

CANADA MEDIA FUND

Experimental Stream Working Group

Date: October 20, 2015

Introduction

For the 2016-2016 Guidelines, the CMF's goal is to review certain parameters of its Experimental Stream to ensure existing policies are still in line with Program objectives and that the Program itself is adequately meeting the needs of the industry.

Overview – Demand and Results

Key statistics from the Experimental Stream can be found in Appendix A to this note.

Demand

As illustrated in Appendix A, Figure 1, the Experimental Stream has experienced oversubscription with a small percentage of projects funded out of the overwhelming demand for program funds.

Results

Appendix A, Figures 2 and 3 present the amount of funding and number of projects supported by the CMF from 2010-2011 to 2014-2015 for each activity: Development, Production and Marketing, while Figure 4 shows the average budget for each activity.

From 2010-2011 to 2014-2015, the CMF's Experimental Stream experienced an increase in total funding dollars provided for all activities (Appendix A, Figure 5). Games and Rich Interactive Media represented the largest share of funding through all activities (Appendix A, Figure 6)

Appendix A, Figure 7 presents data regarding the exploitation of projects up to September 9, 2015.

Topics for Discussion

In the 2014-2015 Experimental Stream Working Group Briefing Note, the CMF discussed a variety of issues that were classified as either short-term topics that could be implemented for 2015-2016 or long-term topics that would position the Experimental Stream to evolve within the context of the CMF's strategic objectives in the coming years.

The CMF implemented a number of policies in connection with the short-term topics (including changes to the Evaluation Grid, option to convert the Development advance into a recoupable Production investment and the elimination of dual recoupment models).

This year's Experimental Stream Working Group will (a) examine short-term proposals that could be implemented in 2016-2017 and (b) continue the discussions started last year around longer-term issues and approaches. As such, the topics for the 2015-2016 Experimental Stream Working Group are as follows:

1. Evaluation Grid
 - a. Combine Business Plan/Distribution Strategy at the Development Stage
 - b. Team Assessment Criterion at the Marketing Stage
2. CMF Recoupment
 - a. Parameters for Buy-outs
 - b. Cap Reduction on Exploitation Fees, Expenses and Enhancement Costs
3. Dual Approach to Experimental Stream
4. Revised Approaches to Financing
5. A3P Summary

1. **Evaluation Grid**

a. *Combine Business Plan/Distribution Strategy at the Development Stage*

The Innovation/Advancement criterion has been deemed the most important factor in the Experimental Program and this is reflected by the weight it receives in the evaluation grid: 65% when evaluated at the Development stage and 40% when evaluated at the Production and Marketing stages, respectively. The Experimental Stream Evaluation Grid is attached as Appendix C.

Currently, at the Development stage, a relatively high mark is given to a project's distribution strategy. As the distribution strategy is usually developed at the later stages of a project's lifecycle, however, the necessity of a thorough distribution strategy at such an early stage can be difficult for the majority of applicants to present and for the CMF to effectively evaluate. Despite this difficulty, however, it is still important that the applicant provides an idea of the project's prospective audience and outlines potential competitors in the marketplace.

Therefore, in order to ensure that CMF selects the most innovative projects developed by the most effective teams in a viable structure, the CMF proposes to review the Development Evaluation Grid as follows:

Team (same sub criteria)	25%
Innovation (same sub criteria)	65%
Business plan	10%
<ul style="list-style-type: none"> o Viability of the project o Financial stability of the applicant o Historical success working with the CMF o Competitive analysis o Targeted audience 	

b. *Team Assessment Criterion at the Marketing Stage*

In the Guidelines' current Evaluation Grid, the Team criterion consists of Studio, Staff and Teamwork factors and receives the following weight percentages: 25% when evaluated at the Development stage and 15% when evaluated at the Production and Marketing stages, respectively.

While the Studio sub-component is examined and evaluated through the lens of Development and Production, the CMF holds that this term does not directly apply to a Marketing Team and the distinct work they provide.

Due to the fact that the Evaluation Grid is a mechanism to ensure that investment and support are being committed at this stage to projects with a higher probability to be marketed and promoted effectively, including specific marketing criteria for the Team at the Marketing stage would serve as a useful tool in evaluating the strength of such Eligible Project.

