All Grown Up: Cash, Creativity and the Independent Production Sector

An independent report by Mediatique Limited

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1. Highlights

- Independent production sector revenues now exceed £2bn a year, with more than half (£1.35bn) coming from primary TV commissions alone, driven in part by a benign regulatory climate
- Sector consolidation has seen the top 10 company market share rise to 65% from 53% since 2005; six companies now have annual revenues in excess of £100m
- The top 20 companies had 78% of total sector revenues in 2007
- Of 700 companies in the sector, top 100 are responsible for 98% of total revenues
- Top 12 companies are either listed or have significant external shareholders; "City" influence more apparent
- Conversely, stock market conditions have deteriorated, and this, among other factors, has led to the "privatisation" of Tinopolis and a planned stock market exit by RDF
- The listed indie sub-sector is therefore likely to shrink
- Recent consolidation has been led by All3Media, IMG, Shine and Shed
- BBC spends the most on independent sector (£436m in 2007); Channel 4 is the next biggest spender (£325m in 2007)
- Channel 4 is biggest contributor to sector as proportion of channel revenues
- IMG, Endemol and All3Media are sector leaders – driven by sport, drama, "reality" programming and quizzes
- "New Media" and overseas revenues climbing sharply; UK formats among most popular global programmes; economic slowdown may temper this?
- Terms of trade are bedding down; business model appears to be advertising funded not subscription; consensus developing around joint broadcaster/independent rights exploitation to "grow the size of the pie"?
- Further consolidation likely, continuing the power shift from broadcaster to rights owner but current stock market conditions and credit crunch may produce hiatus on activity
- Broadcasters, led by the BBC and ITV, reviewing strategy vis-à-vis independent sector; both are targeting indie acquisitions

2. Executive summary

The independent sector, defined for this report as the 700 companies that are current members of PACT and that produce programming for the UK and international TV markets, has undergone a significant transformation in the past five years, reflecting market and technological developments and rapid consolidation.

Far from being the cottage industry of even 15 years ago, out-gunned by its client broadcasters and completely dependent on the commissioning decisions of a handful of broadcast executives, it now generates total revenues of just over £2bn, of which c£1.35bn relates to primary commissions for UK broadcasters, and the remainder to secondary and ancillary markets. Excluding the costs associated with premium sports and movies, the independent sector in the UK was responsible for c22% of UK television programming spend (by revenue) and an estimated 30% by number of hours on the screen in 2007.

This extraordinary performance reflects revenue growth of more than 300% over the past 15 years. Once typified by a very small handful of strong brands and a long tail of micro companies, the independent sector, led by a top tier of companies which have also grown their total market share, is now heavily professionalised, bigger and more highly consolidated than might have been imaginable at its inception. Indeed, the pendulum may be swinging the other way: major broadcasters are increasingly dependent on a smaller number of independent suppliers, who now wield relatively greater power than at any time in the sector's history.

It is easy to forget this relatively positive backdrop when considering the current health of the independent sector. The stock market malaise, which has hit media companies disproportionately, has seen the small independent production sub-sector suffer hugely. Meanwhile, weakness in advertising expenditure has created short-term pressures on budgets at ITV, Channel 4 and five, and the BBC is tightening its belt as a result of a less-than-expected licence fee settlement and continuing speculation about its exclusive grip on TV licence income. Adding to this the uncertainties surrounding the independent sector's legitimate claim to "new media" revenues as broadcasters launch (or attempt to launch) non-linear TV services such as the BBC's i-player and the commercial variant Kangaroo, and the short-term view appears clouded.

Yet the fundamentals remain relatively sound, despite these pressures. Certainly any review of the past 15 years supports amply the view that the independent sector has grown up.

The two main drivers of independent production historically were the launch of Channel 4 in 1982 and the imposition of the indie quota from 1992. Channel 4 in essence kick-started and then nurtured the independent sector through the past 25 years, and was perhaps the single most important influence in the sector's history; the quota added further fuel to the rapid growth. More recently, bilateral agreements between individual broadcasters and the indie sector (through PACT) on the ownership and exploitation of rights have provided added impetus to the market, one consequence of which has been the attraction by many companies of outside investment to fuel their expansion.

