very attractive.” Of these respondents 31% thought that it would be absolutely essential or very important to get help in securing this debt.

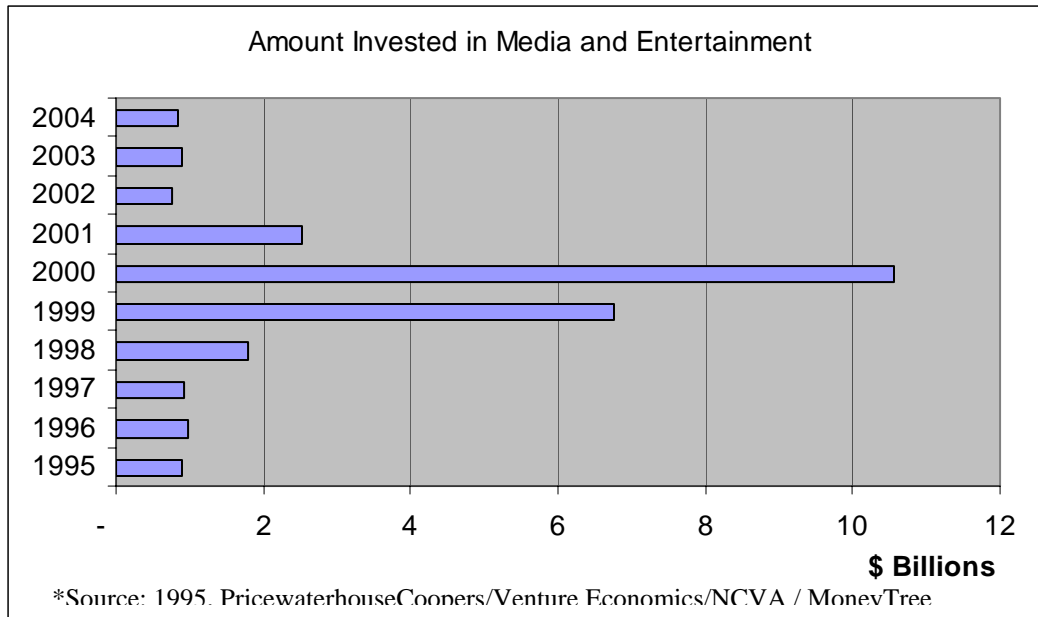
Note that we found that just over 75% of the respondents are actively seeking technical assistance in general, with particular attention to support in raising investment funds. Only 60% of enterprises indicated that they had a written business plan, and only 40% had a three- to five-year financial model, so significant work remains to be done before most would be in a position to attain financing. Of this potential funding, the primary uses would be for direct marketing and promotion (32%), product development and launches, (29%) and staff hiring (19%).

We found that 28% of 611 responding companies were interested in selling their companies (either via public or private sales) or recapitalizing their company to exit the early investors. However, 33% of this same pool desire to hold and maintain control of their companies. A full 13% of the companies would like to keep the business “in the family.”

The Role of Equity in Media

As we show above, the media market has an especially low debt-to-equity ratio. Thus it is important to look at the amounts and kinds of capital invested in media through equity to understand the opportunities and obstacles facing emerging DBL media companies.

According to PriceWaterhouseCoopers, Venture Economics, The National Venture Capital Association, and Money Tree, the total amounts invested through private equity in “media and entertainment” from 1995 through end 2004 totaled \$26 billion. According to Money Tree’s more recent report on investing, investors directed \$890.6 million to “media and entertainment” in 2004, up from \$687 million in 2003. Although the average investment amount was \$2.6 billion per year, generally about a billion per year has been invested, with a few peak years in the period 1999-2001 (see chart below).



This amount includes several different types of private equity investors, which have some unique characteristics and are often referred to by the following terms of trade:

1. Venture Capital Investors: investing in newer, high growth potential companies;
2. Private Equity investors: mezzanine- to late-stage investing in expanding companies which are not publicly owned; and
3. Buy-Out Firms: specializing in turning around poorly performing companies, refinancing their balance sheets or merging them with other companies.

Due to the more guarded nature of this part of the investment industry, we do not have in-depth or detailed data about these three equity groups (or angel investors who represent an informal level of venture capital). We refer to them collectively as private equity. However, for the purposes of this report, we gathered summary data and conducted a broad range of interviews with fund managers and direct investors of each type.

Venture Capital Investing

According to Cambridge Associates (CA), a major firm that tracks venture investing, slightly over \$13 billion was invested by all U.S.-based venture capital firms in 2003. Of that, 9.8% or \$1.2 billion was invested in “retailing and media.” This investment further breaks down into investing by stage (that is, startup, early, expansion, or later stage) funding. On average, in 2003, across all industry areas, 75% of the money invested went to expansion and later stage deals; so we can extrapolate that, if media is similar, about 75% of \$1.2 billion, or \$958 million, went to expansion or later stage deals, leaving 25% or only about \$300 million available for all early-stage media and retail venture capital investing in 2003. This is significantly lower, for

example, than the \$3 billion that we calculate went to retail and media at the height of the investment bubble in 1999.

In addition, Cambridge Associates' 2004 US Venture Capital Investing Report notes that, while most of the investments in 2003 were in later-stage financings, investments in companies in the early stage of development increased for the first time in three years in the last quarter of 2003. In addition, they point out that in 2003, venture capital was experiencing some "overhang issues." This means that, on average, venture capital funds are holding onto more capital (about \$66 billion in CA's estimation) than they would be expected to, and is a sign of the oversupply of capital from vintage years 1999, 2000 and 2001 mixing with an undersupply of adequate deal flow.

Given these overhangs and the relatively small amount being invested in media and retail, we can only conclude that venture capitalists are unsatisfied with the available media deals either because they do not see enough of them or because the deals they do see do not meet their criteria for investment. Overhangs also mean that the fund investors will wait longer to achieve returns and that the funds may be even more pressured to invest only in extremely high growth opportunities.

Equity Investing⁷⁰

In the U.S. today, there are about five to seven firms that specialize in private equity finance in media industry, including: VSS, Spectrum, Abry, Wicks, Quadrangle, Boston Ventures, and Providence. Every one of these firms focuses predominantly on late-stage, leveraged buy-out (LBO) transactions across all media segments. In addition, there are generalist private equity firms that do one or two media investments per year, but do not focus on media per se.⁷¹

Buy-Out Firms⁷²

Buy-out firms (private equity funds that are not VCs) have been important to global corporate finance and structuring. Indeed, since the 1980s, this sector has been at the forefront of value creation and corporate restructuring that continues to influence economic analysis around the world. Today, according to a 2004 report by McKinsey and Company, "buy-out players have alternatively been willing acquirers of underperforming businesses, formidable competitors, and under the right circumstances, valued partners."⁷³ However, the McKinsey report concludes that the model of private equity and buy-out funds may soon look quite different going forward with the rise of such things as auction sales, the commoditization of creative financial engineering skills, and a tougher stock market. These make the quick turnover involved in equity investing (between purchasing, restructuring, and quickly selling) less lucrative and will likely lower median returns over the next five to 20 years. Accordingly, we can anticipate fewer deals involving buy-out firms, particularly in DBL media deals.

As a general matter, private equity investors are notoriously guarded about sharing details about an investment's financial performance. Indeed, they are far more protective than investors in the highly regulated public security and debt markets. Mindful of this limitation, we offer

here analysis of three types of equity investors: venture capital investors (e.g., Fairview Capital), private equity investors (e.g., Spectrum and Quetzal), and buy-out firms (e.g., Leonard Green & Partners). We briefly describe each type of investors' goals and philosophy, some of their respective holdings or key media-related investments, and their definitions of DBL media and how it intersects with their portfolio. At bottom, these firms provide instructive lessons for understanding the opportunities and risks of DBL equity investing from their perspective.

Venture Capital: Fairview Capital

Fairview Capital Partners is an independent firm that aims to provide superior long-term returns in the private market for qualified institutional investors. It is a 10-year-old "fund of fund" vehicle and, as such, invests in other venture capital partnerships that focus on minority businesses.⁷⁴ This particular focus arose largely as a result of the federal government's United States Small Business Investment Companies (SBIC) programs. Fairview founders sought to transform their investee funds from SBIC status into companies that competed in a rationalized but otherwise underserved and rich market of institutional investors.⁷⁵ Notably, the founders did not want to "confuse" investors with the language of social responsibility; these vehicles were and are unequivocally driven by returns. As a consequence of its work, Fairview has pioneered the creation of competitive, ethnically diverse portfolios out of what were underserved markets. Today, investors in Fairview Capital include the California Public Employees' Retirement System, one of the nation's largest pension funds, six other state and local government pension funds, and private pension funds and banks. The fund manages eight separate funds, with about \$1.6 billion in total assets, with more than \$600 million under management currently.

Today, Fairview considers broadcast radio, broadcast television, and cable to be good investment opportunities for those interested in growing ethnic minority markets. For Fairview, broadcast radio is attractive because the amount of capital necessary is small enough, revenue streams are predictable, and costs controllable. While there are high barriers to entry (e.g., high FCC licenses fees in a limited and competitive market), the operating margins are also quite high. Since about 1976, but really from 1984 to 1992 (after the recession of 1981), radio advertising has increased by double digits year after year. Institutional investors nevertheless were not particularly keen on investing in broadcast radio because these deals were not as asset rich; they were cash flow focused, limiting bank participation. Generally, minority-focused media leaders historically have not been not as financially endowed as companies (e.g., Clear Channel) that have pursued aggressive acquisition strategies. The consequent consolidation of the Telecommunications Act of 1996 exacerbated this difficulty and made radio properties harder to acquire. Today, markets are smaller. As such, experienced managers of minority-focused funds like those at Fairview are expanding into other areas of media and communications.

Broadcast television, for its part, is attractive because the number of minority-owned broadcast stations (Asian, African-American, and Latino (English- and Spanish-language) has dropped significantly. The often false but general perception among investors that minority entrepreneurs in media represent a heightened level of risk has often caused entrepreneurs to pay a higher cost of capital because they are forced to lower their valuations. This is why broadcast television is fits so well in a DBL project. Finally, for Fairview, cable television is attractive

because, unlike suburban markets, there is a demand for cable service (and the local service it provides) in urban markets that remains unmet. Along these lines, Fairview has invested in a provider in the South Bronx which is purchasing local cable franchises from an existing operator not interested in serving that area, and then providing second phone lines as well as more flexible cable service.⁷⁶

Such activity in areas like radio and television suggests that foundation or other grant-maker participation can play a vital role in seeding a DBL media company, particularly in the areas outlined above. For example, a one-to-one match of funds from a VC firm like Fairview and foundations like Ford or Rockefeller directed at a particular DBL media company would elevate that company's "level of significance." Fairview asserts that it is always interested in having capital deployed into this space and that they are not territorial because DBL media – particularly minority-focused and urban media – are underserved.

Specialty Private Equity Fund

Spectrum

Spectrum invests in established companies in the media, communications, information technology, and business service industries.⁷⁷ Spectrum manages funds representing more than \$3 billion of committed capital. It invests in a variety of transactions, including leveraged buy-outs and recapitalizations, stock purchases from early shareholders, and financings for growth either organically or by acquisition. The firm typically invests in growing, profitable private companies, in privately negotiated investments in public companies, and in leveraged acquisitions of independent companies or divisions of larger companies.

Spectrum is not focused on specific industry areas, but it has considered social mission driven deals such as Current (Al Gore's cable network) and Piquant's Air America Radio. The mission characteristics of these companies were not that relevant to Spectrum. These companies still need to demonstrate more mature cash flows to attract significant leverage finance. More generally, Spectrum's managers have settled on the Internet, which, from their vantage point, is strong again. The level of accountability within the Web advertising model has moved from very low to this new high benchmark.

According to Spectrum, media companies generally have two classes of stock, which divide editorial control and capital management. Often, there is a class of super-voting stock that allows shareholders who maintain at least 51% to control editorial content but relinquish economic control. The second class of stock has majority control as well as right to certain percentages of cash flows and assets. This split allows families and long-time editorial forces to maintain their mission even as they attend to certain capital market requirements, too.

Quetzal

Quetzal (a strategic partner of JPMorgan Chase) is a \$170 million private equity fund whose mission is to increase ethnic and gender diversity in the management and ownership of U.S. communications companies.⁷⁸ They also seek to generate attractive financial returns by

selectively investing growth-oriented private equity capital. Quetzal is the product of an innovative initiative spearheaded by a group of 15 global media companies. Former FCC Chairman William E. Kennard and a small group of media executives were a powerful force behind seeing its fruition. They see Quetzal as “first critical step” in addressing the challenge to increase ownership and management opportunities for women and ethnic minorities in the communications industry. The Fund was announced in late 1999 and its first deal closing (about \$170 million) was on March 31, 2000.

