

The challenging business of children's content

Successful children's IP can be rewarding, but it's a long term play

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Key findings

- The Walt Disney Company remains the most significant force in the children's TV market
- Public broadcasters and producers like Sesame Workshop, Toei Animation and Hit Entertainment also remain important
- However, building a business with sustainable growth prospects remains a challenge in the children's sector
- Children's programmes are rarely fully funded by broadcasters, leaving producers to cover the deficit
- A business model based mainly on production is difficult to scale without an alternative source of revenue such as rights or licensing
- Companies like DHX Media have been successful in harnessing the energy of hit properties in the children's IP business
- Entertainment One's property Peppa Pig generated \$1 billion in retail sales, with over 600 licensing deals, last year

At the time we published our first report on children's TV, *The Business of Children's Television*, in 1999, there was no question that Walt Disney Company was the leading power in the industry, thanks to its animation studios, branded channels, library of characters, and consumer products division. Disney remains the most significant force in the market, generating \$2.4 billion from consumer products and \$1.5 billion from retail in its 2014 financial year, along with \$15 billion from cable networks (mainly ESPN, but also the Disney Channel) and \$7.3 billion from filmed entertainment. But Nickelodeon, owned by Viacom, and Turner Broadcasting's Cartoon Network, are competing with Disney both in the US and the international market.

Apart from the big three, public broadcasters like the BBC, NHK, ARD and ZDF, France TV and Rai have also remained in the market 15 years later, as have producers like Sesame Workshop, Toei Animation and Hit Entertainment. However, many producers have exited the business, either going bust, being taken over or selling up. Fox—the leading broadcaster in the 2-11 market in the US in the late 1990s—is one example of a company deciding that it had no future in the children's business. Others like BKN, DIC Entertainment, EM-TV, France Animation and TV Loonland ran into financial difficulties and were closed or taken over.

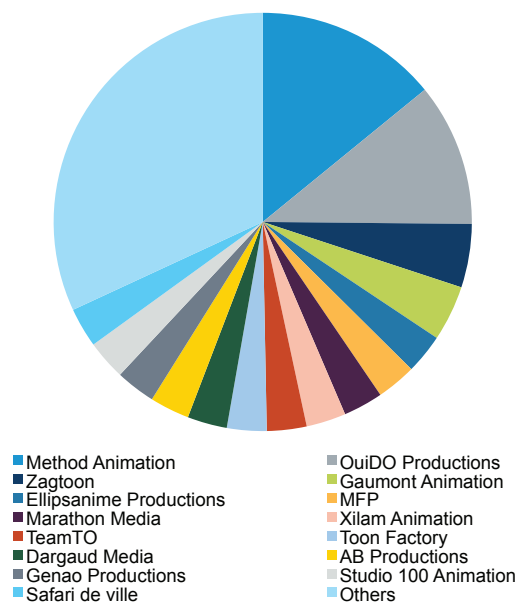
Building a business with sustainable growth prospects remains a challenge in the children's sector. The business model for most independent production is 'cost plus': to put it simply, the broadcaster provides the cost of a programme including a fee for the producer. However, even in 1999, children's programmes were rarely fully funded by broadcasters, leaving producers to cover the deficit through a variety of means, including presales, co-productions, or simply bearing the cost themselves. Since

1999, broadcast funding has dwindled even further, making this model even more perilous, and a series of producers have run into difficulties in attempting to balance the cost of producing new programmes and the sometimes slow returns from sales to broadcasters.

While it is by no means impossible for producers to create a sustainable business from children's programming, there is a clear disparity between the typical scale of most producers and the large, vertically-integrated groups. Crossing the divide between the two is fraught with difficulty; a business model based mainly on producing for television is difficult to scale without an alternative source of revenue such as rights or licensing.

Countries like Canada and France in particular have created support schemes to enable an independent sector to survive. In France, the national funding body the CNC provides loans for development and production. Producers can also set up structures (SOFICAS) to benefit from tax breaks. National broadcasters have relatively stringent quotas to invest in original programmes and animation. In 2014, according to the CNC, a total of 260 hours of animation worth €178 million was funded. The CNC contributed 20% of the funding. It should be noted that even in the French system, animation has to be marketable: a quarter of sales in 2014 were raised from international co-productions and presales.