Therefore, in order to ensure the Evaluation Grid is as case-specific and applicable as possible, it is recommended that part of the Team's assessment be focused on the specific Promotion and Marketing team responsible for delivering the sales and marketing activities, instead of mainly focusing on the team that is producing the product. The CMF holds that with this added emphasis on marketing staff, funded projects will be better positioned in the marketplace and maximize their opportunities to succeed.

2. **CMF Recoupment**

a. *Parameters for Buy-outs*

The issue of buying out the CMF's rights to recoupment has been a primary concern for many stakeholders from the outset of the Experimental Stream. Some argued that only a set, pre-approved formula could provide comfort and predictability to potential buyers in the event of a transaction involving a CMF-funded project. The CMF declined to proceed in this manner, arguing that doing so prior to gaining some measure of market experience, could result in setting a formula that was detrimental to funded producers or to the CMF.

Since the launch of the program in 2010, 3 companies, for 6 projects, have been bought-out by other companies. It is important to note that all of the buy-out proposals received by the CMF were for company sales and none were for the sale of the project itself. Each buy-out proposal was negotiated on a case-by-case basis between the producer and the CMF, to both parties' satisfaction and without recourse to a third party valuator¹. The experience gained in negotiating these buy-out transactions would not, however, enable the CMF to propose any parameters for a pre-approved formula, as each deal was entirely distinct.

For example, one proposal sought to evaluate the CMF share based on the project's sales forecast compared to sales made in the past.

Another company chose to fully reimburse the CMF investment since the company was sold before the project was fully developed and the new owner did not intend to exploit the project. For another buy-out proposal, due to the fact that the project was at the Development stage, the new owner chose to discontinue any additional work in connection with the project. The CMF decided to pay the applicant for the costs incurred before the sale and the remainder of the contribution was reimbursed to the CMF. This case illustrates the common scenario where the motivation of a company's buy-out has more to do with the expertise of the company itself, rather than the specific intellectual property which received CMF funding.

The CMF submits that it is a reasonable assumption that such expertise and good reputation of the company was gained, at least in part, by the specific work done on the CMF-funded project, and added value to the company that was sold.

In attempting to design a formula for buy-outs, there are numerous elements to take into consideration:

¹ For the 6 projects where a buy-out was successfully negotiated, the percentage of the CMF's initial investment that was recouped ranges from 20% to 100%.

- First, as outlined in the Contribution Agreement with the Department of Canadian Heritage (“DCH”), contrary to other types of financiers in the digital space, the CMF invests in projects, not in companies. A formula may be easy to set if a company only has one project, but it becomes much more complex when a company has multiple assets in its portfolio. In such cases, the value of a specific project within the overall value of the company must be determined and this can only be achieved on a case-by-case basis.
- Additionally, a project may be at different stages of its lifecycle when the buy-out proposal is made to the CMF. For example,
 - The project is still in development or production and has not been launched yet;
 - The project is delivered and launched on the market;
 - The project is still in exploitation;
 - The project is no longer in exploitation;
 - The project was financially successful, or not;
 - The project has returned revenues or profits to the CMF / has not returned any revenues to the CMF / has returned lower revenues than the initial investment; or
 - The amount offered to the company by the buyer is higher / lower than the CMF contribution.
- The project/company is sold to a third-party that may or may not be eligible to the CMF (e.g. Canadian or foreign company). If the new owner is eligible to the CMF, does it wish to pursue the development, production and/or exploitation of the funded project? Does the new eligible company wish to continue to be involved with the CMF?

In consideration of all these elements, it may be difficult to develop a one-size-fits-all approach and the CMF may elect to continue to evaluate buy-out proposals on a case-by-case basis.

Alternatively, the CMF may develop broader parameters that could offer a higher degree of predictability for potential applicants, investors or buyers. This could be achieved by setting a minimum percentage and/or a maximum amount of reimbursement of the initial investment. For example, a buy-out model could state that the CMF will never accept less than “X” % of its initial investment, but will never receive more than “X” times its initial contribution. Despite this framework, however, buy-outs would still need to be subject to a case-by-case evaluation.

For the sake of clarity, it is important to note that the CMF will not consider proposals to buy out its investment where the buy-out is primarily intended to extinguish the CMF’s right to recoupment or profit participation from revenues generated by the project. As such, the CMF will expect to receive buy-out proposals in which the amount paid to the CMF would be materially higher than the amount of the CMF’s investment in the project. The expectation is that buy-out proposals will typically be presented when a sale of the project² has occurred. When such sales are made, the CMF’s 7-year rule, whereby the CMF will not receive any proceeds from CMF-funded projects (or companies that produced such projects) that are sold seven years after the submission of the first exploitation report, will continue to apply.