Quetzal invests in a variety of media segments, but has a preference for companies operating in the following sectors: radio and television broadcasting, broadband and cable, information technology, telecommunications, services and equipment, wireless, and the Internet. (The firm has been focusing of late on licensed franchise radio assets, with more mature cash flows. Two examples of their investment successes are Blue Chip Broadcasting, an African-American radio station in urban Midwest, and Inner City Broadcasting, another urban national station.) Quetzal typically invests between \$5 million and \$30 million of equity and prefers to be the lead investor. The fund has the ability to invest significantly more capital in a single transaction through its strategic affiliate relationship with JPMorgan Partners.

At bottom, Quetzal invests equity capital in communications companies with an ethnic minority and/or a woman in the senior management or a significant shareholder position.⁷⁹ As such, this fund’s goals come align (while not perfectly) with the ambitions of the present DBL media project. (The fund parts ways from this project, if only sometimes, insofar as its primary mission is to maximize financial returns for its investors.) For example, Quetzal believes that low-powered television with cable carriage may have some compelling characteristics as a model. More generally, Quetzal recognizes the need for the few larger, more mature funds that have some DBL sensibilities, if not explicit covenants, to be aware of and even willing to collaborate with smaller DBL private equity funds which can function as feeder systems for larger funds. The larger funds can function as senior co-investors and present compelling opportunities for exit strategies for smaller funds.

General Buy-Out Firms: Leonard Green & Partners

Leonard Green & Partners, LP (LGP) is private equity firm with approximately \$3.7 billion in equity capital under management.⁸⁰ The firm, founded in 1989, has invested in 31 companies with aggregate value in excess of \$18 billion. Located in Los Angeles, LGP invests in established companies that are leaders in their markets and are worth more than \$100 million. Through its four funds, iLGP specializes primarily in friendly buy-outs of retailers and consumer products outfits, including companies like Rite Aid, FTD, and PETCO Animal Supplies. Target size of investment is between \$50 million and \$250 million for each company. LGP partners with managers of the target companies to enhance the value of companies through operational improvements, acquisitions, financial engineering, and other strategic initiatives.

LGP’s seeks out private equity opportunities in traditional media with high growth potential and stability in underlying assets. To the extent the firm considers emerging niche markets, it prefers companies with some stability of underlying assets, like Asian Media, one of their investments. While LGP recognizes that Asian Media is addressing an underserved market

as many DBL companies aspire to do, it invests in such deals because of their compelling potential for financial returns.

Their main strategy is consolidation and aggregation. LGP looks for high quality assets that are under the radar of the strategic corporations. It focuses in particular on “best practices in small markets,” including small market publishing, small market radio, and even small market outdoor advertising. Liberty Group Publishing, one of their first investments, is basically an acquisition vehicle for smaller, local newspapers. Anything that is cash flow positive has gotten over a critical investment screening hurdle of LGP’s and may have reached critical mass for an investment transaction. A small newspaper that has only 1,000 readers is sufficient. (The trade defines “small” as “sub-10,000” in circulation.) Newspapers are attractive media properties because they are generally well established in the community, they are part of readers’ lifestyle, and keep readers connected to their communities far more than magazines. The downside of newspapers, for LGP, is that there are not many opportunities for companies that are owned by generations of one family to expand or exit. Outside capital can help such companies purchase equipment, for example, to improve product and profitability. Funds managers are also experts in financial engineering and so can assist a portfolio company with the essential task of cutting costs, too.

In the U.S., there are more than 10,000 community papers, and that since every small town has one, the consolidation work seems almost endless. This is a highly fragmented market with no dominant market share player. In comparison, in major market television, when a fund has positions in top 25 major markets, it has got significant national market position. There are a lot of companies – approximately 100 – who are acquiring regional clusters of community newspapers, but not many of whom are out aggressively acquiring. Liberty is the largest in the U.S. that is focusing on this community paper niche. Most are about \$50 million in aggregated revenues, throwing off \$5 million to \$6 million in profits.

As with the other featured funds in this discussion of equity, LGP does not seek out DBL deals; DBL investors are no different than any other capital investors in that they attend to business fundamentals: focus on management, market position, etc. A company may go into a market with a lower return profile, but it must still focus on fundamentals to survive. The most critical difference, which is a legally actionable factor according to Nolan and Seifer, is LGP’s required attention to the financial bottom line: the covenants of their and every other buy-out fund’s limited partner agreement document mandate that its managers seek to optimize financial returns.

Conclusions about Equity Investing in DBL Media

There is a notable ambivalence among traditional equity investors with regards to investing in DBL media. It is not a coincidence that, of the firms we interviewed which are dedicated to investing in minority-focused, social or independent media, there is no shared definition of investor-worthy DBL media. Indeed, equity investing is a much more difficult area in which to find systematic activity for reasons unrelated to the secrecy endemic to equity investing. Generally, equity investors seek out deals which accord with their idiosyncratic

strategies in their industry areas, as well as the conventional financial return parameters of the institutional investment market.

In any event, there are several chief points about equity investing in media that we can draw from the analysis above. Early-stage equity investors – that is, the ones who could presumably take the most risk, face high “hurdle rates” (expected benchmarks for financial returns), and seek to meet those expectations within a context of significant capital overhang. This leads to a combination of higher performance expectations and less willingness to experiment with unproven risk factors, such as DBL companies. Some investors, like Fairview and Quetzal, are dedicated to finding ethnic minority-managed investment opportunities and are rooted in a deep tradition from conception to do so. Others, like Spectrum and Wicks, see no harm in investing in an ethnic minority-managed company or helping them succeed, but look solely at financial criteria to make that decision. (Fairview and Quetzal only pursue opportunities that generate significant financial returns, but through the lenses of limiting investment criteria.)

Ultimately, the quality of a DBL media deal is often in the eye of the investor. It is important to note, however, that there is more wiggle room at the early-stage of investment for equity investors to take risks and to ensure their objectives align with those of the particular DBL media deal. It is in this general transactional and asset size bracket that we find the most hopeful trend lines of private equity with respect to DBL media. Some angel investors and equity funds have begun to make specific investments in social mission media companies.

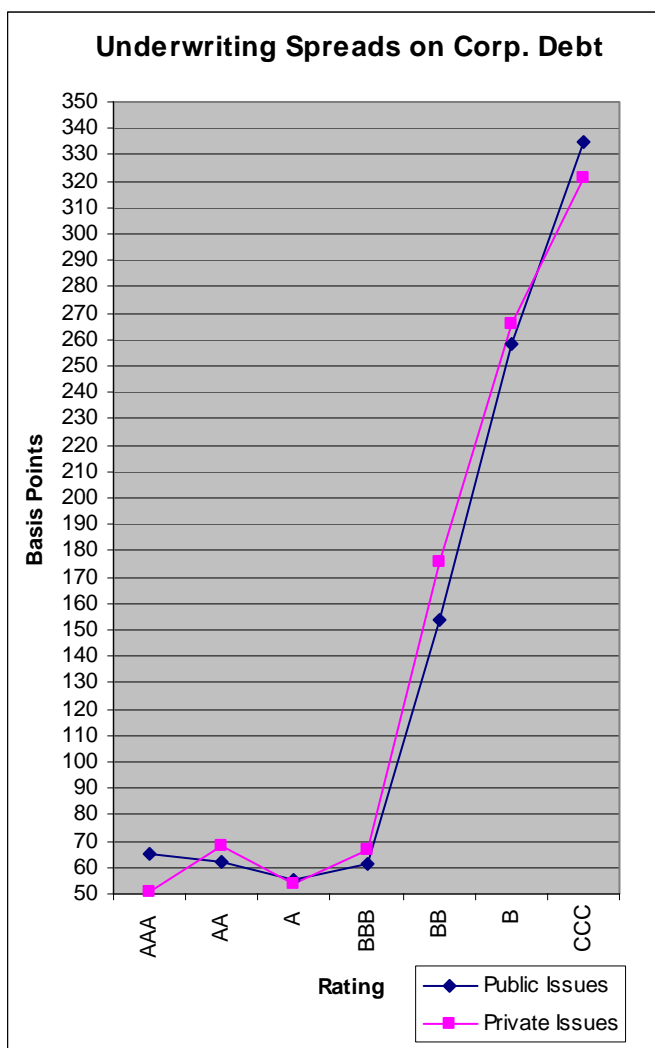
Known social mission angel investors represent approximately 1% of all angel investors and invest infrequently in the media industry. Investors’ Circle (IC), the sponsoring organization of the report, is a network of such angel investors focused exclusively on social mission companies. In IC’s case, its members have invested more than \$100 million into 160 DBL companies across multiple industry and interest areas. Of this investment total, approximately 4% was allocated toward DBL media, despite high general interest in the market and its social impact.

The Columbia Business School’s RISE Capital Market Report was able to survey approximately \$1.9 billion of capital invested in 2002, in social and environmental deals, or about .6% of capital invested by venture capital funds. Further, RISE found that the total number of deals completed by DBL funds represented about 6.2% of venture capital (VC) deals, signifying an orientation towards a greater number of smaller deals. These DBL funds include the following four types: mainstream VC funds that have devoted some portion of its capital to DBL deals; highly focused DBL industry niche funds that focus on specific issues such as charter schools or alternative energy; funds that emphasize increasing opportunities of ownership/management of underrepresented groups; and funds or fund activities embedded within philanthropic foundations and public charities. Researchers have estimated that these equity fund investors have between \$2 billion and \$6 billion available for investing in DBL companies, a small portion of which will be media.

The Role of Debt in Media

As the table at the outset of Part Two illustrates, publicly traded for-profit media industries have soaked up \$281 billion in debt financing of one type or another. And, as the chart below shows,⁸¹ the cost of funds is a function not only of the interest rate environment at a given time, but also of the perceived risk and the difficulty in offering these placements into the market.

Transaction costs quickly snowball for enterprises that are seeking access to debt markets when the investment grade of its public or private debt offering descends below a certain point (e.g., BBB on the Standard & Poor's scale).⁸² This is especially germane to DBL companies as they tend to be below 'investment grade' or too small to get rated. As we discuss later in this report, DBL enterprises often lack audits, business plans, and the scale that would put them in a better position to access the capital markets. Even without deep industry analysis, we make the important presumption that this may be more a reflection of the maturation of the capital market



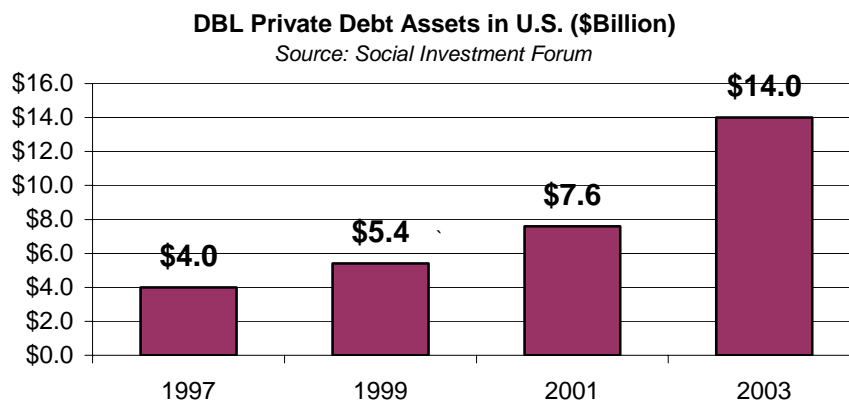
for a rationalized DBL media market than the value of any particular DBL company. If the goal is to grow the DBL media industry, then interested parties must systematically support and encourage DBL media enterprises to access debt and develop strategically discrete offerings in order to overcome scale and shortfalls.

The large and growing “community investment” market provides an instructive model.⁸³ As measured by assets invested in community development and social enterprise, this market was valued at \$14 billion in 2003 and has had a compound annual growth rate of 23% over the last six years. Growth, moreover, actually has been *accelerating* at 36% over the last two years. Assuming the CAGR continues at even 20% over the next five years (as opposed to 23% over the last six years, or 36% over the last two), “social investors” in the U.S. will more than double their capitalization of the space from \$14 billion in 2003 to \$35 billion in 2008. A portion of these investment assets will be available for media enterprises, and this is further discussed in the DBL Loan Fund section below.