As investment in the sector has increased so too the management has become more professionalised. Margin growth has been substantial; among those companies providing full accounts margins are approaching 12% against an historical average in low to mid single digits.[1]

Consolidation has continued apace throughout the period. The top 10 reporting companies (all backed by private equity or the stock market) now account for more than 65% of the sector's revenues; six companies had revenues of more than £100m in 2007, and two companies – IMG and All3Media – are above the £200m revenue mark. These companies are also increasingly international in scope and aspiration, taking advantage of the huge popularity of original formats and strong programme brands.

Perhaps the most directly illustrative effect of the bilateral rights agreements has been the growth in non-primary revenues. These so called "ancillary" revenues, comprised of international format and rights sales, UK secondary revenues, merchandising and DVD and new media receipts, (including fees from mobile, DSL and other emerging platforms) now account for c.37% of the sector's income.

Given the size of the opportunity, and the incremental margin contribution provided, it is not surprising that we are seeing the long-awaited development of independent distribution operations, both as stand-alone entities and housed within the indies themselves. Whilst it is early days for these operations, the UK production industry is clearly beginning to create long-term value on an international level.

The next few years are likely to see a slowing of corporate activity as City appetite appears sated for the moment. Indeed, the combination of company-specific factors, recessionary pressures and the general stock market malaise have encouraged companies to re-consider their market listings, with Tinopolis, the Television Corporation owner, exiting through a sale to private equity and RDF, a leading independent, currently executing plans to take the company private with the backing of management.

However intra-sector acquisitions will continue, albeit at a more cautious rate, as mid-size companies take advantage of the relative security and resource which can be provided by their larger counterparts. In the past year, Wall to Wall has been bought by the bigger (and still quoted) Shed Media, while ITV has bought 12 Yard Productions, the game show maker and NBC Universal has purchased Carnival from Southern Star.

At the same time we are witnessing significant, albeit differing pressures within each of the sector's major broadcast clients. The BBC has announced it will make "fewer and better" programmes to offset the effects of a lower-than-desired licence fee settlement; meanwhile, its commercial arm is investing in independent production companies and expanding in content internationally. Channel 4 is re-focussing attention on public-service programming as part of its strategic review of a potential funding gap; whilst ITV, buffeted by cyclical declines in advertising, is openly seeking to commission more programmes from its in-house production arm and has established a "fund" of £200m for acquisitions to bolster its in-house capability.

Moreover, the economic climate is affecting budgets not just in the UK but overseas as well. A sustained recession, particularly if it continues to affect advertising expenditure,

[1] Margin analysis is notoriously difficult, as the independent sector still harbours within it a large number of small operators whose profit and loss accounts are often impervious to external review. Among the factors that affect publicly available financial data are dividend policy and lags between booked and received revenue from broadcasters. In the present context, Mediatique has checked its analysis against published reports from PACT, the industry body, most notably its 2007/8 review.

will have a deleterious effect on the independent sector as commissioners are more selective and as the number of cost-effective acquisitions, particularly from the US, increases.

The shared result of these individual pressures is, according to the indies, likely to be a reluctance among the broadcasters to take risks on new talent and formats, and an increasing reliance on a few, large "trusted" suppliers. From the broadcasters' perspective, there are growing concerns that they may become too reliant on a narrowing source of external supply, driven by market, regulatory and technological developments over which they have little or no control. Meanwhile, recognising the costs associated with both developing and marketing new programmes, broadcasters and producers alike are looking to secure commitments to longer runs of series, potentially posing a danger to future innovation on screen.

This could free up additional one-off slots for the smaller companies consisting of just a few individuals; it is the mid tier, facing the higher overhead costs associated with on-going development and execution, that must be most at risk.