In light of all of the above, in advance of implementing any new buy-out parameters, the CMF seeks stakeholder feedback and proposals.

² Either alone or as an asset in the sale of the applicant company/companies (or similar transaction) by the applicant(s) to a party unrelated to the applicant.

b. *Cap Reduction on Exploitation Fees, Expenses and Enhancement Costs*

With the multiple goals of simplification, applicant predictability and administrative efficiency, the CMF abandoned the two-model recoupment approach in 2015-2016. This adoption of a singular model allowed the CMF to participate in profits for all projects funded.

Despite the fact that the Experimental Stream's mandate is to fund "leading edge, non-linear projects...", the CMF's Programs are also guided by the principle of sustainability (i.e., ensuring sufficient ROI).

Currently, before the CMF recoups its share of revenues, "the Applicant is permitted to deduct commissions, fees, and expenses related to the exploitation and, if applicable, the enhancement costs of the project up to a maximum of 75% gross exploitation revenues".

In an attempt to balance the above-noted objectives and pivot the Experimental program towards an increased level of sustainability, the CMF has examined alternatives to its policy in connection with the 75% cap on deductions.

As such, the CMF submits that in an effort to increase its potential ROI, a more appropriate policy would be to maintain 75% cap in a project's first year of the exploitation, but then reduce the cap to 50% in all subsequent years.

3. **Dual Approach to the Experimental Stream**

The final "long-term" topic discussed in the October 2014 Experimental Stream Working Group was the CMF proposal to divide the Experimental Stream into two sub-streams of commercially-viable and innovative/experimental projects.

The policy directive in the Contribution Agreement has always required a focus on innovation for *all* types of digital content and enabling technologies. When the Experimental Program was launched, the CMF responded to this directive by designing a single program in which innovative console games, casual games, interactive web series, social media applications and enabling technologies, to name a few, competed in a selective process for the same pool of funds.

The potential "long-term" split approach in the Program would permit producers to continue to develop their successful projects even if "innovation" is not at the forefront of the project, while also allowing producers to continue to explore riskier new technologies and storytelling approaches by experimenting with their innovative and leading-edge ideas. The more commercial projects, which would likely have more favourable ROI, could help finance the more innovative projects, while the more experimental projects would help bring innovation back into the mainstream.

As noted above, a division of the Experimental Stream into innovative and commercially-viable sub-streams could not be fully implemented until the language in the Contribution Agreement is amended.

Until that time, in keeping with the principles and strategies outlined in the Fall 2015 cross-country Consultation, the CMF seeks stakeholder feedback on the following option.

In lieu of splitting the Program along the lines of innovative and commercial, the CMF proposes to implement a dual approach and allocate a portion of the Experimental Program budget to the subset of projects that lend themselves to a higher probability of commercial exploitation based on the results we have seen to date: Games. By carving out this section of the Program, Applicants who submit Games projects will be competing against like-applicants and like-projects for a distinct portion of the Experimental

Stream Program budget. In turn, all other projects would no longer have to compete against this sub-set of Projects.

As evidenced in Appendix A, Figure 6, a growing share of the majority of the CMF's budget allocation is already being directed to Games projects. On average, in the past five years, 52% of the Experimental Program budget has been provided to Games, with a high of 67% in 2014-2015. Additionally, based on the first round results of 2015-2016, this upward trend of Games-based spending seems to be confirmed. The CMF submits that the proposal to split the contribution into two sub-streams would stimulate applications from other types of projects in an effort to achieve a more balanced portfolio of CMF-funded projects.

In light of these numbers, the CMF is proposing to reserve roughly 50% of the total Experimental Program budget to projects other than Games and roughly 50% to Games, with the caveat that such percentages would remain sufficiently flexible if the CMF determined the quality of eligible projects in a designated sub-stream did not warrant the respective defined budget allocation.

While this would not be a strict division of the Program along the lines of innovation and commercial that has been previously discussed, this alteration would, in effect, position the Program to adapt to future changes in line with the themes and strategies outlined in the Fall 2015 cross-country Consultation.