Volume of animation produced in 2014 in France, by producer (hours)



Total volume of animation production: 326 hours

Source: CNC

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Production company events			
Company	Main office	Event	Date
Entertainment Rights	UK	Listed on LSE	Feb-96
HIT Entertainment	UK	Listed on LSE	Aug-97
EM-TV	Germany	Listed in Frankfurt (Neuer Markt)	Oct-97
Gullane Entertainment	UK	Listed on LSE	Feb-99
Jetix Europe	Neths	Listed on Euronext (as Fox Kids Europe)	Nov-99
BKN International	Germany	Listed in Frankfurt (NM)	Mar-00
Cinar Group	Canada	Shares suspended (Toronto)	Mar-00
Mondo TV	Italy	Listed in Milan	Jun-00
4Kids Entertainment	USA	Listed on NYSE	Sep-00
BKN International	Germany	Listed in Frankfurt (NM)	Mar-00
TV Loonland	Germany	Listed in Frankfurt (NM)	Mar-00
Mondo TV	Italy	Listed in Milan	Jun-00
Toei Animation	Japan	Listed in Tokyo (JAO)	Dec-00
Maverick Entertainment	UK	Listed on AIM London	May-01
Carrère Group	France	Listed in Paris (Nouveau Marche)	Jun-01
Millimages	France	Listed in Paris (Nouveau Marche)	Jun-01
Galleon Holdings	UK	Listed on AIM London	Dec-01
Woodland Animations	UK	Acquired by Entertainment Rights	Nov-01
Xilam Animation	France	Listed on Paris Euronext	Feb-02
Gullane Entertainment	UK	Acquired by HIT Entertainment	Sep-02
Chorion	UK	Listed on AIM London	Oct-03
Cinar Group	Canada	Acquired by Cookie Jar	Mar-04
Dreamworks Entertainment	USA	Listed on NYSE	Oct-04
HIT Entertainment	UK	Acquired by APAX Capital Ptnrs, delisted	Mar-05
Mike Young Productions	USA	Acquired by Moonscoop	Oct-05
DIC Entertainment	USA	Listed on AIM London	Oct-05
Chorion	UK	MBO backed by 3i	Jun-06
DHX Media	Canada	Listed in Toronto and AIM London	May-06
Classic Media	USA	Acquired by Entertainment Rights	Dec-06
Coolabi	UK	Listed on AIM London	May-07
Contender Entertainment	UK	Acquired by Entertainment One	Jul-07
Marathon	France	Acquired by De Agostini Group	Aug-07
Indie Kids	UK	Acquired by Coolabi	Oct-07
Studio B	Canada	Acquired by DHX Media	Dec-07
Alphanim	France	Acquired by Gaumont	Dec-07
DQ Entertainment	India	Listed on AIM London	Dec-07

