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Hollywood's top talent agencies may need a bailout from their PE backers as the coronavirus hammers big bets on live sports and studio production

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As the coronavirus shutters studio production for TV shows and films, it's also cutting off the supply of commissions that feed the salaries of the industry's top talent agents — the people who represent actors, directors, and writers in their content deals.

In recent weeks, the big four talent agencies — Endeavor, Creative Artists Agency, United Talent Agency, and ICM — have all taken steps to confront the new reality and shore up their finances. These firms have issued layoffs, furloughs, or salary cuts as government shutdowns and stay-at-home orders have frozen businesses across the country.

Top Endeavor execs Patrick Whitesell and Ari Emanuel have foregone salaries for the year, and they've rolled out staff pay cuts on a sliding scale. AP Images

Endeavor, the largest agency with 7,000 staff across an array of businesses, has laid off 250 employees whose jobs can't be done remotely, and a planned equity buyback for partners in April has been shelved. Top Endeavor execs Patrick Whitesell and Ari Emanuel have foregone salaries for the year, and they've rolled out staff pay cuts on a sliding scale.

CAA and UTA similarly slashed salaries in recent weeks.

"I know they are all trying to manage it as best they can, but the problem is, no matter where they look, most of their clients' businesses, and businesses that hire their clients, are shutting down," said Bobby Schwartz, a prominent Hollywood lawyer with Quinn Emanuel, whose clients have included Netflix, Lionsgate, and Sony Pictures.

"If clients aren't getting paid, you aren't getting your commission, and if you don't have a pipeline, there is no future commission."

Some deals are still getting done, but many movies and TV shows have been pushed out, including the filming of "Mission: Impossible 7," along with the production of live-action Disney projects, such as Ridley Scott's "The Last Duel" with Matt Damon and Ben Affleck.

"By definition, that's going to have an economic impact," said Craig Martin, an entertainment lawyer with Paul Hastings, noting that talent agents' salaries are linked to various stages of production.

But the problem extends beyond commissions, as the economic peril now threatens returns for investors that have plowed billions of capital into Hollywood agencies in recent years.

Starting about a decade ago, private-equity giants began placing big bets on entertainment talent agencies — bets that for years flourished.

As agencies gobbled up PE money — namely, Endeavor and CAA — they levered up and went on a buying spree.

Now, their backers are facing the prospect of valuation hits to their investments, according to some of the industry's top bankers.

For the two largest firms, which expanded their remit beyond talent representation and into studio production and live events, it's become a more challenging environment.

Endeavor had its credit rating downgraded by S&P Global this week on concerns it was overleveraged and unable to absorb the revenue losses.

"This is an environment where liquidity is king. If your balance sheet is already leveraged to the hilt, you have nowhere to go," Lloyd Greif, a veteran Los Angeles investment banker and the founder of boutique Greif & Co. told Business Insider.

As the pandemic drags on, some of the buyout giants may soon be forced into a painful decision: Plow more money into these pricey investments to keep them afloat, or save their cash to deploy to opportunities with better prospects.

"I would suspect the private-equity companies are going to think very hard with respect to whether they want to invest more money into some of the talent agencies," said Gene Del Vecchio, a USC professor and Hollywood guru who is the author of Creating Blockbusters, which covers how to market hit TV shows, movies, video games and books.

"Every dollar they spend, they have to think, 'Where is that dollar going to be best spent?' Is it putting it behind one of these talent agencies, which is in a chaotic industry to begin with and now is being hit by coronavirus? Or is it in a tech company in which we are already invested?"

Business Insider reached out to the private-equity backers of each of the big talent agencies, as well as the agencies themselves. The parties say PE firms are acting as good business partners, and are prepared to weather the storm.

"Endeavor is a strong and dynamic company and we believe its intrinsic value has not been affected by the Covid-19 pandemic," a Silver Lake spokesperson said in a statement.

"Silver Lake is as committed as ever to Endeavor and its management team and will stand behind it with capital if and when necessary."

TPG, too, issued a statement, saying CAA was "well positioned headed into the crisis," calling its liquidity levels "healthy" and its debt load "reasonable."

"TPG has been working closely with CAA to help manage the business given the shelter-in-place orders in the US impacting live events," a spokesperson said, noting the firm remains "deeply supportive" of CAA's efforts.

A more recent recipient of PE capital, the CEO of ICM, Chris Silberman, provided a seven-word statement.

"The partnership is excellent, nothing has changed."

Private equity's history with Hollywood

Private equity began sinking its teeth in the business of Hollywood in 2010 when TPG bought a 35% slice of Creative Artist Agency.