4. Revised Approach to Financing

The policy directive in the current Contribution Agreement between the CMF and DCH requires that the Experimental Stream provide project-based financing (as opposed to corporate financing) and allows the CMF to fund eligible expenses at all stages of a project's lifecycle. To reflect this directive, the CMF designed an approach which divided the financing of a project between the Development, Production and Marketing stages (with an evaluation process at each stage).

As discussed in the October 2014 Experimental Stream Working Group, the CMF's current approach to financing has created certain challenges for both applicants and the CMF, as the most prevalent financiers in the digital media sector – VCs, angels, etc. – finance companies rather than projects, and accompany projects from conceptualization to launch through several funding rounds at given milestones of corporate growth.

In anticipation of the potential adoption of the principles and strategies outlined in the Fall 2015 cross-country Consultation, the CMF is currently examining options that reflect the approach adopted by private investment, whereby the CMF would be involved with the project from the conceptualization phase to the launch of the project provided that key milestones are met during the lifecycle of the production. Instead of financing the product at different stages with an evaluation process for each phase (Development, Production, Marketing), the CMF would accompany the project throughout its entire development, providing more predictability for producers and other funding partners.

The CMF is currently evaluating the pros and cons of such an approach. Once a strategy has been developed, the CMF will involve stakeholders in a review and discussion of the CMF's proposal.

5. A3P Summary

The Accelerator Partnership Pilot Program ("A3P") was created in 2013-2014 with the objectives of providing digital media projects with better access to mentorship, markets and capital. In this program, the CMF seeks to connect domestic and international business accelerators with previous recipients of

development or production funding from the CMF's Experimental Stream. Once an accelerator has selected an eligible recipient (pursuant to the CMF Guidelines), the CMF provides up to \$30K in acceleration program funding for the recipient's CMF-funded project in the form of a non-recoupable contribution. The recipient and accelerator's relationship is framed by an agreement which outlines the provision of training and mentorship by the accelerator in exchange for equity in the recipient's company.

While the Program did not receive as many projects as expected in its first two years, the A3P has begun to gain traction. As noted in Appendix B, in 2015-2016, demand outstripped supply as 16 out of 22 possible projects received funding. While the CMF has not yet seen a significant ROI from projects that have received A3P support, the Program has been spurred by other benefits for both applicants and the industry, writ large. The global reach of the projects have brought value to the Canadian digital media industry through technological advancement or innovative intellectual property. Additionally, the majority of A3P-funded companies have used the Program to develop and improve their internal infrastructure. Finally, the Program has opened the door to new markets that would have otherwise been inaccessible to applicant companies.

Moving forward, the CMF will continue to encourage more education about the Program in the digital media community, develop stronger partnerships and more strategic alliances with eligible foreign accelerators to open additional new markets and opportunities for CMF-funded projects and review the eligibility criteria for accelerators to ensure the right mix populate the Program in furtherance of the CMF's goals and objectives.

Conclusion

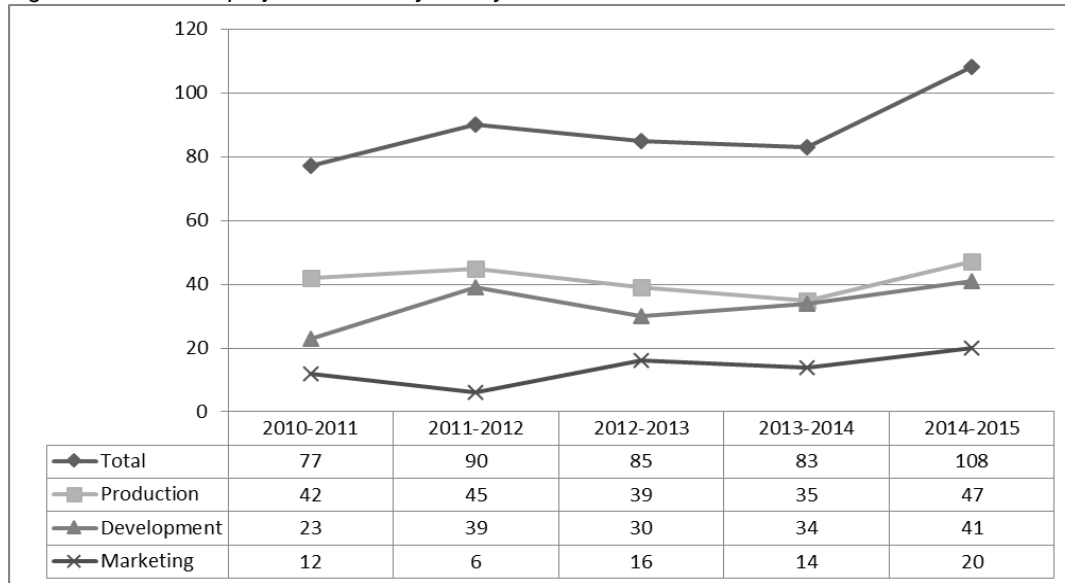
The CMF is nearing the end of its Fall 2015 cross-country Consultation and is actively exploring revised program financing options in step with the themes and strategies presented to the industry during this process. While major substantive changes may not be implemented by 2016-2017, the CMF will continue to engage stakeholders on potential changes to the Experimental Stream to ensure its Program meets the current and future needs of the distinct sectors of the digital media industry and submits that other proposals and topics contained herein remain aligned with the CMF's current strategic objectives while positioning the CMF for the future.

