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MGM Debt Drama Nears a Climax

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LOS ANGELES -- Metro-Goldwyn-Mayer Inc.'s latest drama is near a denouement.

The lead character is the studio itself, which after a storied past as a Hollywood icon is looking at a frugal future as a hedge-fund asset.

On Friday, creditors vote on a plan to send MGM into bankruptcy court, to be relieved of a crushing debt load, not to mention a management that offered spending solutions at sharp odds with desires of the lenders.

But there is a last-minute plot twist: Stalking the studio with a rival plan of his own is activist investor Carl Icahn. This week, he sweetened an offer to buy debt from other MGM creditors, in an effort to upend the plan before them and raise the chances of ultimately controlling the studio's fate himself.

The Hollywood/Wall Street culture clash at MGM was on vivid display in a scene at its headquarters in Century City last March. Speaking to a packed screening-room audience was the studio's top film executive, Mary Parent, who began by offering apologies for "Hot Tub Time Machine," a raunchy comedy that disappointed at the box office.

The rest of the news was bad, too. Cash from MGM's vast film library was falling, amid the burden of servicing some \$4 billion of debt. An effort to sell the company had drawn only one cash offer, a low-ball bid from Warner Brothers.

MGM management's solution: Raise another billion dollars so the studio could produce around 10 big new movies a year and recapture its glory. "If you're not willing to properly resource the company," Ms. Parent said, "you are going to wish you had sold it to Warner Brothers."

In the screening-room seats was no ordinary Hollywood audience but the increasingly powerful creditors, among them Charles Tauber of hedge fund Anchorage Advisors, one of the biggest MGM debt-holders. After the presentation he told a banker for the creditors, "We need to discuss alternatives."

The option they developed is what all creditors will vote on Friday. If it wins enough support -- odds appear to favor it -- MGM will file for a Chapter 11 bankruptcy as soon as Sunday, and the 86-year-old company, the source of more than 200 Academy Awards for classics like "Gone with the Wind," will pass to distressed-debt investors more accustomed to reworking home-health-care firms and community banks.

They aim to be ruthless about costs. They plan to outsource to another studio the task of distributing films to theaters, then focus on the television business -- cutting deals with cable-TV channels, video-on-demand services and online streaming companies, especially abroad.

To do this, they would hand management to Gary Barber and Roger Birnbaum, founders of Spyglass Entertainment, a small production company half-owned by private-equity firm Cerberus Capital Management. Working with a budget half what Ms. Parent proposed, the pair would make just four to six movies a year, most with modest budgets of \$50 million or so, though allowing for an occasional big one.

It's a gamble. The hedge funds are mostly new to Hollywood. They've been warned against trying to run a studio on the cheap.

"Part of MGM's problem has always been that many of its owners are financial players more focused on the short term than the long term," says Clark Hallren, a consultant and former banker for MGM. "Being in the entertainment industry is typically a long-term play because of the nature of distribution and massive amounts of capital needed."

That gamble won't be an issue if Mr. Icahn has his way. In an 11th-hour move, he is pushing a plan in which MGM would merge with Lions Gate Entertainment Corp., a rival studio he has been trying all year to take over. Mr. Icahn has acquired about 13% of MGM's debt and offered to buy debt from other creditors if they vote against the Spyglass plan.

He is now offering a premium to MGM debt holders, provided they vote against the Spyglass plan Friday. If enough agree to sell, the Spyglass plan could be scuttled and Mr. Icahn could end up owning enough MGM debt to block any future plan he dislikes.

But the Anchorage-led creditors backing the Spyglass plan already hold their own "blocking position," of over one-third of the debt. The result could be a stalemate that would push the struggle for MGM into a prolonged final act.

Ms. Parent is already gone, having negotiated an exit package and left in mid-October. A moving truck picked up office furniture she had installed herself in a modest effort to contain costs. This account of MGM's tumble from filmdom's glittering heights to a likely humbler future is based on internal documents and interviews with more than a dozen people close to the famed studio, many of them key players in the drama.

MGM was formed in 1924 by theater owner Marcus Loew to make and distribute films for his Loews Theatres chain. MGM soon dominated the golden age of film, for much of that time led by Louis B. Mayer.

While it changed hands, its future still seemed grand at the time of a 2005 leveraged buyout. A group of private-equity firms including Providence Equity Partners and TPG, along with Sony Corp. and Comcast Corp., bought the studio from investor Kirk Kerkorian for \$5 billion, loading it with debt.

MGM's 4,100-title film library, with heirlooms like the James Bond and "Rocky" films, was generating over \$500 million a year after expenses. The new owners figured they could pay for the acquisition by selling millions of DVDs. To get a decent price from cable channels and others for older films, a studio must group them with some new hit movies. The new owners relied on partner Sony to produce these hits. But Sony wasn't able to produce enough. Library proceeds started falling.

In early 2008, MGM hired Ms. Parent, who had made her name at Universal turning films like "Gladiator" into box-office smashes, with a plan to ramp up a big slate of new films and return MGM to glory. The erosion in film-library revenue wouldn't allow that, however. The owners in 2009 brought in a turnaround specialist, Stephen Cooper, who shared a new executive suite with Ms. Parent.

Lenders grew testy. On an autumn 2009 conference call, Mr. Cooper told them the studio planned to stop paying interest on its debt and consider bankruptcy, so the creditors should start to think of MGM as "your studio." Said one lender on the call: "This deal has sucked from Day One. The sponsors are corrupt, management's incompetent, and you're an a -- ."

"Thank you," Mr. Cooper replied. "Next question."

At creditors' insistence, Mr. Cooper put MGM up for sale. When it drew no better all-cash offer than a \$1.5 billion bid from Time Warner Inc.'s Warner Brothers, spooked investors in MGM bank debt started selling.