Silver Lake followed suit two years later, spending $200 million to acquire a minority stake in William Morris Endeavor.

That was just the beginning. The money kept flowing from there, and the valuations started to soar.

TPG in 2014 increased its stake to more than half of CAA at a valuation north of $1 billion. That same year WME closed its $2.4-billion acquisition of IMG, the sports and fashion agency, and Silver Lake injected $500 million more into the firm as part of the deal, building its stake to 51 percent.

By 2016, SoftBank had gotten in on the party, adding $250 million for a 5 percent stake, which valued WME at $5.5 billion and supplied capital for further acquisitions and expansion, according to the Financial Times.

A year later, WME was valued at $6.3 billion after a $1.1-billion capital raise from the Canada Pension Plan Investment Board and Government of Singapore Investment Fund.

More recently, other top agencies have found their own private-equity backers, including United Talent Agency, which announced an investment from Investcorp and Public Sector Pension Investment Board, in 2018, and ICM Partners, which received a $150-million investment from Crestview Partners just this December.

The ever-increasing valuation figures justified private-equity's talent agency binge, providing substantial returns on investment, at least on paper.

It was all to culminate in late 2019 with Endeavor's initial public offering — a first among talent agencies — at a nearly $8 billion valuation.

But even before the novel coronavirus reared its head, the industry started to feel headwinds.

Storm clouds form

By Del Vecchio's thinking, the recent coronavirus downturn is just the latest of a series of events that have threatened private-equity's long-term investments in talent agencies.

He pointed to the ongoing union battle between the talent agencies and their writer clients, who object to a large agency revenue source: packaging fees, or money they earn from selling TV shows and films to studios as a package, with the actors attached.

This provides talent agencies with an ongoing ownership stake in the shows they sell, which has proven quite lucrative. Endeavor, for instance, reportedly earned $140 million in TV packaging fees in 2013, according to financial records obtained by TheWrap at the time.

But it also can put the agencies at odds with the writers they represent, because agents may settle for writer pay that is lower than they feel they deserve, in what writers contend is an effort to make the show more profitable and build relationships with studio buyers.

"The top three agencies now operate under the pressure of private-equity-level profit expectations," the Writers Guild of America wrote in a report in March 2019 criticizing private-equity's influence. "This has caused a seismic shift away from an agency's core mission of serving clients over all else, fulfilling its fiduciary obligation to always act solely in the best interests of clients and to avoid conflicts of interest."

Agencies have argued that packaging allows writers to avoid paying customary commissions to agents.

A month after WGA released the report, roughly 7,000 WGA-represented writers simultaneously fired their agents.

The entities have since locked horns in a legal battle over packaging fees that, as of earlier this year, showed no signs of resolving any time soon.

Endeavor makes massive bets on content and events

Firms that diversified away from purely representing talent appeared better situated to absorb the attack and weather a hit to commissions.

With the backing of TPG, CAA has expanded into content production and ownership, as well as events. It also further built out its sports representation business.

But no agency embraced expansion more than Endeavor, which was laying the groundwork for its IPO in early 2019, around the same time that WGA was firing off opening salvos in the packaging-fee battle.

The firm had just been whetting its M&A appetite with its IMG purchase in 2014. Endeavor bought Professional Bull Riders in 2015 for an estimated $100 million, followed by acquisitions of the Miss Universe pageant and Frieze, an art events and media company.

Continuing to lean hard into live events, Endeavor in 2016 led a consortium of buyers that spent $4 billion buying mixed-martial arts league UFC — considered the largest sports acquisition in history.

By mid-2019, the company was on track for $4 billion in annual revenue — up from $1.3 billion five years earlier — but only a third of it from representation, according to documents filed with the Securities and Exchange Commission as part of the company's IPO effort. Nearly two-thirds was driven by entertainment and sports events.

By September, the company was planning to sell more then $600 million in shares at a valuation of nearly $8 billion.

But then, the IPO market caught a chill. Fast-growing but unprofitable companies including Uber, Lyft, and Peloton all faltered in their public market debuts, and the unfolding WeWork debacle was further spooking investors and drawing scrutiny to IPO valuations.

Endeavor for years had racked up wide losses, save for 2018 when it benefitted from the sale of one of its businesses.

The target valuation was cut to $6.5 billion, and then on a Thursday in late September, a day before it was set to launch, Endeavor called off its IPO altogether.

"There didn't seem to be any discernible logic amongst all the pieces," said Greif, who added that he thought Endeavor's underwriters overreached on the valuation. "There was no revenue-enhancing synergy among these far-flung businesses."

Now, the company is saddled with some $5 billion in debt, and at a time when the majority of its business has been frozen.