APPENDIX A

Figure 1: Percentage Committed of Total Demand Dollars

Percentage Committed of Total Demand Dollars	2010-2011	2011-2012	2012-2013	2013-2014	2014-2015
Production	21	36	56	23	45
Development	8	28	8	14	24
Marketing	27	26	22	17	28
Total	18	33	23	19	34

Figure 2: Number of projects funded by activity



APPENDIX A (continued)

Figure 3: Funding \$M by activity

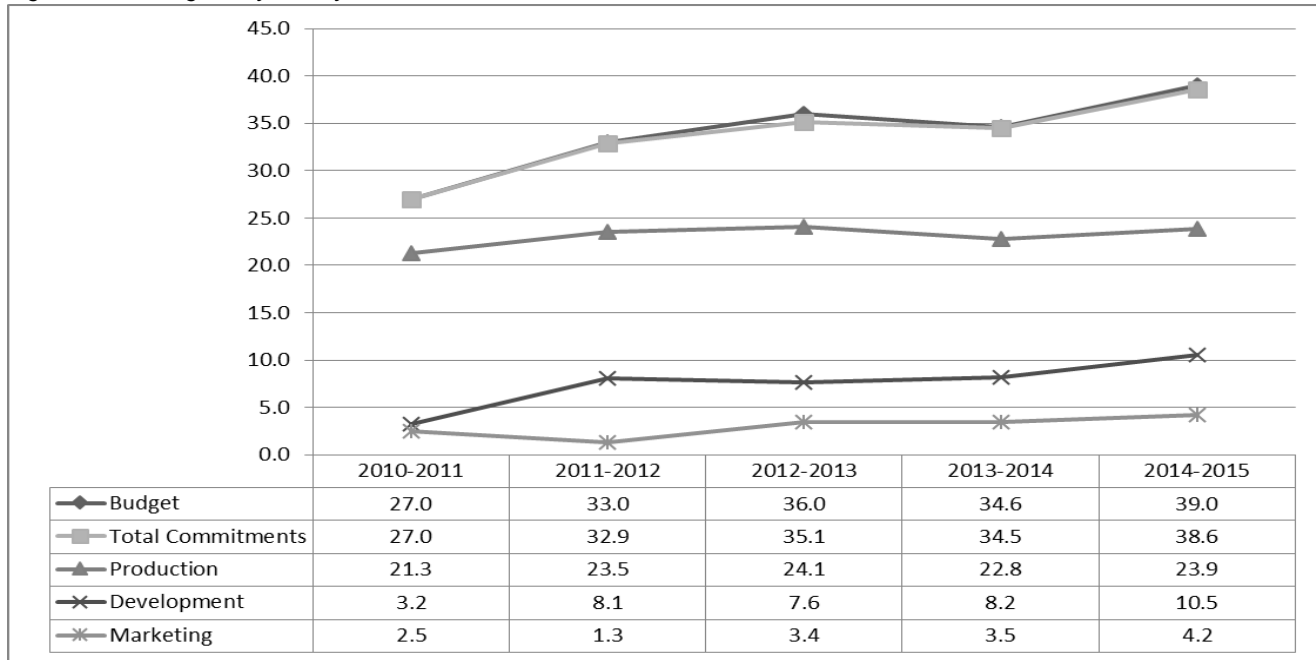
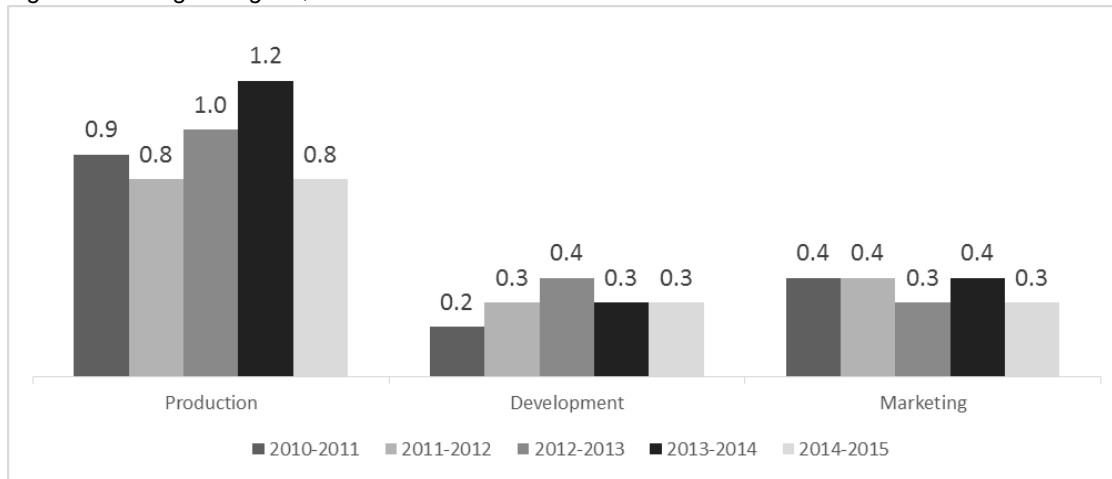