Production company events			
Company	Main office	Event	Date
EMTV	Germany	Acquired by Studio 100	May-08
DIC Entertainment Holdings	USA	Acquired by Cookie Jar	Jun-08
Jetix Europe	Neths	Disney acquired full control, delisted	Feb-09
Entertainment Rights	UK	Acquired by Boomerang Media	Apr-09
Jetix Italy	Italy	Management buy out from Disney	Jul-09
Zinkia Entertainment	Spain	Listed on MAB (Madrid)	Jul-09
Marvel Entertainment	USA	Acquired by Walt Disney Company	Aug-09
Animation Collective	UK	Acquired by HandMade Films	Oct-09
BKN International	Germany	Declared insolvent	Oct-09
TV Loonland	Germany	Filed for insolvency	Dec-09
Red Kite Animation	Singapore	Acquired by August Media Holdings	Sep-10
Wildbrain Entertainment	USA	Acquired by DHX Media	Sep-10
Cake Entertainment	UK	Acquired by Zinkia	Apr-11
4Kids Entertainment	USA	Delisted by NYSE	Jun-10
4Kids Entertainment	USA	Filed for Chapter 11 bankruptcy	Apr-11
Kombo	Finland	Acquired by Rovio Mobile	May-11
Chorion	UK	Company broken up	Sep-11
Chorion	UK	Sold Mr Men rights to Sanrio (Japan)	Dec-11
HIT Entertainment	UK	Acquired by Mattel	Feb-12
Chorion	UK	Sold Noddy, Olivia rights to Classic Media	Dec-11
KidsCo	USA	Corus and NBCU buy out Cookie Jar	May-12
Classic Media	USA	Acquired by Dreamworks Animation	Jul-12
Cookie Jar Entertainment	Canada	Acquired by DHX Media	Oct-12
Switchover Media	Italy	Acquired by Discovery Communications	Jan-13
Moonscoop SAS	France	Went into administration	Jun-13
Ragdoll Worldwide Ltd	UK	Acquired by DHX Media	Sep-13
Sprout	USA	NBC Universal bought out PBS and HIT	Nov-13
KidsCo	USA	Operations closed Feb 2014	Feb-14
Zinkia Entertainment	Spain	Went into administration	Feb-14
Epitome Group	Canada	Acquired by DHX Media	Apr-14
Family Channel (Bell Media)	Canada	Acquired by DHX Media	Jul-14
Splash Entertainment	USA	Bought 100% of Moonscoop LLC	Feb-14

Source: IHS

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Canada's animation support schemes are even more comprehensive than those of France. They include broadcast quotas, tax breaks at federal and provincial level, and loan schemes. Canada also has an animation 'mini-treaty' with France to facilitate co-productions further. The Canadian company DHX Media, which floated in 2006 and is one of the rare success stories among public children's content companies, says that 'direct production costs [are] typically 100% covered at green lighting from contracted Canadian broadcast licensing revenue, tax credits, other subsidies and presales'.

Support schemes like these were used by producers in the UK to argue for government support. With justification, they argued that they were at a significant disadvantage to competitors and especially vulnerable to funding cutbacks by broadcasters. Lobbying efforts bore fruit with the introduction of tax breaks for animation productions costing more than £1 million an hour in 2013. The regime was extended to children's live action TV in 2015.

Children's IP business on the stock market

In March 2009, Entertainment Rights went into administration and its shares on the London stock exchange were suspended the following day. The UK and US operating subsidiaries, which were not in administration, were sold to Boomerang Media, backed by US private equity group GTCR and headed by Eric Ellenbogen and John Engelman. Ellenbogen and Engelman sold their company, Classic Media, to ER in January 2007. No figure was disclosed for the sale, though ER said the amount was lower than its debts, which were reported to be £125 million.

ER experienced a catastrophic 2008, with sluggish sales of new and library programmes to its core TV and DVD markets. ER reported a pre-tax loss of £105 million on sales of £20.2 million in the eight months to 31 August 2008 and subsequently reported that Christmas sales were disappointing. It was in dispute with its US DVD licensee Genius Products, and was also stricken by the collapse of Woolworths and its subsidiary Entertainment UK Ltd.

The Boomerang partners revived the Classic Media brand and in July 2012, agreed to sell the business to Dreamworks Animation for \$155 million. In the 12 months ended 29 February 2012, Classic Media made net revenue of \$82.2 million and operating profit of \$19.2 million.

In April 2011, US children's content company 4 Kids Entertainment filed for bankruptcy protection to stay a lawsuit from the Japanese owners of the Yu-Gi-Oh property. The month before, 4 Kids was informed by Asatsu-DK Inc and TV Tokyo Corporation of their intention to terminate their licensing agreement for Yu-Gi-Oh in the US. The move followed an audit of 4 Kids' books which the Japanese companies undertook to review its agreement to receive 50% of the gross revenues from Yu-Gi-Oh, minus certain expenses. They alleged that they had found examples of questionable accounting by 4Kids and as well as terminating the agreement, demanded \$4.7m in damages.