In Manhattan, Kevin Ulrich decided to pounce. A former Goldman Sachs Group Inc. debt trader, he had helped start Anchorage Advisors, and with co-founder Tony Davis managed some \$8 billion. Anchorage started buying MGM debt at a big discount. Doing the same were three other hedge funds: Highland Capital Management, Davidson Kempner Capital Management and Solus Alternative Asset Management.

To funds buying MGM's debt, it wasn't so much a classic Hollywood studio as an asset with a famous brand and attractive film library. They could take it over and make deals to improve library cash flow, which had plunged to \$228 million.

They waited to strike until after Ms. Parent's late-March address to creditors, where she said MGM needed a range of big-budget comedy, action and family films. One creditor asked why it couldn't make just two films a year to save money.

"That's why you have a movie slate, to diversify," Ms. Parent said, to blank stares. "Let's put it another way," she added. "Would you feel comfortable if the only asset you had in your investment portfolio was MGM?"

After Anchorage's Mr. Tauber told a banker from J.P. Morgan Chase & Co. -- MGM's lead creditor -- they needed to discuss alternatives, the banker rounded up big creditors for an impromptu meeting and asked who would sit on a committee to plot MGM's fate. Ultimately, Messrs. Ulrich and Tauber of Anchorage

joined, plus people from Highland, Davidson Kempner and Solus. Anchorage was on its way to accumulating over \$700 million of MGM's debt, and the other three more than \$800 million combined.

Anchorage brought in Creative Artists Agency partner Bryan Lourd as an adviser. The hedge funds then sought out other Hollywood luminaries for a crash course in the film business and to find an eventual new MGM chief. Over two days, the moguls visited the creditors at the offices of investment bank Houlihan Lokey.

Most, such as Joe Roth, ex-head of Walt Disney Studios, echoed Ms. Parent's contention that MGM needed a bold effort. "You either compete head-on or you don't compete at all," Mr. Roth, who had no interest in running MGM, said in an interview. "By making half-efforts, you never get the right product or talent." Terry Semel, ex-leader of Warner Brothers and Yahoo Inc., also visited, and also suggested that MGM produce many films and TV shows.

Jonathan Dolgen, a former Paramount head, pitched a plan in which he would lead the studio, with director Ridley Scott serving as the creative head along with his brother, Tony Scott.

The lights dimmed and Mr. Dolgen showed clips called "sizzle reels" of films directed or produced by the Scotts, such as "Robin Hood." When the lights came up, he folded his arms, leaned forward and said: "I think that speaks for itself. What questions can I answer?"

A pause followed. Patrick Daugherty, a blunt Texan and a partner at Highland Capital, had been checking his iPhone while Russell Crowe's Robin Hood fired arrows. "What would be your plan to run this company?" he asked. The hedge funds were concerned that Mr. Dolgen and the Scotts hadn't teamed up before and hadn't developed detailed plans for the studio.

The Hollywood visitors who clicked best with the hedge funds were Messrs. Barber and Birnbaum of Spyglass, who mentioned they didn't feel their creativity curbed by Spyglass's private-equity half-owner, Cerberus. One sticking point: The hedge funds wanted board approval for every substantial deal the studio struck.

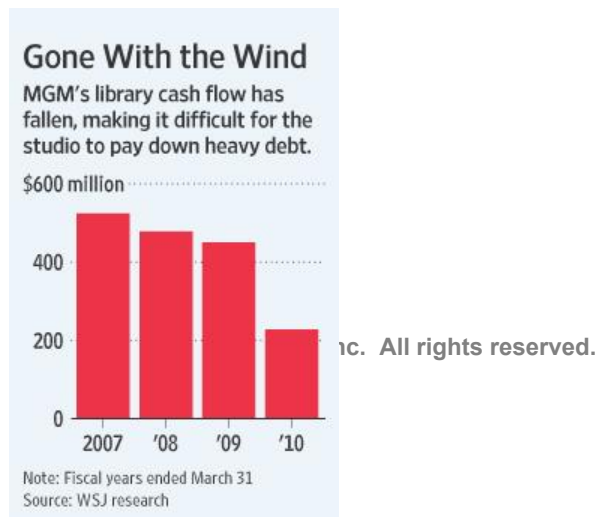
Mr. Barber protested. He cited a remake of "Star Trek" last year, saying Spyglass had just 24 hours to decide to co-finance it with Paramount, too little time for a board meeting. The pair were told they would have deal freedom but also a strict budget.

Spyglass and its Deutsche Bank advisers worked out a plan for Spyglass to get a nearly 5% interest in MGM after merging some older Spyglass films with MGM's library. The creditors envision the library's cash flow rising to \$455 million annually in five years.

The hedge funds also entertained and rejected ideas for mergers, including with Lions Gate. But in late September, Mr. Icahn, who has built a large stake in Lions Gate, summoned Anchorage's Messrs. Ulrich and Tauber and asked them to again consider merging with that studio. When MGM went ahead with plans for creditors to vote on a prepackaged bankruptcy deal putting the Spyglass officials in charge of MGM, Mr. Icahn made his move to scuttle that plan -- setting up Friday's showdown.

Spyglass's Messrs. Barber and Birnbaum are behaving as if their deal will go through. They have parking spaces at MGM and have already helped the studio with a key project: two "Hobbit" films in partnership with Warner Brothers, a project MGM's financial woes had jeopardized. Those much-anticipated films should eventually give the MGM library a boost.

The pair have helped get the Hobbit films back on track under "Lord of the Rings" director Peter Jackson. The new plan under consideration: Warner will foot the production bill and be partly paid back by MGM later.



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