What remains for interested analysts and investors alike is to understand and then align the demand for debt by DBL media enterprises with this and any relevant subsets of this emerging socially aware debt capital. To this end, we once again turn to our national survey work with DBL media companies.

We found that approximately 30% of respondents from respondents consider debt an “attractive” to “very attractive” financing approach. What is more, roughly 30% of these general respondents thought that it would be absolutely essential or very important to have professional assistance in securing this debt. Another 30%, however, were relatively indifferent to taking on debt for financing needs and 40% deemed debt “unattractive” or “not applicable” to their situation.

We note that the respondents’ interest in securing debt should not be confused with the appropriateness of debt. It is likely that a given enterprise may well be thinking of grants or equity as more attractive when, from an outside investors perspective, those options may not be an optimal capitalization mix. (This tacit disagreement suggests that these companies could benefit from a more professionalized intermediary market of debt financing entities that can help DBL companies better assess the financing options and build capitalization that meets there needs. Indeed, only 60% of respondents indicated that they had a written business plan at all. Only 40% had a three- to five-year financial model.) In any event, the primary uses for any potential debt financing, according to respondents, could be for “direct marketing and promotion” (32%), “product development and launches” (29%), and “staff hiring” (19%).



Significant work remains to be done before most such media organizations will feel comfortable with the capital markets, particularly debt financing. Careful analysis shows that new financing should be devoted to “direct marketing and promotion,” “product development and launches,” or “staff hiring,” these companies need working capital. They do not need the sort of capital used for facilities expansion or other hard asset financing. This discovery has profound implications for debt’s fit in particular. The responsible and risk-managed delivery of debt and equity financing to non-asset based activities requires much deeper and involved underwriting and monitoring, not too mention on-going technical assistance. These concerns are addressed in more detail in the IPA discussion later in this report.

We now will take a cursory look at how debt may be able to fit the finance needs within the DBL media market.

Debt Use by DBL Media Segments

Drawing on the 11 media industry segment studies on which this report is based, we provide here a snapshot of debt use among DBL media companies in and across industry segments. This is a huge landscape to address, and the information and insights we draw are necessarily preliminary and anecdotal. Nevertheless, we presume that much of the information has broad applicability.⁸⁴

TV: Broadcast, Satellite and Cable

The major challenges facing DBL broadcast owners are the lack of access to capital, FCC media ownership and audience reach rules, and the high cost of the required analog-to-digital conversion. There is certainly an opportunity to aid in gap or completion funding, but major station or system acquisition and ownership seems an unlikely investment opportunity. Existing funds of reasonable scale (\$50 million to \$170 million) have not been successful to date in participating in a single television station deal. Opportunities in small targeted markets, depending on the assets involved, are much more likely to be debt financed. Furthermore, it is worth keeping an eye on Link TV to see whether and how it is able to strengthen its position, although it is unclear how debt or PRIs specifically can play a role in that DBL (non-profit) enterprise.

Radio

Radio offers a large number of DBL opportunities. Recently, new technologies and distribution methods have brought new financing needs to radio. For public radio, NPR is pursuing high definition digital radio for example, and seeks funding to roll out the technology across the country. The Ford Foundation has already had some experience in applying PRI funds to this need. Public Radio Capital, a nonprofit dealmaker, also has proven that debt can play an important role in the noncommercial DBL radio space. However, public stations do not have much in the way of excess profit margins (2.3% of gross revenues nationally after total expenses, compared to 30% for for-profit networks) to pay for debt service of interest. There will likely need to be certain concessionary aspects to this financing.

Innovative local programming developed to target specific demographic groups may be the most important determinant of individual radio (and television) station success. Historically, local advertising revenues have been a more stable revenue source for the broadcast industry as they are less susceptible to economic swings than national sales. In the future, debt financing may be used to compliment existing resources. The Independent Press Association, discussed later in this report, has already had extensive experience in this area.

Air America Radio (AAR), a start-up left-of-center radio network, is currently searching for operational capital, specifically loans to operate its stations. AAR will become highly leveraged, as the debt can be secured with the assets or leases of a radio station and funded by

advertising revenue streams. Public radio does not have as strong an asset base, and often relies on grants for its funding. Debt-heavy radio networks, however, are risky opportunities. SBS, for example, has 26 stations and a debt to earnings (before tax, depreciation and amortization) ratio of more than 10 times at the end of 2003. If AAR proves there is an audience, a second DBL network that owns and operates may be a candidate for debt funding to acquire stations.

Motion Pictures

The real debt financing opportunities in the film world are in bridge, gap and completion financing for small independent production companies and projects. There is a limited amount of aligned debt capital ready to engage in bridge loans to carry projects over until their more permanent funding sources are obtained (for example, a bank loan that still needs to close). This funding would cover any gap in pre-sale deals and completion funds which, though critical, are relatively low risk because they are “last in and first out.” Therefore, while they appear to be attractive debt opportunities, it is questionable how valuable they can be to growing the capital market for DBL media. They are more likely to be employed when the appropriate opportunity arises. Designing whole facilities or financing programs around this type of financing, however, might be somewhat redundant.

Consider Echo Lake Productions, an independent film production company that also has a loan financing division and access to a private investment equity fund. It provides bridge, gap and completion loans up to \$1 million per film. And there are others. But there is a shortage of social mission-focused firms that specialize in the high-leverage debt financing that tends to be missing.

Video-DVD

The video-DVD segment revolves around marketing and distribution. The opportunities for debt remain unclear for DBL media in this segment. Consider, however, the “grassroots” model employed by Moveon.org in collaboration with Robert Greenwald, producer of the popular film *Outfoxed*. There, through their massive pre-2004 election e-mail and small community salon campaigns, sold more than 100,000 units of Greenwald’s *UNCOVERED: The War on Iraq War*.

Moreover, a catalog consolidator of DBL video purchases also can improve distribution efficiencies. As analysts can assess risk in the catalog business easily, debt may be able to play an important role by providing short-term working capital to distributors who are moving large quantities of video-DVD to market.

Video Games

Production equipment and facilities for creating software across numerous hardware platforms are prohibitively expensive for small investors. Game software is a point of entry only for those DBL businesses that can structure credible cause-related marketing and charitable partnerships. For these producers, their content generally meets graphics and action standards of this segment. And, as it seems with all segments, shifting economics are in favor of the

blockbuster games, the huge multi-market players, etc. Debt finance opportunities are not apparent to us.

Publishing: Newspaper, Book, Magazine

Generally, in the publishing segment, debt leverage ratios are not particularly high (.61), but certainly there are ample opportunities. Wiley, the New Jersey based publisher, has been able to access more than a half billion dollars in bank debt: that is, \$129 million more than its tangible asset value. Smaller book publishers like Chelsea Green and newspapers like Nguoi Viet Daily News (profiled elsewhere in this report) certainly have need for acquisition capital or other growth needs. The question is whether their appetite is actually for debt as well as equity.

On the distribution side, small DBL magazines and newspapers lack economies of scale and deep sales and marketing infrastructure to compete effectively for newsstand sales. Since these smaller publications do not typically capture as high a percentage of advertising revenues, single copy sales become a more important factor for them. To illustrate, the Independent Press Association's independent magazine members typically lack distribution services that can even compete with the dominant players. The IPA's privately held industry distribution broker, Indy Press Newsstand Services (explained below), has links to a variety of alternative and mainstream retailers, including Barnes and Noble. The Newsstand Service currently handles 82 magazines in 21 consumer market categories. It has grown from \$1.2 million in revenues in 2001 to \$2.8 million in 2003. Of course, more working capital lines of credit will increase the economic clout of individual DBL magazines and the intermediaries that serve them.

Internet

Web sites' cost to produce content is a lot lower than any other traditional medium, but costs of attracting "eyeballs" and advertising dollars, as well as the time to reach critical scale, are high. Most successful web businesses are adjuncts to brick and mortar publishing concerns. Some DBL players such as Salon, Alternet and Globalvision Media have had some success, but this segment remains an uncertain target for debt financing. At the moment, it seems highly speculative at best. For this reason, this segment is probably a good candidate for technical assistance and high-risk equity.

Advertising

Interestingly, according to Bill Imada, Executive Director of the Asian American Advertising Federation, capital is highly accessible. He says that "banks are throwing money at" AAAF members. This would seem to square with the fact that, of all the media sub-segments, advertising is by far the most highly leveraged as it has a debt-to-equity ratio of 1.2.

While there are certainly many opportunities in DBL advertising, as with every other segment, risk remains. For example, the two equal partners and founders of Egg, an independent socially responsible advertising and branding firm, relied solely on minimal personal start-up capital – i.e., founders' equity. They each contributed \$10,000 at the outset, adding \$10,000 to \$15,000 more over the first six months. They did seek assistance from Wells

Fargo and their SR bank, Shorebank Pacific, but were turned down. Trade groups, associations, and revolving loan funds may be interested in similar early-stage DBL companies.

C. SPECIALIZED FINANCING VEHICLES

In our research, we focused on three segments of specialized finance activity and institutionalization: foundation program-related investment (PRI) funds, revolving loan funds (RLFs) and limited partnerships. In all cases, examples of DBL media financing – both debt and equity -- were limited, but illustrative of significant potential.

Foundation PRI Funds

PRIs are defined by the IRS as mission-based concessionary investments that count toward grant distribution requirements. They generally take the form of debt, but also may take the form of equity. According to the Foundation Center, all foundations with an explicit media focus have about \$32.76 billion in endowment on a combined basis and \$1.96 billion in annual grants distributions, collectively. The percentage of these foundations that also conduct program related investments (PRIs) have \$24.47 billion in total assets and \$1.41 billion in annual grants distributions available.⁸⁵

According to the most recent Foundation Center Program Related Investment report,⁸⁶ the nation's more than 61,000 active private and community foundations are making \$200 million in PRIs every year (roughly 0.66% of \$30 billion in annual charitable distributions) or just 0.04% of total assets. More pertinently, 8.4% of these PRI dollars – approximately \$16.8 million – went to “arts, media, and historic preservation” during the 2000-2001 fiscal year.⁸⁷ We profile the PRI activity of three leading foundations, with particular attention to their media-focused PRIs activity.

Ford Foundation

The Ford Foundation started its PRI Fund in 1968 and currently has a portfolio of approximately \$137 million and another \$26 million in commitments to 87 organizations. Capital is generally deployed in low-interest private debt placements. Ford places its limited media oriented PRIs in the “social venture” category, which supports a variety of projects, including health centers (17%), arts enterprises (19%), public television/media enterprises (23%), and, during the past 10 years, several workforce development initiatives (7%). In addition, these PRIs have provided a range of financing, including start-up capital (17%), business expansion capital (36%), project financing/new line of business support (24%), and working capital (23%).

Ford has made a number of investments in media over its history even though media companies are not a significant or defined portion of its portfolio. Among Ford's media investments that are most pertinent to this report are in the development of software and information services initiatives for public television and radio stations (Public Radio International) and an Internet magazine (OpenDemocracy.org). Ford has experienced losses of \$5.9 million on 13 investments (23%) in this “social venture” category, with the highest level of loss sustained for PRIs used in start-up financing. This loss rate is higher than the 16% loss rate Ford experiences across all of its PRI portfolios. While this loss rate is notably higher than that of other social purpose debt financing default rates (which ranges from 3% to 15%), it does not,

in and of itself, indicate higher risk. A detailed post-mortem of the portfolio positions would need to be undertaken to compare performance in a meaningful way.

In any event, Ford has responded to the higher loss rate by implementing a strategy that disburses this type of funding in phases so that, among other things, disbursements are conditioned on the organization's ability to hit specific performance targets, a higher degree of monitoring (monthly for the first year), and a loss reserve rate of 20% upon approval in order to better match expectations of loss. As to the latter, there is also an option to lower the loss reserve to 15% following a positive first year performance review of the social ventures.

One specific example of Ford's investment in media is its ongoing PRI in OpenDemocracy.org, the global Internet magazine on politics and culture. The Foundation expects repayment to come from revenue as OpenDemocracy continues to grow. This investment had a closing date of December 2003 for the first capital disbursement when \$500,000 of a committed \$2,000,000 was released. A second disbursement of \$375,000 is tied to performance of OpenDemocracy's business plan and was anticipated to be made in fall 2004. Ford, moreover, has a number of covenants structured around net income, net worth, liquidity, debt service coverage, burn rate and board diversity. If the total commitment is disbursed, principle will be repaid in two equal installments in December 2009 and December 2010, although interest-only payments will be due throughout the term.