4Kids Entertainment saw its revenues soar when it owned the rights to Pokemon outside the US at the beginning of the 2000s. The company continued to license Japanese properties and programmed the Saturday morning children's block on the CW Network. In subsequent years, 4Kids saw a dramatic reversal

of fortunes. Annual net sales in 2010 were \$14.5 million, having fallen from a peak of \$62 million in 2006.

In October 2011, toy company Mattel agreed to acquire the UK-based children's intellectual property owner HIT Entertainment for \$680 million from a consortium led by Apax Partners funds. The acquisition will give Mattel full ownership of Thomas the Tank Engine and Friends and other important preschool brands including Bob the Builder, Barney, Fireman Sam and Angelina Ballerina. Mattel already owned global licences to produce die cast and moulded plastic products based on Thomas which it said generated global sales of \$150 million.

HIT Entertainment, originally a distributor founded by the late Peter Orton, was one of the first children's content producers to list publicly in 1996. It used cash raised from the stock market to develop the Bob the Builder brand and build its portfolio through acquisition. The company went private when it was acquired by Apax Partners for £490 million (\$636 million) in 2005.

HIT's business shrank significantly from its heyday: annual sales were £166 million in its 2006 financial year to £113 million reported by Mattel at the time of its acquisition. HIT's difficulties were exacerbated by the nature of the loans raised to fund the Apax deal, which were reported to be 'highly syndicated'.

Canadian producers Halifax Film Company and Decode Entertainment merged to form DHX Media and floated on the Toronto stock market in May 2006. DHX has since carried out a series of acquisitions, beginning with animation company Studio B in 2007. The key acquisitions include Canadian firm Cookie Jar and Europe-based licensing agent Copyright Promotions in 2012, the UK's Ragdoll Worldwide in 2013, and the Canadian specialty channels Family Channel, Disney Junior and Disney XD acquired from Bell Media in 2014 for C\$170 million (\$160 million).

DHX Media's annual revenues have grown from C\$15.9 million in the year ending 30 June 2006 to C\$116.1 million in the 2014 financial year. At the end of its 2007 financial year, DHX Media has 1750 half-hours of programming, but by 2014 its library had grown to 10,000 half hours (300 titles) of mainly animated programming is more than double the size of any other independent producer. It also says that it produces 75 to 150 new half-hours of children's programming a year.

Making a success of children's TV

As the growth of DHX Media shows, some companies have been successful in harnessing the energy of hit properties in the children's IP business to build sustainable businesses. While it remains a volatile business subject to peaks and troughs, some of the most successful children's properties are those which have been around for decades.

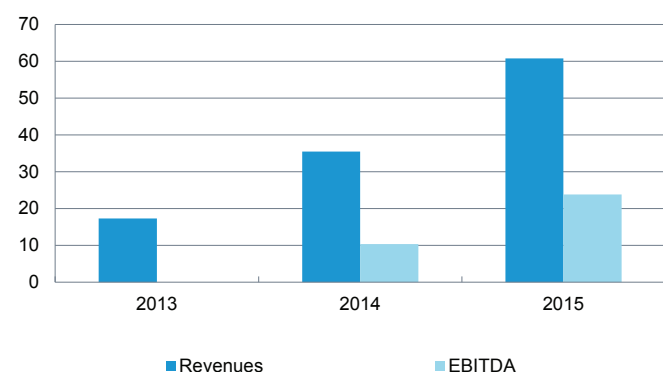
Entertainment One: Peppa Pig takes flight

Entertainment One (eOne), originally a Canadian record and tape retailer, has grown through a series of acquisitions and IPOs in Toronto and London into a 'mini-major' film and TV distributor. Its key move into the children's business came with the acquisition of UK DVD distributor and producer Contender Entertainment Group in 2007. This deal brought 50% of the preschool property Peppa Pig into its stable, just as it began to take off globally. The other half is owned by British animation studio,

Astley Baker Davies. In its latest financial report, Entertainment One said that Peppa Pig generated \$1 billion in retail sales, with over 600 licensing deals.