3. Introduction

Mediatique Limited has produced this report on the evolution and future development of the independent production sector in the UK. In part, the present report is an update on a Mediatique paper published in September 2005.[2]

In this report, Mediatique provides a general background, an analysis of the key drivers affecting the sector, a review of transactions and other corporate activity, and a consideration of the likely evolution of the sector in the future.

Note on methodology and sources

Where necessary, we have relied on external secondary sources for the financial data contained in this report. We note, however, that the independent production sector has not been properly audited since the launch of Channel 4 in 1982. For the 1990s, the only sources are some disclosures from broadcasters (particularly from Channel 4 itself) and an annual survey conducted from 1993 to 2003 by Televisual, the trade magazine. More recently, Broadcast has surveyed the industry and provided more relevant detail. For the past two years, PACT has undertaken its own survey, in co-operation with KPMG and Bank of Ireland.

As a result, all figures included in this report are based on calculations by Mediatique and sourced from Televisual (1993-2002), Broadcast (2003-2008), PACT and Mediatique estimates. In addition, information has been sourced from the London Stock Exchange, company reports and brokers' estimates. The sector revenues (total) include all revenues generated by independent production companies (primary commission, secondary markets, programme sales, format sales, overseas, new media, agency, events management, etc.), The amount represented by primary commission is based on calculations by Mediatique, and is sourced from reported accounts of a range of companies and interviews with industry players. The number of independents is based on a number of sources, including Televisual and PACT.

These secondary sources have been backed up by primary research, including confidential interviews with key representatives from the independent production sector, broadcasters, trade bodies and regulators. We have included unattributed quotations from these sources in certain sections of this report in order to clarify our views on the sector, and to support the financial analysis contained herein.

[2] Mediatique Limited, *From the Cottage to the City: the Evolution of the UK Independent Production Sector* (commissioned by the BBC, September, 2005).

4. Background to the independent production sector

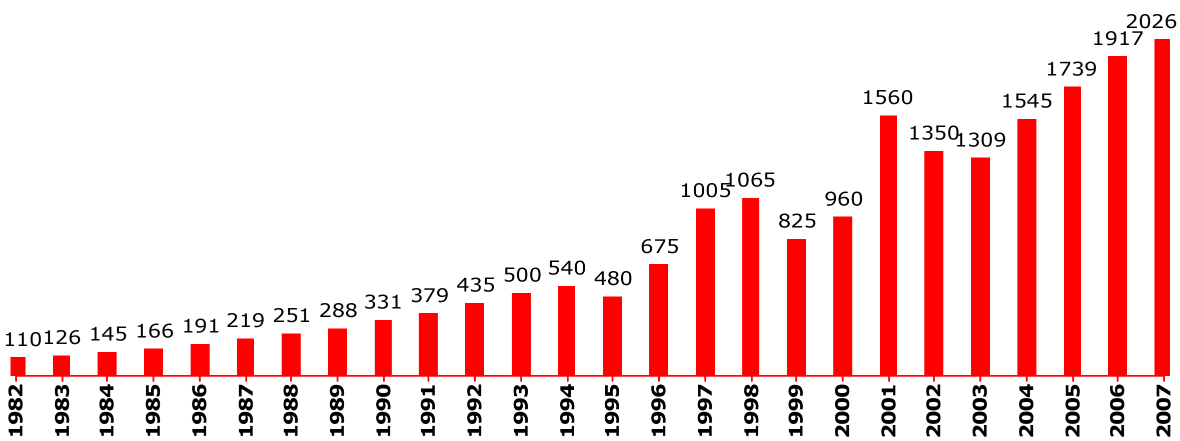
The independent sector, defined here as the 700 companies that are current members of PACT and that produce programming for the UK and international TV markets, is responsible for total revenues of just over £2bn, of which c£1.35bn relates to primary commissions for UK broadcasters. This latter category includes all production meeting the 25% quota imposed under the Broadcasting Act (1990) and subsequent Acts, most recently re-confirmed in the Communications Act (2003).

Excluding the premium sports and movies market, the independent sector was responsible for 22% of programming (by revenue) and an estimated 30% by number of hours on the screen.