ProVenEx/Rockefeller Foundation

The Program Venture Experiment (ProVenEx) of the Rockefeller Foundation represents approximately \$12 million of \$2.6 billion (or 0.5%) in total foundation assets allocated for PRI activity. Where generally 30% of PRIs are below market rate capital and 70% are private equity with possible market rate return, "all investments are made to further a specific program strategy of the Rockefeller Foundation and leverage expertise and networks that exist within the Foundation's program areas." The financial return expectations range from 0% to 26%. In 2002, the Boston Consulting Group (BCG) performed an assessment of ProVenEx which is available at the Rockefeller Foundation's Web site.⁸⁸

Although investments in media enterprises are not its focus, ProVenEx is currently invested in two media positions, involving "world music" and software development, as part of its Creativity and Culture program. The "world music" PRI position is most germane to this report. Smithsonian Global Sound is a network of international cultural institutions working to preserve and distribute music from archives worldwide as well as foster appreciation for traditional music.⁸⁹ Through the Internet, Global Sound will offer audio and video downloads, streaming media, educational resources and detailed liner notes. Also, various musical collections will be available for purchase and immediate download. Global Sound's archives will include music from more than 30 nations, and will generate revenue for musicians, help them enter the global marketplace, and work to safeguard their intellectual property. ProVenEx invested \$500,000 in a soft loan for 10 years at 3%. The placement has a grace period on principal and interest for three years (with interest accruing) after which it converts to straight-line amortization.

MacArthur Foundation

The MacArthur Foundation's PRI portfolio has a current outstanding balance (including commitments) of approximately \$150 million. There are 73 borrowers in the portfolio and 124 active PRIs. The Foundation's PRI portfolio has a commitment ceiling of \$200 million. The portfolio is self-contained in that earnings and repayments are recycled into new PRIs.

The MacArthur PRI portfolio consists of roughly 80% long-term, amortizing debt and 20% equity investments. About 40% of the portfolio consists of community development financial institutions (CDFI's). Another 40% is for affordable housing groups. And 10% is for equity investments in community development venture capital. The final 10% is devoted to international direct PRI loans for environmental projects.⁹⁰

MacArthur has only made a few media-related PRIs through its General Program and has no mandate to support this field. Examples of its media PRIs are the Media Development Loan Fund (profiled later in this section), a vehicle that provides low-interest loans and equity investments to independent media in Eastern Europe's emerging democracies, and Downtown Community TV, a NY-based production center that provides video production training to low-income students. While MacArthur media PRI's are few, these particular projects provide a useful context for exploring the potential for significant growth in media PRIs from foundations in the coming years.

The Future Potential of PRIs

The absolute financing support that foundations are already devoting to PRI programs provides an excellent opportunity for DBL media. Indeed, the high-risk, low financial return, and high social impact profile of DBL media enterprises covered in this report could be aided substantially by the PRI programs of foundations like Ford, Rockefeller, and MacArthur. Concessionary debt and equity from foundations (and the intermediaries they fund) may be a critical way of developing a more efficient and effective social capital market for DBL media across industry segments.

Revolving Loan Funds (RLFs)

Revolving loan funds are a critical, albeit nascent piece of the DBL media debt financing landscape. Historically non-profits, RLFs are lenders that act as intermediaries for investors or donors wishing to reach enterprises' capital needs in a sustainable, cyclical manner.⁹¹ More specifically, RLFs are a highly targeted capital delivery system that can work in partnership with equity investors to finance social mission enterprises and deliver critical technical assistance to ensure more successful execution at the local level. RLFs manage an ecology of "blended value"⁹² by balancing concessionary issues, manage risk, and combine grant and network capital. They meet a deep need in the social capital markets for "on the ground" professional financial institutions.

As of the end of 2003, there were about a total of \$3.6 billion in such loan funds. Very few of these, however, specialized in media. Nor do they systematically track the industry. We,

nevertheless, view the development of intermediary professionals as key to the potential of a higher functioning capital market for DBL media.

Two Notable Media RLF Case Studies: IPDF and MDLF

We summarize the activity of the two most well-defined RLFs that systematically consider DBL media: the Independent Press Association's Development Fund (IPDF) and the Media Development Loan Fund (MDLF).⁹³ These particular RLFs probably offer some of the best near-term opportunities for social investors wishing to reach the DBL media space via debt vehicles. While the majority of MDLF's investment activity is debt, it also offers equity investments and technical assistance services. Extended case studies of both organizations as well as an analysis of the IPA's fund and are available as separate reports on Investors' Circle Website at www.investorscircle.net.

In addition we profile a third specialty fund that engages in packaging both debt and equity investments with a particularly narrow portfolio focus – independent documentary films for IMAX theatre distribution.

The Independent Press Association: A Case Study

The IPA Organization

The Independent Press Association (IPA) is an important player in the DBL media landscape. IPA is an organization whose central mission is to expand the role and influence of the independent press in our media environment through public policy advocacy. This core mission is supplemented by activities intended to support the independent press, including lending, distribution, and technical assistance for more than 600 affiliated organizations. As such, it employs a business model that is instructive for funders and investors who share an interest in deploying capital to independent media in the United States. Though it has experienced many challenges, and continues to wrestle with its business and service delivery models, the IPA is one of the most interesting organizations in the country that have the potential to help support and build a media infrastructure that is hospitable to an independent press.

IPA is notable for the changes it has undertaken in only the past couple of years. Today, it has an operating budget of around \$2.5 million, and is shifting its source of revenues away from grants and toward product and service revenue largely because these programs are reliable sources of revenue. The association generated \$217,000 in revenues from its IPA Media Network (formerly AllCAS, the advertising placement service) and \$740,000 from its Indy Press Newsstand Services (formerly BigTop Newsstand Services, this service serves as a distribution broker for affiliated independent magazines) in the past year and expects that revenues for these programs will be \$150,000 and \$1.1 million, respectively, next year. In 2004, IPA's collected a little less than \$2 million in revenues, a very small fraction of which is from affiliate media organizations. The organization expects to generate \$2.7 million in 2005.

The organization offers five core programs, a regional program in New York, and technical assistance services to its affiliated organizations. IPA operates a number of core

programs. We profile one of them, the Independent Press Development Fund (IPDF), below. The other programs include the IPA Media Network and the Indy Press Newsstand Services (both mentioned above), as well as the Campus Journalism Project (which provides training, networking and mentoring to young journalist activists), and New Voices in Independent Publishing (which promotes journalists of color in the independent press). Indy Press Newsstand Services, acquired in 2000, continues to have a large impact on IPA's finances; it accounted for 28% of total revenue in 2003. IPA Media Network also has expanded very rapidly in this time period.

IPA currently has 20 staff members in San Francisco (its headquarters) and New York City. The organization hired a new Executive Director, Richard Landry, in the summer of 2003. Landry came with 19 years of publishing experience and had most recently been a strategic planning consultant for publishing, new media and information technology. In the past, he served as Editor-in-Chief and associate publisher for *PCWorld*. Many of the improvements the organization has experienced in the past couple of years are due largely to Landry's work.

The IPDF

IPA recognized at a very early stage that independent media were often unable to obtain financing from conventional and unconventional lending institutions. To be sure, much of this difficulty arises from the idiosyncrasies of the publishing business. More pertinently, however, independent publishers are often not as adept at developing market-oriented strategies for long-term sustainability. The IPDF arose out of these circumstances in 1999.

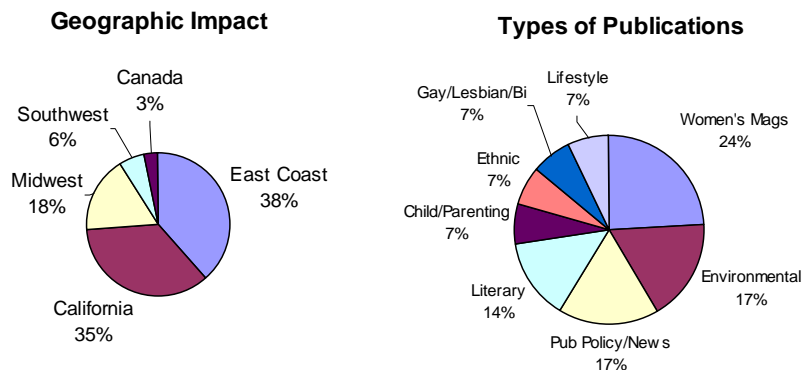
To start the program, IPA obtained below-market interest loans from Working Assets Financial Services and the Packard Foundation, as well as a general support grant to support its operational efforts. With the latter, the goal for equity capital for the Fund was achieved, at least for the total capitalization level that existed at that time. In 2002, the IPA Board adopted several policies for IPDF, including specific capitalization targets and the establishment of a loan loss reserve goal of 10% of outstanding debt. The Board also determined that the necessary amount of equity for the IPDF was established at 10% of total capital.

In April 2004, IPA unveiled a new set of programs and guidelines which detailed four specific types of loan programs: direct mail assistance loans, enterprise loans, bridge and emergency loans, and audit assistance loans. But IPDF continues as major lending program for affiliated media organizations. These loans are generally secured through personal guarantees (usually from a board member or other institution) and Indy Press Newsstand Services receivables. With regards to the latter, IPDF obtains loan repayment from the repayments the Newsstand Service would normally make for distribution payments when a default occurs. Of all loans made by IPDF throughout the program's history, IPDF has declared 5.66% of them in default (based on total charge-offs to total lent). As the borrowers tend to be seed- to early-stage, this default rate is expectedly higher than for commercial lenders. This is precisely why recoverable loans are vital to launching DBL media start-ups.

Today, the simple and most important facts about IPDF are that the finance margin is positive. The loan fund lends two-thirds of its funds to non-profit borrowers and one-third to

for-profit borrowers. This contrasts with the practically even distribution (that is, 50%-50%) of non-profit and for-profit affiliated media organizations. Borrowers generally tend to be smaller publications with circulations generally are between 5,000 and 15,000. The largest borrower has a circulation of about 225,000. Similarly, excluding the three largest borrowers, revenues of the borrowers are also quite low; the average annual revenue for these smaller borrowers was \$330,000, ranging from \$200,000 to \$500,000.

In any event, the IPDF loans are disbursed across a wide region and type of magazines (by number in 2003):



Of the three to four dozens of loans made to date, over a quarter were for direct mail campaigns. The two other loans were directed at printing or cash-flow, inventory, advertising, ancillary income generation (book promotion), and fundraising events.

IPDF's lending activity has improved substantially since the program's establishment. The loss rate, as of this summer, was 2% and declining. The challenge will be to increase volume without sacrificing the quality of credit. Improvements in this regard will continue with tighter underwriting, intensive technical assistance and more aggressive collections. There is also a minimum loss fund utilization of 80% (at \$500,000).

Borrowers interviewed for a 2003 IPA report were universally approving of the loan program. They appreciated the availability of funds that, for most of them, would be unavailable from most (if not any) conventional lending source. They found the process very reasonable and were extremely complimentary about the support they received from staff. The impact of the loans, especially the direct mail loans, has been substantial. For example, direct mail campaign loans have led to more than 50,000 additional readers since 2001.

IPA and IPDF as Emerging DBL Media Companies

By the end of 2006, IPDF projects that it will eliminate its present negative fund balance. Landry also has added some increased measures of financial discipline and vision to the organization through recent hires. Indy Press Newsstand Services and IPA Media Network provide IPA with two reliable revenue generating programs that help to support the operations of the organization.

Most pertinently, the Ford Foundation recently has committed substantial support to IPDF: by the end of this year, the IPDF expects \$400,000 in net asset grants from the foundation and \$1.5 million in PRI support. This will lift the organization to the next level of scale and finance market opportunity and enable the organization to expand on the services it already provides to affiliated media companies.

The IPA staff and board are interested in further capitalization of the IPDF. Indeed, as the number of affiliated media organizations grows, IPA already has considered increasing the number of loan products. A full analysis of the IPA and IPDF in the appendix contains more detailed information about the organization.

Media Development Loan Fund: A Case Study

The MDLF Organization

Media Development Loan Fund, Inc. (MDLF) was founded in 1995 as a non-profit organization dedicated to assisting independent news outlets in emerging democracies to develop into financially sustainable media companies. Today, MDLF is an impressive organization that achieves its stated mission in two ways through offices around the world. First, it lends funds to high-risk media ventures in emergent democracies at below-market interest rates and does not seek an equity rate of return. Second, MDLF provides a level of project management, monitoring and assistance that is more typical of venture capital and private equity funds than of banks.