Figure 4: Average budgets \$M

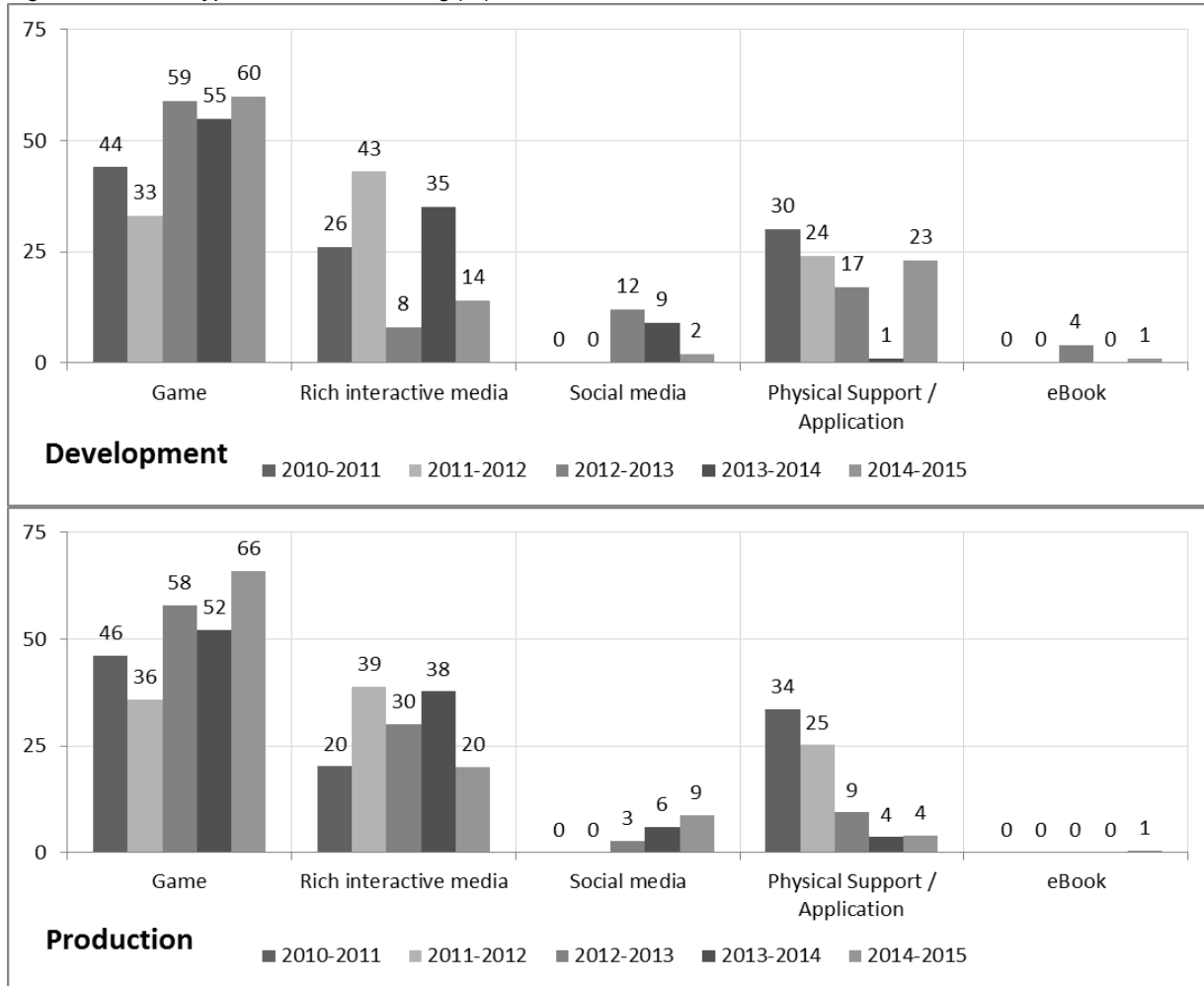


APPENDIX A (continued)

Figure 5: Average CMF Contribution

		2010-2011	2011-2012	2012-2013	2013-2014	2014-2015	2015-2016 1st round
Development	\$K	138	200	251	241	257	218
	% of budget	67%	72%	67%	69%	74%	69%
Production	\$K	516	522	613	653	509	639
	% of budget	43%	60%	58%	54%	61%	65%
Marketing	\$K	208	225	198	251	211	227
	% of budget	53%	64%	68%	65%	63%	65%

Figure 6: Content types - Share of funding (%)



APPENDIX A (continued)

Figure 6: Content types - Share of funding (%)

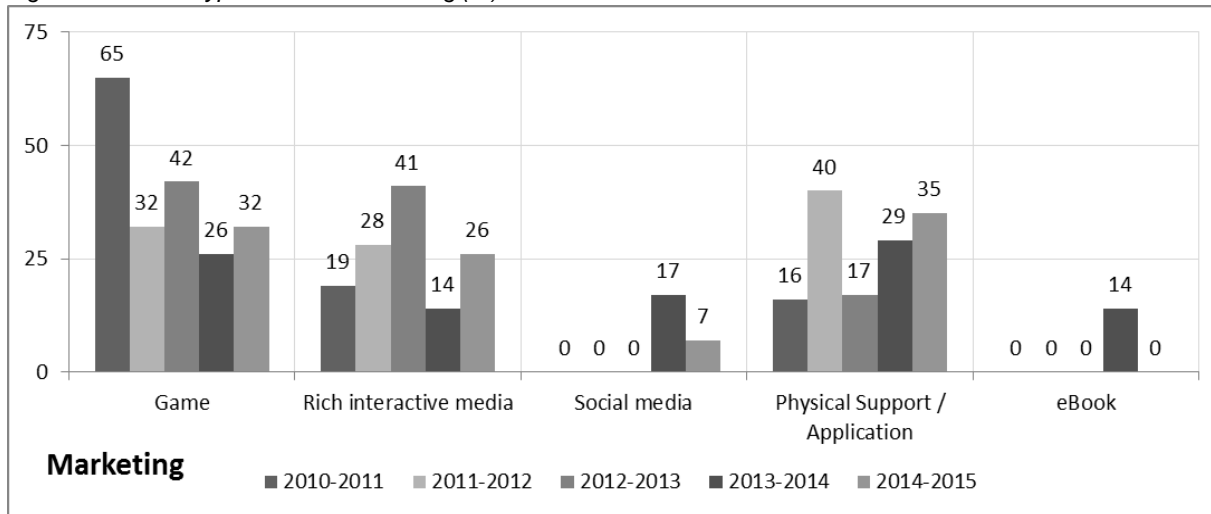


Figure 7: Recoupment by Reporting³ Period

Reporting Period	Total # of Reports Received	# of Reports with recoupment to CMF	% of reports with recoupment	Total \$K recouped
2012-2013	13	19	68%	884
2013-2014	34	79	43%	2,129
2014-2015	53	161	33%	1,805
2015-2016 1st period	30	87	34%	374

³ Reporting period years do not represent fiscal years. The year is made up of the June and December reporting periods. The number of reports received does not represent projects as the project reports twice a year after the reporting requirement begins. The data noted above in Figure 6 is as of September 9, 2015.