In mid-March, S&P put Endeavor and UFC on a negative credit watch, calling Endeavor "very highly leveraged" and citing "significant exposure to live events, entertainment, and content production."

This week, it downgraded Endeavor's debt to CCC+ from B, forecasting that Endeavor would have adjusted debt to EBITDA above 8x for 2020 and that it may not be able to support its hefty debt burden.

An Endeavor spokesperson said in a statement that the "long-term prospects for our business remain unchanged, but like other companies, we are implementing measures to mitigate the impact of this pandemic."

The company is scheduled to pay $650 million in interest and principal payments on its debt between this year and next, according to company filings from September.

And it's on the hook to pay $1.9 billion in 2020 and 2021 in purchase obligations and guarantees — contracted costs for events, media production, and representation rights.

Unless they have force majeure out clauses or can renegotiate, they face substantial cash outlays for entertainment projects that are on ice and hold uncertain revenue prospects, according to Greif.

"That's a huge issue that they don't have the luxury of ignoring," Greif said.

Emile Courtney, a senior credit analyst with S&P, told BI that it was still unclear how these contracts would impact Endeavor's near-term cash position.

"We're not assuming that existing guarantees all by themselves create a near-term liquidity problem for Endeavor — not yet," Courtney said.

UFC, Endeavor's largest live-event investment, has been scrambling to find workarounds to avoid canceling fight events. The company receives lucrative monthly media rights fees from ESPN, but it could lose that cash if postponed fights are ultimately canceled and not aired this year, according to S&P.

The MMA league has made headlines amid the coronavirus fallout over its creative attempts to circumvent government shutdown orders to stage pay-per-view fights, including a failed bid to hold the UFC 249 event on sovereign tribal land in California, as well as assurance by UFC president Dana White that he's secured a private island to hold fights.

Based on the broader stock market decline since it pulled its IPO — but not taking into account operational pressures from the coronavirus — Greif estimates Endeavor's valuation at no more than $5 billion, and "potentially significantly less."

"The house is burning around them," Greif said.

No time to exit

The long-term health of any of these firms depends on how quickly the economy reopens and gets back to normal. Endeavor has about $550 million in available cash, enough to last a couple quarters, according to S&P.

But if the coronavirus isn't contained by mid-year, Endeavor's financial risk "could motivate the company to seek a distressed debt restructuring," S&P said in a note discussing its rating downgrade.

While CAA's straits don't appear as dire as Endeavor's, it's also saddled with a large debt burden. After the company refinanced in November with a $1.15-billion term loan — in part to fund $400 million in employee stock repurchases — S&P revised its debt outlook to negative because of its elevated leverage of roughly 7 times EBITDA.

Similarly, Moody's said at the time that CAA's "very high leverage level" leaves the company "very little availability for additional debt or future underperformance over the next two years."

TPG, which calculates the company's leverage ratio differently than the ratings agencies, said in a statement that CAA is "well capitalized with a strong balance sheet that includes less than 5x EBITDA leverage."

"The company's diversified revenue streams position it well amid the current disruption within the entertainment industry," the statement said. "CAA management has taken appropriate steps to respond to the crisis and we continue to support their ongoing efforts."

The firm declined to specify the financial figures used in its calculation or whether it had reduced its debt load in recent months.

Both Silver Lake and TPG have owned chunks of Endeavor and CAA, respectively, for about a decade. Both have signaled intentions to hold their stakes for even longer.

In February, Buyouts reported that TPG was running a sale on the secondary market of its stake in CAA. If executed, a deal would set TPG up with a so-called continuation fund, where the private-equity firm could transfer its stakes while letting existing investors cash out. That structure would allow TPG to manage its investment for a longer time period, the publication said.

A deal has not yet closed, but in March, Goldman Sachs and Neuberger Berman emerged as major investors discussing the purchase. TPG's stake was then reported to be worth more than $1 billion.

Other more recent backers are earlier on in their investment horizon.

Crestview invested $150 million in ICM Partners in December and Investcorp, along with other investors, announced a $200-million investment in UTA in 2018.

"COVID-19 will impact virtually all businesses," Brian Cassidy, partner at Crestview Partners, told Business Insider in a statement.

"That said, we believe, as strongly as ever, in our partners at ICM, the client representation business in which they are a leader, and the future of the entertainment industry."

Investcorp, similarly, expressed optimism that the industry would snap back in time.

"We are confident in UTA's long-term prospects with its outstanding team of world-class talent and capabilities. We remain bullish on the sector's long-term opportunities," said Dave Tayeh, the head of North America private equity at Investcorp, in a statement.