MDLF's administrative headquarters are in New York City and its operations center is in Prague. It has a regional office in Moscow that services MDLF's projects in the former Soviet Union. The organization also maintains satellite offices in Warsaw, Jakarta and Hong Kong. MDLF's clients include television and radio broadcasters, newspapers, magazines, news agencies and online media across Eastern Europe, the former Yugoslavia, the former Soviet Union, Asia, Africa and Latin America.

MDLF's Portfolio Activity

MDLF's clients are in countries that often have few protections for independent media companies. The high degree of financial and political risk in these countries often makes MDLF the sole provider of financial services for its clients. As such, the organization provides the gamut of services, including loans, finance leases, equity investments, financial monitoring, specialized consulting, management training and technical assistance.

While the organization has offices around the world, it has placed 80% of its portfolio in the former Soviet Union and former Yugoslavia. Moving forward, MDLF expects to leverage its success in these two regions to other emerging democracies, including countries in Latin America, Africa and Asia.

MDLF's portfolio investments have varied from \$5,000 to \$6 million, with most falling in the \$300,000 to \$800,000 range. Most MDLF loans and finance leases have terms of five to seven years, including grace periods of six months to one year for beginning principal repayment. Most MDLF loans and leases now carry interest rates of 6% to 7.5%, and range as high as 8% for loans to more established clients. MDLF's "standard" interest rate was increased to 7.5% as of March 2004. And, from 2000 to 2003, the organization maintained repayment rates of 86%, 88%, 90% and 91%, respectively.

Historically, MDLF has shown strong performance and seen repayments of its lending portfolio. From its inception through 2004, the organization has collected more than \$15 million in principal, interest and dividends, while maintaining a loss of just over 3% to total collections. This write-off, coupled with MDLF's history of recovered delinquent payments, can be attributed to the solid monitoring systems and processes for its loans, leases and investments. With solid account management and oversight, regular reporting and partnerships with local counsel, MDLF has been able to increase the repayment of its investments and, more importantly, remain proactive in attending to such things as restructures and write-offs.

MDLF and the Future

As of June 30, 2005, MDLF had provided about \$42.5 million in financing to 47 media companies in 17 countries. The size of its revolving fund had reached about \$30 million, raised through a combination of grants and concessionary loans from U.S. foundations, including the Calvert Foundation, MacArthur Foundation and the Open Society Institute; European foundations, including the DOEN Foundation, Novib-Oxfam Netherlands and Stichting Democratie en Media; and the international development agencies of Sweden and Switzerland. With proof of concept, MDLF is now launching an investment vehicle, Free Press Investment Notes, that will enable the general public to invest in its revolving fund through a simple debt instrument, modeled on Calvert Foundation's own community investment notes program.

Other Notable RLF-Related Activity

The Calvert Social Investment Foundation and the Open Society Institute (OSI) have collaborated to provide an interesting variation of the IPA and MDLF models. Pursuant to OSI's interest in diversifying MDLF's investor base, OSI awarded a \$1 million recoverable grant to the Calvert Foundation on the condition that it stay on the balance sheets in a "first loss" position for as long as the Calvert Foundation had outstanding investments in MDLF. Calvert has used this security enhancement to leverage a \$3 million loan to MDLF. In this way, OSI, as a strategic PRI funder, was able to gain a multiple of its own dollars in support of MDLF, while bringing another institutional PRI funder to the table. Furthermore, Calvert's involvement may provide greater comfort to other institutional funders that may wish to advance PRIs to MDLF in the future. Calvert's senior liabilities, moreover, come from more than 2,000 small funders across the country that, by participating in a diversified media finance entity, are learning about the social impact that MDLF can have.

This model demonstrates that the potential for macro level intermediary organizations to reach media enterprises across the country and around the world is great. Note, for example, that

the Calvert Community Investment Note which is the vehicle that collected the \$3 million for the loan to MDLF, is a nationally registered instrument that is now available in brokerage accounts across the country by virtue of an arrangement with the Bank of New York, the Depository Trust Corporation, and various wire houses such as Schwab. Concepts borrowing from this model are discussed in greater detail in the Recommendations at the end of this report.

Private Limited Partnerships

There are few private for-profit partnerships or financing companies that conduct both debt and equity funding of DBL media companies or projects. One notable example is Lowell, Blake and Associates which has financed large-format (IMAX) films.

*Lowell, Blake and Associates: A Case Study*⁹⁴

Background

The large-format film industry started in the early 1970s with funding from major cultural institutions around the world that sought to increase visitor traffic and to build new revenue streams with exciting, experience-oriented educational presentations. The first large-format films to be produced were often linked to the destination site and funded as a part of the original theater development.

By 1988, when Lowell, Blake and Associates (LB), the Boston-based private investment adviser firm, initiated efforts to create structured finance comprised of debt, equity and grant funds that aligned for-profit and non-profit interests, there were 57 large-format theaters worldwide. The industry had reached a critical mass that allowed for the wide distribution of film properties to theaters across the network. Destination films were no longer the only game in town. A good film on a popular subject could drive attendance (and revenues) at institutions around the world: from Boston to Chicago to Tokyo. Film grosses also were improving, supporting continued institutional support and opening the door for a wider group of funders to participate in large format films.

As continued theater growth drove further demand for new films, the need for new funding resources became clear. Surprisingly, however, the original models that had been put in place at the industry's founding remained intact into the late 1980s. Institutions held on to the lion's share of box office (75% to 85% compared to 40% to 50% for most traditional feature films). Producers and distributors invested only to secure relatively onerous service contracts. These elements of the industry left little on the back end for a pure investor.

Investors soon realized that funding brought leverage: They were not going to change industry standards without bringing new financing resources. But they also needed to be

sensitive to the kinds of funders that could participate in the industry. Since the major revenue drivers at that time were educational and cultural institutions, large-format films were compelled to have both educational and entertainment value. Overly commercial films or films with clearly promotional crediting had little chance for wide distribution. Funders, therefore, had to have at least an informal interest in either the educational mission of the particular film that needed funding or the simple idea of a growing large-format network that thrilled viewers with life-like, immersive educational experiences.

The initiation of large-format film funding by the National Science Foundation was a watershed event for the industry and validated the educational value of large-format enterprises. The importance of the educational component of this format was vividly illustrated when a film fully funded by Intel was spurned by viewers as too commercial. This also proved to be a defining moment in the industry's history.

LB felt it was critical to provide sensible valuation in order to establish reasonable and inviting bases for non-industry participants to consider funding large-format films. Mission-based organizations needed to have a clear and compelling vision of a given film's educational content and scope. Return-focused investors needed to understand the specific risks and opportunities attendant to an investment in a particular film and they needed to see a straightforward return model. Promotional opportunities and limitations needed to be specifically set forth.

Drawing on its experience in finance, LB developed some rules that instilled confidence in investors who initially uncertain about funding these large-format projects. These rules provided that:

1. Each film must be treated as a separate investment entity. No funding of operating companies. No bleeding of funds from one project to another.
2. Recoupment of every investor's initial investment must be the top priority for all participants in the film. Returns may not be pro rata, but no producer or investor gains an additional participation until all of the original investors are whole.
3. Estimates must outline likely performance in good and bad scenarios. (If an investment manager proves that it does not understand the risks or the limits of the opportunities on one project, it has poisoned the well for many projects to come.)
4. No divergence from the presented return structure.
5. No green light until the entire budget is funded.

Lowell Blake Financing Case Study: *Whales*⁹⁵

Different funding entities have different priorities and appetites for financial risk. With the 1996 large-format film *Whales*, investors learned that you could follow sound financial principles and also offer a mix of investment formats. Mission-based organizations and endowments may sacrifice ultimate potential profit by demanding a loan (as opposed to equity) structure and first-out recoup. Investors may choose to maximize profit with pure equity investments as long as they have the comfort of knowing that they are standing pro rata with other equity investors and that capital recoup is a priority in the model.

The funding pool for *Whales* was as follows:

- \$1.65 million loan from conservation organization endowment. (7% interest with a back-end equity kicker; first position recoup);
- \$500,000 NWF equity position (enjoys pro rata equity recoup after loan plus pro rata back-end participation with other equity investors);
- \$700,000 investment from distributor (enjoys pro rata equity recoup after loan plus pro rata back-end participation with other equity investors); and
- \$350,000 investment from individual investors (enjoys pro rata equity recoup after loan plus pro rata back-end participation with other equity investors).

The returns for *Whales* were as follows:

	1997	1998	1999	2000	2001	2002	2003	Residual	Totals
Theaters showing <i>Whales</i>	26	28	22	10	8	6	4	4	108
Avg. lease rate	\$ 85,000	\$ 80,000	\$ 75,000	\$ 65,000	\$ 60,000	\$ 55,000	\$ 50,000	\$ 40,000	
Gross to LLC	\$ 2,210,000	\$ 2,240,000	\$ 1,650,000	\$ 650,000	\$ 480,000	\$ 330,000	\$ 200,000	\$ 160,000	\$ 7,920,000
Distribution	\$ 442,000	\$ 448,000	\$ 330,000	\$ 130,000	\$ 96,000	\$ 66,000	\$ 40,000	\$ 32,000	\$ 1,584,000
Marketing Expenses	\$ 600,000	\$ 250,000	\$ 80,000	\$ 80,000	\$ 50,000	\$ 50,000	\$ 50,000	\$ 50,000	\$ 1,210,000
Gross Return after Distribution	\$ 1,168,000	\$ 1,542,000	\$ 1,240,000	\$ 440,000	\$ 334,000	\$ 214,000	\$ 110,000	\$ 78,000	\$ 5,126,000
<i>Recoupment</i>									
Endowment (\$1.65 mil loan)	\$ 1,168,000	\$ 732,000							\$ 1,900,000
Distributor		\$ 365,796	\$ 334,204						\$ 700,000
NSF Grant Sponsor		\$ 261,306	\$ 238,694						\$ 500,000
Private Investors		\$ 182,898	\$ 167,102						\$ 350,000
Return after Recoupment	\$ -	\$ -	\$ 500,000	\$ 440,000	\$ 334,000	\$ 214,000	\$ 110,000	\$ 78,000	\$ 1,676,000
Endowment participation @20%			\$ 100,000	\$ 88,000	\$ 66,800	\$ 42,800	\$ 22,000	\$ 15,600	\$ 335,200
Production Participation @25%			\$ 125,000	\$ 110,000	\$ 83,500	\$ 53,500	\$ 27,500	\$ 19,500	\$ 419,000
Net Returns			\$ 275,000	\$ 242,000	\$ 183,700	\$ 117,700	\$ 60,500	\$ 42,900	\$ 921,800
<i>Breakdown of Net Returns</i>									
Distributor			\$ 124,190	\$ 109,287	\$ 82,959	\$ 53,153	\$ 27,322	\$ 19,374	\$ 416,285
NSF Grant Sponsor			\$ 88,715	\$ 78,069	\$ 59,262	\$ 37,970	\$ 19,517	\$ 13,840	\$ 297,373
Private Investors			\$ 62,095	\$ 54,644	\$ 41,479	\$ 26,577	\$ 13,661	\$ 9,687	\$ 208,142

The majority of funding for *Whales* came from sources that had not previously funded large-format films. No investment would have come without the more rigorous financial priorities LB had set forth. The company accordingly won concessions from the distributor and investment from the distributor on their terms. Most notably, *Whales* has been in distribution for eight years and has been a profitable investment for every investor; it has grossed more than \$40 million at the box office. The film has met and advanced the educational and social missions of the primary funding organization while also helping it to build its membership base.

Lesson Learned

Today, the large-format film industry boasts more than 300 theaters and has found growth through new commercial outlets and in new three-dimensional technologies. Educational

films, however, must also compete with reformatted Hollywood products and high-production-value escapist fare. Therefore, mission-based films have become more expensive and require a greater deal of production investment. Making profits from large-format films has become more difficult for most investors these days as more and more products are choking the limited distribution channel.

But, as the *Whales* example illustrates, strong partnerships provide synergies and insulation from the pitfalls of this increasingly competitive environment. Large-format theater managers want to work with teams that will provide a good film with appropriate educational and promotional support. This sort of commitment to long-term partnerships has allowed the investors and producers and other interested players to do better than survive in the industry; today, they thrive in the industry. The vigilance demonstrated by LB in demanding that return of capital be the first priority of funding partners has allowed LB to recycle original investments in these initial alternative media projects into funding for new projects.