In the financial year ending 31 March 2015, eOne's Family & Licensing Division more than doubled year-on-year EBITDA to £23.8 million (\$35.6 million), while revenues were up 70% year-on-year to £60.8 million. Originally aired on Channel 5 in the UK, Peppa Pig broadcast seven days a week on Nick Jr in the US. Products are launching in Wal Mart and licensing campaigns being rolled out in several key markets including France, Germany, Brazil and China.

eOne Family division financials: year ending 31 March (£ millions)



Notes: EBITDA of division not reported in 2013
Source: IHS

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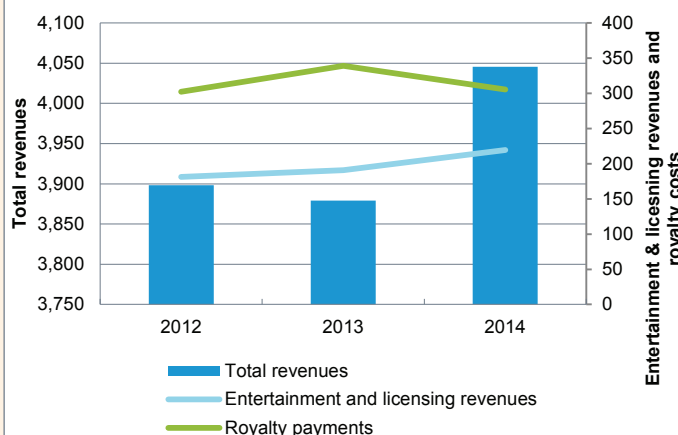
Hasbro Studios: not about toy television

The relationship between toy companies and TV production has always been strong. Toy companies buy TV advertising aimed at children, they pay royalties to IP owners and rights holders to produce toys based on TV programming, and for some years have been closely involved in development of TV programming.

However, recent years have seen toy companies take significant steps further. In 2009, Hasbro set up a Los Angeles-based studio and acquired a 50% stake in Discovery Kids, the US network. In 2011, its rival Mattel acquired Hit Entertainment, the UK-based preschool producer behind Thomas the Tank Engine and Friends. Hasbro's entertainment and licensing division is comparatively small in relation to its core toy sales activity, generating \$191 million in revenues in 2013 out of a total \$4.1 billion. However, entertainment and licensing sales have increased every year since 2009 while Hasbro's overall revenues have been stable.

Hasbro Studios, according to its management, 'is not about toy television, but about making IP as compelling as possible'. In the five years since it was set up, Hasbro Studios said it has invested in 1,100 hours of programming, including series based on its portfolio of 1,500 brands like My Little Pony and Transformers and other, original properties. The company works with what it calls 'creative stewards' to create programming, and sub-contracts animation work third party studios around the world. International distribution is managed by the company itself, with programming sold to broadcasters worldwide.

Hasbro financials (\$ millions)



Source: IHS

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Sesame Workshop: moving on from the Street

Sesame Workshop, the not-for-profit educational organisation best known for the long-running PBS series, Sesame Street, works with partners around the world furthering both its educational aims and the commercial activities which keep them, going.

Sesame Workshop is funded by donations from organisations and individuals as well as commercial revenues. Licensing accounted for 40% of its \$105 million in revenues in the last financial year.

The company is also active outside its core production and distribution business. Sesame Workshop was a launch partner in the preschool TV network Sprout, but bought itself out in 2012. In November 2014, it launched an over-the-top subscription service branded as Sesame Street Go.

In August this year, HBO agreed a five-year deal with to make Sesame Street available on the HBO channel, HBO Go, HBO On Demand and over-the-top service HBO Now. After a nine-month exclusive window, the series will be made available to PBS member stations for no charge. Sesame Workshop said a key part of the deal is that it will be able to produce 'almost twice as much new content' thanks for increased funding from HBO.

Sectors
TV Programming

Source
IHS Technology TV Programming Intelligence Service

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The business of children's content

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