APPENDIX B

Number of Projects by Accelerator

Accelerators	2013-2014	2014-2015	2015-2016	Total
Accélérateur de création d'entreprises technologiques - ACET	0	0	1	1
Brain Rack Industries Inc.	1	0	0	1
Canadian Film Centre	2	0	0	2
Canadian Technology Accelerator Initiative (CTA) - NY	0	1	0	1
Canadian Technology Accelerator Initiative (CTA) - San Francisco	0	0	1	1
Canadian Technology Accelerator Initiative (CTA) - UK	0	1	0	1
Centre d'entreprises en innovation de Montréal (CEIM)	2	2	3	7
Communitech (Waterloo region)	0	0	1	1
Corinthian Entertainment Ltd	0	0	1	1
Digital Media Zone at Ryerson University	1	0	2	3
District 3	0	0	1	1
Execution Labs Inc.	0	0	1	1
George Brown College	1	1	1	3
Inno-Centre	2	1	2	5
Innovate Manitoba Inc.	1	0	0	1
Innovation Factory	0	1	0	1
Invest Ottawa	1	0	0	1
Québec International - Propulsion	0	1	1	2
The Generator at One	0	1	0	1
Victory Square Labs Inc.	1	2	1	4
York Entrepreneurship Development Institute (YEDInstitute)	0	1	0	1
Total	12	12	16	40

APPENDIX C

Evaluation Grid

Assessment Criteria	Weight		
	Development	Production	Marketing & Promotion
Team <ul style="list-style-type: none"> • Studio <ul style="list-style-type: none"> ▪ Experience and achievements of the studio • Staff <ul style="list-style-type: none"> ▪ Experience and achievements of producer and project management staff ▪ Experience and achievements of the creative and technical staff ▪ Experience and achievements of the marketing and promotion staff • Team work <ul style="list-style-type: none"> ▪ Cohesion and complementarity of staff expertise and ability to work in a team 	25%	15%	15%
Innovation and advancement <ul style="list-style-type: none"> ▪ Originality of the content and form ▪ Integration and/or development of new technologies ▪ Sophistication of design and programming (architecture, navigation, interface, graphic design, creative elements) ▪ Interactivity and control exercised by the end user ▪ Potential for legacy to the industry 	65%	40%	40%
Business plan <ul style="list-style-type: none"> ▪ Viability of the project: budget, financial structure, diversity of financial partners, risk assumed by the producer, risk assumed by the CMF, leveraging effect ▪ Distinctiveness of the business model: revenue models and potential for revenue generation adherence ▪ Financial stability of the Applicant in relation to the size of the project ▪ Historical success working with the CMF (adherence to proposed timelines and budget, deliverables comply with initial submitted proposal, historical sales performance of previous CMF-funded projects [if applicable], etc.) 	N/A	30%	20%

<p>Distribution strategy</p> <ul style="list-style-type: none"> ▪ For projects submitted in development: <ul style="list-style-type: none"> ○ Quality of the market study <ul style="list-style-type: none"> • Appropriateness of market and competitive analysis • Appropriateness of audience analysis ○ Quality of the project's preliminary marketing and promotional strategy ▪ For projects submitted in production or in marketing: <ul style="list-style-type: none"> ○ Quality of the market study <ul style="list-style-type: none"> • Appropriateness of market and competitive analysis • Appropriateness of audience analysis ○ Quality of the project's preliminary marketing and promotional strategy <ul style="list-style-type: none"> • Quality, diversity, relevance of the distribution modes • Relevance of promotional activities • Involvement of the market channel partners (if applicable): level of demonstrated interest (advances, pre-sales, licences) 	10%	15%	25%
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APPENDIX D

*Number of products accessing more than one Experimental program -
2010-2011 to 2015-2016 1st round*

Development to Production	Development to Marketing	Production to Marketing	All 3 programs
36	2	25	8