The combined results of *Whales* and other LB-financed films have reached a total of more than 25 million people in theaters around the world with powerful social mission messages (e.g., environmental conservation) that, among other things, have provided formal educational materials for more than 1.5 million students as well as attracted more than \$120 million in box office revenue to some of the leading cultural institutions in the world.

PART THREE:
RECOMMENDATIONS

A. FINDINGS AND CONCLUSIONS

Equity, debt and other specialized and hybrid investment vehicles such as PRIs have a vital role to play in the development of and nurturing of the DBL media space. For-profit enterprises with a strong double bottom line are challenged and often marginalized in the traditional capital markets. Non-profit organizations that historically relied on donations and public subsidies are increasingly being asked to earn a growing share of their operating budgets through revenue generation. Only now are these organizations realizing that more investment – either direct or indirect (i.e., a fund) – in DBL media can help achieve their social missions.

Summary of Findings

Before enumerating our specific recommendations for investors who are interested in supporting DBL media enterprises and infrastructure development with one investment asset class or other, we summarize immediately below some of the findings of this report:

DBL Media Offer an Opportunity for the DBL-Minded Investor

- There are DBL media companies in every segment of the industry. While predominantly smaller and earlier stage than the average mainstream media corporation, these companies offer credible prospects of high social mission impact and for self-sustaining growth that aligns closely with the objectives of an identifiable array of investment sources.
- The television segment is consolidated and, for smaller DBL companies, difficult to penetrate. The radio segment and small local broadcast stations, in particular, offer lower cost structures than television.
- Publishing has lower cost structures for production and distribution than television or radio. This segment is one of the most promising for successful DBL investment, especially for aggregation plays of content and distribution.
- The Internet segment has the lowest content creation and distribution costs of any media segment. However, in general, revenues do not yet cover sales and marketing costs. DBL investors should remain mindful that new technologies in this segment could help create new models of distribution and marketing.

DBL Media Companies Need Financing and Technical Assistance

- Both for-profit and non-profit DBL media companies report that they are in need of financing for the near- and long-term. To date, respondent enterprises financed their activities with \$16.35 million in debt and \$5.69 million in equity. Furthermore, 75% of 426 respondents are presently or will be in the future actively searching for financial investment.

- The scale of that need, moreover, appears to be significant. DBL companies express an appetite for almost \$220 million in near-term funding. (As the survey response rate was only 11%, we speculate that the appetite for outside financing may be more than \$2 billion for DBL media companies.)
- In addition, companies also need technical assistance in securing financing. For example, nearly 40% and 30% of respondents consider equity and debt, respectively, to be attractive, yet only 60% indicated that they had a written business plan and only 40% had a three- to five-year business plan. Thus, significant work remains to be done before most DBL companies can be in a position to obtain the kind of financing discussed in this report.
- Equity is the primary source of capital needed for start-up and early-stages of development. Understanding this financial segment better – including its risk management criteria -- is critical to aligning its interests with the capital and technical needs of DBL media companies. In turn, the lack of technical assistance for DBL media creates the central chicken-and-egg hurdle, and therefore addressing this need is a linchpin issue.
- Debt may play a useful role for stable media companies with proven subscription-based cash flows, even during earlier stages of growth. Debt investment in infrastructure, like some forms of community development and facilities finance, may provide a rich opportunity for investors interested in supporting DBL media enterprises as well. However, very few of the media organizations reviewed in this report reported that infrastructure was their primary financing concern.

DBL Media Are Working in a Capital Market Gap

- Many DBL media enterprises are attempting to launch or grow in the absence of an appropriate capital market. Specific capital gaps for early (with \$100,000 - \$1 million need levels) and expansion stages (with \$2 million – \$3 million need) are particularly notable. However, access to capital is stymied by a lack of transparency about financial and social value, and the absence of independent third parties to broker investment relationships. The lack of an aligned capital market well attuned to the particular needs of DBL media companies will only slow the growth of the sector.
- There may be a significant opportunity for building the DBL media capital market as investors in the U.S. continue to explore and increase their allocations for SRI public equity, DBL private equity, and DBL debt. For example, Investors are projected to more than double their capitalization of DBL debt from \$14 billion in 2003 to \$35 billion in 2008. A portion of these investment assets will be available for DBL media enterprises if they can be leveraged and directed by careful strategic applications that, as of this writing, do not appear to exist.

Investors in DBL Media Would Benefit from a Portfolio Approach

- The media industry is not like most other industries. Media ventures tend to be much more cash-flow- and equity-oriented and less asset-backed. When engaging in seed funding – particularly for content and production financing – it is critical for investors to diversify risk through a portfolio strategy.
- Equity investors seek the presence of reliable debt facilities and an understanding of their point of entry criteria before committing lead equity capital in this risk environment. Conversely, debt investors understand the inherent risk of lending to enterprises that have few hard assets and, therefore, require media companies to obtain adequate equity before providing debt support. Concessionary debt capital also may play a critical complementary role in financing many DBL media enterprises for this reason.
- Overall, there are certainly investment opportunities across DBL media segments, particularly in aggregation and expansion.

Financing Options Exist But Do Not Meet the Extent of Need

- While DBL private equity activity begins to grow among angel and fund investors, interest in the media segment has been, at best, modest. The media industry’s idiosyncratic accounting conventions (or lack thereof) are often the cause of investor reticence. The two most critical factors needed to fostering greater equity participation involve establishing: understandable metrics for market performance; and more sophisticated communication and eventual collaboration within a “lead investment community” as well as across other investment asset classes.
- Revolving loan funds (e.g., IPDF and MDLF) serve narrow areas of the nascent capital market for DBL media particularly well. However, due to the lack of resources and professionalization on one hand, and the isolation from lead equity investment and technical assistance on the other, they are not positioned to meet the diverse needs of the different media enterprises in a coherent and scaled way.
- The social and financial risk-return characteristics of DBL media companies and RLFs fit the investment goals of foundation PRI programs. RLFs often require the same kinds of concessionary funder engagement to provide the necessary debt capital to DBL media borrowers. Coordinated investment market activity amplifies further alignment among these entities and early stage DBL private equity. Seen as a community of practitioners, PRI funds are in the best position to establish a lead role in affecting risk mitigation, syndication, and co-investing.
- About 61,000 foundations made only \$16.8 million in PRIs to all arts and media companies in 2001-2002, of roughly \$30 billion in annual charitable distributions, and more than half a trillion dollars in total assets. And, most of this allocation currently goes towards one sub-segment of media – namely public broadcast. This is an understandable legacy issue of their long-term philanthropic support there. PRIs, therefore, remain a largely untapped resource.

- Default rates among some foundations’ “social venture” PRI portfolios illustrate a dramatic deficit within foundations of portfolio management experience with intensive, long-term requirements of early stage companies. While such default rates may deter some foundations from entering the space, it should illustrate the natural potential alliance with other DBL investment management companies and intermediaries. Default rates also may increase foundation participation unless risk diversification and performance metrics can be addressed.

More DBL Media Intermediaries Are Needed

- DBL investors are often stymied as they attempt to establish direct financial relationships with enterprises. Divergent one-to-one direct relationships between investors and enterprises are inefficient and prohibitively costly, especially at the small scale of these DBL transactions. Investors lack analyses of enterprises at the local level even while DBL media enterprises are interested in identifying financing sources. The interests of both the sources and users of capital can best be served through market intermediaries.
- The capital market for DBL media, like any other, requires “market-makers” that define standards and norms, enhance transparency, and promote more efficient transactions. Presently, these are too few. And, even among those that exist, most lack sufficient scale.
- A number of membership intermediaries (e.g., NCM and PMA) may be able to broaden the scope of their work and cross-over into capital financing in some manner. Their trade industry knowledge has enormous value for understanding market and management issues. However, rather than dilute focus and core competency in the face of their limited resources, it may, in general, be advisable for such trade groups to establish strategic partnerships with financial service-focused intermediaries.

Lessons Learned From the Conventional Financial Markets

Below are notable features of the conventional financial markets that compellingly illustrate how capital also might be channeled to DBL media investment opportunities:⁹⁶

Agreed Upon Standards and Norms

- Conventional markets have adopted broadly accepted standards and norms to define success. Whether measured through net present value, internal rates of return, or earnings per share, there is general agreement regarding the measures and benchmarks of success. Professional and diversified portfolio managers must develop the success metrics (both financial and social) and discipline to rationalize the flow of capital for this media space. This will take business models that support this sustained effort, and the ability to connect this activity to real market ecologies involving professional managers and numerous investors demanding such standards and norms.

Transparent Outcomes

- Because there is agreement on appropriate standards and norms, it becomes possible to measure outcomes – leading to greater transparency and consistency. But this requires investment in industry infrastructure and the creation of best practices for measuring such things as outcomes and social returns.

Standardized and Scalable Products, Transactions and Services

- Standardized products and services contribute to economies of scale, and hence the potential to scale up and reach greater impact. For example, IPDF employs a revolving loan model that investors should explore. Similarly, there are some notable DBL private equity funds in education and other markets that are managing risk while also meeting social objectives well enough to merit further study. However, unless conforming deals are tracked over time, the market will be merely anecdotally understood and standardization and scale will be very hard to attain.

Market Infrastructure

- The formal financial market relies upon a host of institutions that create a level playing field and facilitate transactions – stocks and bonds can be sold, not only because they can be valued through consistently defined measures, but because there are stock exchanges, brokerage houses and market makers. The DBL media capital market must invest in building syndicates of exchange of capital and information.
- There are important industry examples of entities that are providing some of these services. While they, collectively, are clearly inadequate against the potential opportunity, they provide indicators of deepening market interest and good preliminary initiatives for just such broader market infrastructure. The Social Investment Forum and SRI in the Rockies provide annual informational forums and reports for mutual fund market investors and are interested in increasing research on debt and private equity products, too. The Investors' Circle presently conducts the only national deal flow distribution of and venture fair events for the DBL private equity industry as a whole. The Community Development Venture Capital Association and CleanTech provide similar services for the community development and environmental service and alternative energy market segments, respectively. The Calvert Foundation's collaboration with the Open Society Institute in support of the Media Development Fund (MDLF) is a model that debt investors should explore.

Unique Features of a Capital Market for DBL Media

Even while the financial markets provide helpful lessons, a market for DBL companies likely requires features that depart from the conventional financial markets. Such features might include:

Personalization

- Social media investors (including equity and debt investors, and grant-makers) seek to express their preferences, to an unconventional large degree, according to a subjective barometer of significance and value. The investor defines investment goals in terms of desired financial returns and social impact. Operating efficiencies may be important for investors, but even these goals will rarely trump the larger social goals of DBL companies.

Relationships

- While the capital market infrastructure is designed to create neutral, impersonal and consistent interactions, DBL investors typically seek at least one of two things: a more engaged, high-touch relationship with or a more transparent representation of social mission and impact of the organizations in which they invest.

Flexibility

- Investors want, above all, to drive transactions toward their interests and values. They accordingly seek flexible instruments in term, rate, security and social impact that are responsive to their priorities. The ability to target specific deals and/or sectors and geographies becomes critical on the social impact alignment, even while the offering of various levels of risk and return is critical to match investor profiles.

Looking Forward to a Capital Market for DBL Media

In sum, we see an emerging DBL media capital market that needs to blend aspects from both the traditional and the social capital market ecologies. It must combine standards, transparency, standardization, and infrastructure with personalization, higher-touch relationships, and flexibility.

PRI-type and DBL private equity capital from social investors and foundations both have a critical role to play as the mission-alignment and need for concessionary terms become more fundamental to the market development equation. Debt has the potential to greatly increase the leveraged impact of the sector. However, DBL media companies face some obstacles as debt is often either difficult to impossible to obtain without an increase in equity or grants to lead or support it. What is more, (traditional) lenders are more likely to finance more mature enterprises. Indeed, where equity and PRI's together may generally be more appropriate for very early-stage ventures, it will then be easier for debt to follow into later-stage or large-scale market rate transactions. There is already a critical middle layer of strong enterprises and intermediaries that is emerging to serve early-stage DBL media ventures. Today, the traditional market simply will *not* meet these intermediaries on agreeable terms.⁹⁷ In any event, in all cases, the DBL media landscape is in need of stronger market infrastructure and active intermediaries to connect the sources and users of capital.

B. GENERAL INVESTOR GUIDELINES

In helping organize the DBL financing market, the community of prospective direct investors and Limited Partners of prospective funds must come to understand the clear distinctions and inter-relations of funding vehicles within this market:

- noting how equity and PRI funds open the market to new risk thresholds;
- how revolving loan funds and other innovative debt pools could fuel expansion and mezzanine growth; and
- how social capital intermediaries help service the development process of each of these stages.

While the recommendations stated below are somewhat related, they are not necessarily contingent or dependent on each other. Finally, we wish to acknowledge that these recommendations are based on the anecdotal information we have gathered from survey respondents and our own preliminary research and direct experience in the market. Thus, our recommendations can hardly be considered exhaustive or final. Further research will certainly qualify some of our recommendations as well as uncover additional DBL financing opportunities.

We first reiterate some generalizations about the DBL investor community:

Assumptions About DBL Media Investors

There are many DBL media companies and most of them are high-risk, low-return opportunities. Only a certain kind of investor should consider investing in these companies. Below, we describe some of the assumptions we have made about the investors that may have interest in the DBL media space.

- Most institutional investors with an interest in the DBL media industry invest in larger companies, particularly in the nascent ethnic minority broadcast television sub-segment;
- Pension funds, banks and government funds have invested in minority-focused media funds in increments of \$1 million to \$5 million. These particular funds tend to invest in high-return, larger media companies rather than smaller, high-risk DBL media companies. These funds and their institutional limited partners often do not self-identify as DBL investors, even though they recognize the added social value to certain profit-centered investment areas, including media;
- Most DBL media investors are individuals and foundation PRI programs set to invest between \$100,000 and \$2 million per deal directly or through media funds;
- Most DBL media investors are particularly motivated by important social issues, and therefore, this group of investors is unique in the investment community;

- DBL media investors recognize that their investments are intended for stable, long-term revenue and profit growth, and, on occasion, lower to medium growth over time. While the community has no real DBL performance benchmark as guidance, it appears more “patient” and accepting of below-market rates of return;
- Lack of collateral on the balance sheets makes equity investments, rather than debt, the appropriate (and exclusive if not lead) instrument for growth and expansion finance for DBL companies in most cases;
- Debt instruments are a good investment instrument for DBL media companies in two cases: first, when a company needs to launch sales and marketing campaigns for reliable, subscriber-based cash flows; and, second, when a company requires completion gap financing for creative product that is near completion and that has secured distribution; and
- DBL media investors understand that they are financing, in part, the development of a unique market. Since DBL media companies go public or get acquired at a lower rate than industry average, such investors must be willing to tie up capital for longer periods of time.

Next we enumerate investor guidelines for financing DBL media.

Investor Guidelines

1. *Distribute Investment Risk*

Invest in funds or other similar vehicles that apportion risk across multiple DBL media companies and that emphasize diversification of businesses and follow-on investment. This is particularly necessary for investors participating in fragmented, undeveloped markets such as the DBL media industry. In particular, we recommend that the following vehicles be considered in the short-term:

- *Private Equity DBL Media Fund.* Form an early- to expansion-stage private equity fund for DBL media focused on “industry change,” with an experienced management team, likely from the general media investment or some other investment field;
- *Private Debt DBL Media Fund.* Invest in and support the growth of a revolving loan funds dedicated to DBL media such as the IPDF;
- *Hybrid Debt-Equity Media Fund.* Establish a specialty fund investment partnership that allows for both equity and debt allocations. The partnership could either operate as a direct investment fund or a micro fund of funds to a newly formed DBL Equity Media Fund and a revolving loan fund such as IPDF;
- *Technical Assistance for DBL Media Companies.* Create financial services to support DBL media companies and help reduce their overall risk profiles. While we advocate

independent intermediaries below, we also see the need for more closely integrated service components in relation to the funds described above.

2. Insist on Business Fundamentals

Investors should choose DBL media companies that employ standard business fundamentals to drive their businesses. In other words, the ideal target company:

- has proven, competent management;
- is addressing an unmet and growing demand in the market place;
- produces and delivers a high quality product or service;
- manages debt well;
- is not overextended and is focused on the core business proposition;
- is using traditional financial management tools to run the business; and
- has a deep understanding of the competition and their market focus.

Unique DBL characteristics, in of themselves, are not sufficient investment criteria.

3. Design for Scale

Investors should choose DBL companies with clear opportunities to scale revenues and market share. Screen for companies that have: prospects to scale sales of current products into existing or incremental markets, thus amortizing fixed production costs; and can reasonably achieve broader distribution of products through distribution deals.

4. Aggregate

Invest in the aggregation of several DBL companies into a larger business platform that can benefit from scale but still keep mission focus protected. .

5. Leverage Dominant Players

Choose companies that have a proven track record in establishing deals for distribution or production, including strategic partnerships with the larger players.

6. Plan for Exit

Choose DBL companies that have a credible plan for and demonstrated ability to manage an exit strategy for its investors, including private sale, recapitalization during an expansion round, or initial public offering. Newer, fast growing segments that are “flying below the radar” of the traditional media industry may be attractive acquisition candidates (by larger DBL companies or dominant media industry players) in a relatively short period of time. Bear in mind that acquisition of DBL media companies by mainstream media companies can seriously compromise the social mission of these companies.

7. Provide Technical Assistance and Support Capital Market Intermediaries

Independent market infrastructure needs to be built to offer services for both institutional and individual investors who wish to invest in DBL media. Intermediaries between entrepreneurs and investors could be essential for building infrastructure and assisting DBL media companies to secure capital by providing technical assistance. Such active capital market intermediaries will attract new investors or individual or syndicates of investors to DBL media projects. Increasingly rationalized and coordinated investment efforts will necessarily follow.

We now turn to more strategic term-based recommendations.

Looking to the Future

For the long term, we recommend the development of an intermediary marketplace that can act as “merchant bankers” and a coordinated social capital market for DBL media. The creation of such a marketplace is admittedly speculative at this point. We, nevertheless, are confident that implementation of the equity and debt finance, and related service recommendation described above will in all likelihood set the stage for the organic emergence of an intermediary market for DBL media. Such intermediary elements naturally evolve as the average deal size matures – i.e., as the DBL companies grow and mature. More research and development need to proceed on the basis of the foundational work done in this report to ensure that such a market does emerge. For one, we need to formulate rigorous and practically unimpeachable measures of success for both bottom lines.

In any event, we note that the DBL media space is in need of a sustainable infrastructure through which a range of financing vehicles, consulting services, industry analyses, and other administrative services can facilitate financing from institutions and individuals who are interested in DBL media. A needed value chain of financial services will emerge to provide the following:

- *Analysis and due diligence:* Intermediaries typically conduct due diligence on enterprises interested in raising debt capital. These intermediaries or funds analyze these groups to determine if they are qualified for investment. Based upon sufficient experience, firms can aggregate similar groups interested in similar terms and conditions for inclusion in a range of portfolios, including firm and unimpeachable social impact measures. Methodology of due diligence and analysis is often standardized within a given field, and these help inform best practices and streamline future efforts. DBL media investment capital intermediaries will have to be especially attuned to the various qualified measures of *DBL* success.
- *Structuring and packaging:* Intermediaries structure financial transactions according to the organizations’ social mission profiles, as well as market demand. The work of creating the financial structures can include the introduction of credit enhancements to help organizations match the risk profiles of investors in the market. This will help to define the terms and kinds of the capital needed. Once structuring is complete, deals are

put into “offerings” or “placements” available to potential investors which can be either private or public depending upon whether they are oriented to the public securities markets or not. Securities registration may, accordingly, be needed to reach retail investors.

- *Syndication:* These deals are brought to a network of core DBL investor partners consisting of revolving funds, foundations and other social investors. The larger the deals, the broader the base of individuals and institutions. And the greater the need for capital beyond the “core converted,” the more champions must be found among major investors to bring in their peers and build comfort and momentum. Careful attention must be paid to the ways in which DBL projects are presented to investors outside of the “core converted.”
- *Post-investment asset administration and monitoring:* Intermediaries service funds through the collection of interest payments, ongoing credit analysis, financial return reporting, and social impact analysis. They streamline the processes, create best practices, and disseminate them to the broader markets and their stakeholders.

Creating a series of linked capital market intermediaries and syndicates of investors would facilitate the financing of a range of DBL media projects, localized intermediaries, and DBL-focused funds. Such a capital market network for DBL media would involve a number of “capital classes” discussed in this report working in coordination. An equity or debt facility could even register an investment note offering at the national and state levels in order to solicit retail investors across the country in addition to investment from accredited and institutional investors.⁹⁸

As intermediaries build a range of facilities and networks, they can help create a capital market for DBL media finance that could further diversify risk for a broad range of investors. Another possible dimension of this DBL capital network could be the addition of an endowment of equity-like PRIs or grants that would serve as an “underwriting pool,” perhaps structured as first-loss recoverable grants or “equity equivalents.” Such an underwriting pool would ensure that deals were fully funded in a timely manner as pending opportunities develop.

Finally, with successful performance, securitizations (e.g., bonds, etc.) could be offered to the market. These could presumably garner investment grade rating with the proper security enhancements. It is for this reason that performance becomes critical for the secondary markets to be able to assess risk. The conforming aspects are necessary so that relatively homogenous pools of similar assets can be constructed.

All told, a dynamic market profile can evolve in a decentralized manner, driven by transactional opportunities. An early stage network model⁹⁹ could be housed within a new social capital market intermediary specializing in DBL media – a sort of “executive producing” entity for deal flow and value-chain needs that could map in all appropriate expertise and capital partners, as well as ensure that projects continue to be developed. It is also possible that an existing entity could be built out and augmented to perform this role. A centralized underwriting

pool could be funded to act as risk capital and guarantor for a more coordinated ecology of activity.

The cost of such activity would likely be distributed among a number of partners, each with various revenue models that would help to defray expenses. Developing a plan for this sort of network would require a concerted effort on the part of a number of players, but likely could start in relatively short order.

DBL investment funds and aggregated localized intermediaries can play an essential role in coordinating a systematic approach to DBL media financing. In this vision, such intermediaries would systematically integrate equity, debt and other financing strategies under one guiding umbrella with leadership and substantial support from DBL media experts. Through the use of time-tested market instruments, such a fund would be an excellent investment vehicle for a range of limited partners, including foundation PRI programs as well as debt and equity investors. Most pertinently, however, we believe that such an approach would develop the DBL media into a self-sustaining industry and, in turn, create a healthier, more diverse and vibrant “media ecology.” Furthermore, technical assistance from various network partners in the form of expertise and other consulting support can be essential to ensuring that DBL media companies consistently incorporate and employ best business practices. Such assistance should and will likely grow hand-in-hand with the core delivery of capital.

Final Comments

DBL media companies exist throughout every media segment. Creative and real financial support from sympathetic investors and advocates is vital if these companies are to be self-sustaining in an otherwise competitive market by creatively mobilizing financial capital. This support will be essential to serving their shared interest in fostering democratic civil society, an informed citizenry, and an efficient free marketplace of ideas.

More to the point, for advocates of such things as democracy, human rights, social justice, and environmental sustainability, philanthropic support of DBL media is not enough. The consolidation trends in commercial media require more. Indeed, if new and arresting ideas buried in books, films, community newspapers, or blogs are to reach people who are ripe for that elusive but ever-so-gratifying moment of inspiration, investors and activists alike must attend to the financial needs of individual DBL media companies. Alternatively, investors and activists interested in changing the broader, infrastructural limitations that stifle DBL media must seek to create financial instruments and funds that can impact the production and distribution of a diversity of content. In any event, we think it is vital that investors and activists alike attend to the capital markets in their efforts to support DBL media.

Ultimately, we seek to develop a more integrated and rationalized market for DBL media that will be inviting to DBL investors. Of course, many investors today seek out media deals that jibe with their own sense of social mission. It has become clear, however, that the one-shot approach to DBL investing is not enough. The large scale implementation of best business practices in the work of DBL media entrepreneurship will help to generate a more vibrant media landscape and, in turn, a healthier civil society.

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ENDNOTES

¹ See Veronis Suhler Stevenson, Communication Industry Report 2004 (VSS CIR 2004) and the Communication Industry Forecast 2004 (VSS CIF 2004). The market capitalization figure represents publicly traded companies engaged in all media segments discussed in this report, including advertising, broadcast and cable television, feature and documentary film, publishing, and the Internet, as well as all activity of media-related conglomerates like Sony and Microsoft. These values were reflective of the industry as of September 22, 2004.

² Phases III and IV of this research project are not represented in this report. They will involve an effort to analyze and launch the best investment vehicle for pool capital and managing investments in this niche market.

³ See VSS CIR 2004, VSS CIF 2004.

⁴ See id.

⁵ See Veronis Suhler Stevenson, Communication Industry Forecast 2005 (VSS CIF 2005).

⁶ VSS attributes this expected growth to strong institutional end-user spending (e.g., professional and business information services, television programming, and outsourced training in educational and training media) which, in light of the consumer-citizen oriented objectives of DBL media, is outside of the scope of this report

⁷ See, for example, Catherine Clark et al., *The Double Bottom Line Project Report: Assessing Impact of Double Bottom Line Ventures* at www.riseproject.org/DBL_Methods_Catalog.pdf; and Jed Emerson, *Counting the Social Value of Investments, 2003* by Jed Emerson at gobi.stanford.edu/facultybios/bio.asp?ID=323.

⁸ See The Project for Excellence in Journalism, *State of the News Media 2005: An Annual Report on American Journalism* at www.stateofthemediamedia.org/2005 (State of the News).

⁹ See VSS CIR 2004, VSS CIF 2004, supra note 1.

¹⁰ See VSS CIF 2005, supra note 5.

¹¹ See *State of the News*, supra note 8.

¹² The reader will note that the chart lists only 10 organizations. Two participating organizations had no responses to the circulated survey, and therefore have not been listed here.

¹³ See VSS CIR 2004, supra note 1.

¹⁴ See Thompson Venture Economics at www.ventureeconomic.com.

¹⁵ Data obtained from conversations with professionals at McKinsey and Cambridge Associates, as well as with managers from Abry, Wicks and Spectrum.

¹⁶ See National Venture Capital Association Yearbook; and Thompson Venture Economics, see supra note 14.

¹⁷ See Center for Venture Research, University of New Hampshire at wsbe.unh.edu/cvr/.

¹⁸ Note that is also helps explain the relatively low ROE of media at 6.6%, when compared to the weighted average of all sectors of 16.2%. Debt leverage helps to amplify equity return, though certainly the current cycle of various media industries, their relative strength or weakness, also explains much of this.

¹⁹ For more information on “blended value investing” as explained by Emerson, see www.blendedvalue.org. The paper cited in the text is located there.

²⁰ See Clark and Gaillard, Columbia University Business School’s Research Initiative on Social Entrepreneurship (RISE), *RISE Capital Market Report: The Double Bottom Line Private Equity Landscape, 2002-2003* at www.riseproject.org/reports.htm.

²¹ See Timothy Bates and William Bradford, *Venture Capital in Minority Business Investment* (May 2004) at www.culma.wayne.edu/pubs/bates/minorityvcmay04.pdf.

²² See RISE, Data sort for “media” as a listed area of interest within the online DBL Investor Directory at www.riseproject.org.

²³ See RISE Capital Market Report, 2002-2003, supra note 20.

²⁴ See Investors’ Circle Foundation; The Harvard Business School/McKinsey Portfolio and Member Survey Results Presentation, 1992-2002.

²⁵ See Foundation Center, *PRI Financing: Trends and Statistics (2000-2001)*, excerpt of the Foundation Center’s *PRI Directory* (2003) at fdncenter.org/research/trends_analysis/pdf/03pri_ex.pdf.

²⁶ See www.wpsocom.

²⁷ See www.urban-america-tv.com.

²⁸ See www.ethicalmarketplace.com.

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- ²⁹ See wn.com/s/televisionkorea/index.html.
- ³⁰ See www.urbancom.net/.
- ³¹ See www.iwtnews.com/mission.
- ³² See www.airamericaradio.com.
- ³³ See www.spanishbroadcasting.com.
- ³⁴ See www.quetzaljpmorganpartners.com/news02_07_01.html.
- ³⁵ See www.wlib.com; www.quetzaljpmorganpartners.com/news12_26_00.html.
- ³⁶ See www.indigent.net.
- ³⁷ See www.progressivepictures.com/pp1.html.
- ³⁸ See www.venturadistribution.com/.
- ³⁹ See www.film-makerscoop.com/.
- ⁴⁰ See www.filmmovement.com/Default.aspx.
- ⁴¹ See www.greencine.com/static/about.jsp.
- ⁴² See www.msnbc.msn.com/id/4946011/.
- ⁴³ See www.time.com/time/archive/preview/0,10987,1009648,00.html.
- ⁴⁴ See www.mondotimes.com/1/world/us/5/316/14224.
- ⁴⁵ See www.nguoi-viet.com/.
- ⁴⁶ See www.ncmonline.com.
- ⁴⁷ See www.nnpa.org/.
- ⁴⁸ See www.indypress.org.
- ⁴⁹ See www.utne.com. See also www.mediainfocenter.org/story.asp?story_id=79729428.
- ⁵⁰ See www.chelseagreen.com.
- ⁵¹ See www.pgw.com/home/.
- ⁵² See www.bibliodistribution.com.
- ⁵³ See www.nbnbooks.com.
- ⁵⁴ See www.rowmanlittlefield.com.
- ⁵⁵ See www.ipgbook.com.
- ⁵⁶ See www.cbsd.com.
- ⁵⁷ See www.igc.org.
- ⁵⁸ PriceWaterhouse Coopers and Interactive Advertising Bureau, *Internet Advertising Revenue Report* (Sept. 2004).
- ⁵⁹ See www.salon.com/ir/faq.
- ⁶⁰ See altnet.org.
- ⁶¹ See www.globalvision.org/who/who.html.
- ⁶² See www.anyone.net/homesite/index.
- ⁶³ See the Agency Report, an advertising industry guide.
- ⁶⁴ See www.eggusa.net/flash/.
- ⁶⁵ See news.ncmonline.com/news/view_custom.html?custom_page_id=41.
- ⁶⁶ See www.indypressny.org/allcas/index.shtml.
- ⁶⁷ Reuters. Table was valid as of June 30, 2004.
- ⁶⁸ Note that is also helps explain the relatively low ROE of media at 6.6%, when compared to the weighted average of all sectors of 16.2%. Debt leverage helps to amplify equity return, though certainly the current cycle of various media industries, their relative strength or weakness, also explains equity return.
- ⁶⁹ The following are the numbers of survey participants which responded from each association: 376 from the Publishing Marketing Association, 162 from the Independent Press Association, 46 from the New California Media, 8 from the National Newspapers Publishers Association, 7 from the National Black Programming Consortium, 42 from the National Asian American Telecommunications Association, 14 from the Asian American Advertising Federation, 10 from the Independent Television Service, 5 from the Association of Hispanic Advertising Agencies, and 17 from IFP/New York.
- ⁷⁰ The information in this section is based on over a dozen interviews with fund managers in the industry.
- ⁷¹ Publicly traded media companies, often referred to as strategic players in this context of finance and acquisitions, are another category of equity investor. Companies like Liberty and Comcast look to invest in other companies for reasons related to their own global investment strategies. These giant conglomerates tend to look predominantly at

transactions in the billion dollar range. Often, they compete in a highly fragmented manner, depending on what sub-sector in which they are shopping.

⁷² We are indebted to Royce Yudikoff, Partner at Abry Partners, for information in this section.

⁷³ See *Private Equity's New Challenge*, McKinsey Quarterly, August 2004.

⁷⁴ We interviewed Ed Shirley, Partner, in August 2004. Shirley has been in the VC equity business for 20 years, with a particular depth of experience in equity investing in media. In addition to fund investment, Fairview also invests with its investee partnerships in a limited number of portfolio companies. It also has some crossover with the other investor types, as the portfolio includes targeted investment in partnerships that specialize in expansions, buy-outs, and later stage investments.

⁷⁵ Joanne Price, co-founder of Fairview's with Larry Morse, was Director of the National Association of Investment Corporations (NAIC) for 12 years, and head of it for a large number of these. NAIC is a private trade outgrowth of the federal effort to support minority or specialty businesses, including matching funds for minority-focused investment funds. NAIC is now a private trade group that focuses exclusively on minority-focused private equity funds. NAIC is the nation's largest trade group supporting funds focused on investing in minority focused enterprises.

⁷⁶ One of our advisors notes there is a non-profit group working on providing Internet services to inner city consumers at lower prices, called One Economy, which is funded by the Ford, McArthur, Kellogg and JP Morgan Chase Foundations, among others. See www.one-economy.org.

⁷⁷ We interviewed Associate Mike Gorzynsky in August 2004.

⁷⁸ We interviewed Lauren Tyler, Managing Partner, in August 2004.

⁷⁹ Quetzal defines ethnic groups in a similar fashion to the guidelines provided by the FCC.

⁸⁰ We interviewed John Seifer, Managing Director, and Peter Nolan, Managing Partner of LGP.

⁸¹ See Miles Livingston and Lei Zhou, "The Impact of Rule 144A Debt Offerings Upon Bond Yields and Underwriter Fees," *Financial Management* (Financial Management Association, Winter 2002) at articles.findarticles.com/p/articles/mi_m4130/is_4_31/ai_96904308/pg_7.

⁸² The nuances of why an offering falls into BBB vs BB, etc, is beyond the scope of this report. Readers, however, are invited to read the discussions of methodology located at www.standardandpoors.com.

⁸³ Community investment is defined as community development and social enterprises supporting affordable housing, nonprofit facilities, small business and micro enterprises -- across a range of sectors. These include individual enterprises and the intermediary facilities (e.g., CDFIs) that serve them.

⁸⁴ While equity financing can play an equally important role in developing DBL media, as we suggest above, it is a much more difficult area in which to find systematic activity among investors. Generally, equity investors seek out deals that accord with their respective idiosyncratic investment strategies.

⁸⁵ This data is culled from the Foundation Center subscription databases.

⁸⁶ PRIs are defined by the IRS as mission-based concessionary investments that count toward grant distribution requirements. They generally take the form of debt, but may also take the form of equity.

⁸⁷ See Foundation Center, *PRI Financing: Trends and Statistics (2000-2001)* excerpt of the Foundation Center's *PRI Directory* (2003), fdncenter.org/research/trends_analysis/pdf/03pri_ex.pdf.

⁸⁸ See rockfound.org/documents/564/provenex_assessment.pdf.

⁸⁹ See www.globalsound.si.edu/.

⁹⁰ See www.macfdn.org/programs/pri/overview.htm.

⁹¹ By "sustainable," we mean that the funds revolve, come back, and then are relent over time.

⁹² As we explain above, "blended value" (a term coined by Emerson) is short-hand for the process by which social and financial considerations can be integrated and rationalized in capital deployments. See www.blendedvalue.org.

⁹³ Note that a third media fund, the Sundance Documentary Fund, was established at the Sundance Institute in 2002 through a \$4.6 million grant from the Open Society Institute (OSI), and originally was designed to be a RLF even as it eventually became structured solely as a grant fund. Its mission is to promote documentary films that specifically focus on social justice and social change in order to encourage public discourse on those broad topics. The fund consists of two entities: the Development Fund and the Work-in-Progress Fund. Filmmakers apply for grants from the first fund in the initial stage of development and research and from the second fund when they have started filming or are in post-production. Grants from the Development Fund are for a maximum of \$15,000 while the Work-In-Progress fund provides individual filmmakers with up to \$75,000. We do not profile these funds as, today, they do not to deploy debt.

⁹⁴ This profile and the more in-depth Case Study addendum were based upon interviews/written materials from Charlton Reynders of Lowell, Blake & Associates, creynders@lowell-blake.com. Also please review www.whalesfilm.com, www.dolphinfilm.com, and www.coralfilm.com as examples of film websites and www.destinationcinema.com and www.nwf.org/productions for additional insights.

⁹⁵ Note that the other large-format films that Lowell Blake has helped financed include *Dolphins* and *Bears*. See www.lowell-blake.com.

⁹⁶ Credit is due to Shari Berenbach, Executive Director of Calvert Foundation, for her input on the following discussion.

⁹⁷ The authors posit that as the community development industry has matured, certain intermediaries have graduated somewhat to non-PRI sources of capital and secondary markets for certain segments have developed (e.g. mortgage backed securities), but this is spotty at best and has taken decades to develop. And even now, CDFIs have not become any less efficacious themselves to the local enterprises they serve. DBL media may expect some of the same future.

⁹⁸ The Calvert Foundation has done quite a bit of this type of retail securitization activity with Calvert Community Investment Notes. See www.calvertfoundation.org.

⁹⁹ This model has been adapted from Calvert Foundation's Community Investment Partners (CIP) community development merchant banking model.