The sector has grown impressively since the original quota was established in a bid to encourage plurality of source for TV broadcasters and to nurture the creative industries in the UK. While there have been independent producers in the UK ever since the launch of commercial television in 1955, there were two main drivers of the sector's growth in the past – the launch of "publisher broadcaster" Channel 4 in 1982 and the imposition of the indie quota from 1992. More recently, bilateral agreements between individual broadcasters and the indie sector (through PACT) on the exploitation of rights in defined windows have added a third exogenous source of growth, which may be the engine of expanded revenues, certainly at the top tier.

The size of the independent market has grown nearly twenty fold since 1982, from £110m to £2,026m of total market turnover in 2007. The two peaks that occur around 1998 and 2002 reflect the advent of multi-channel, precipitated by Sky's move to digital in 1996 and the roll-out of legacy extension channels by the mainstream broadcasters.

Total market revenues (£m)



Source: Mediatique, Broadcast, company reports
Note: Figures between 1982 and 1993 are an average estimate based on the market size at the beginning and end of that period

In the past 15 years, the size and shape of sector have been transformed out of all recognition. Once typified by a very small handful of strong brands and a long tail of micro companies, the sector is now heavily professionalised, bigger and more highly consolidated. Formerly owned and staffed by "refugees" from the major broadcasters (and in particular the BBC), there are now scores of senior programme makers whose experience has been gained solely in the independent sector. Moreover, there is greater movement of talent between production companies, rather than just from broadcasters to the independents, and a clear trend (marked in recent years) for larger independents to successfully woo talent from within the sector (either through outright acquisition – Shed, Shine and IMG being the chief recent acquirers – or through more innovative "talent aggregation").

The top-line revenue growth has been driven in large measure by the top tier of independents, which have also grown their total market share. There are now 10 companies with revenues of more than £50m, of which 6 have revenues of more than £100m. In 2007, both IMG and All3Media exceeded the £200m revenue level, easily topping the league tables.

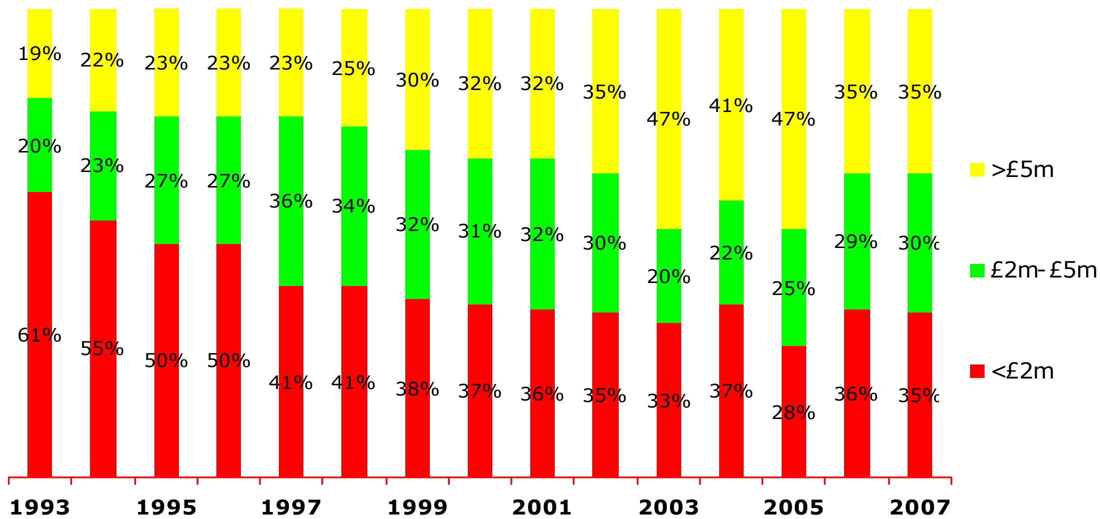
Top-10 independent production companies, by turnover (2007)

Rank	Name of indie	Turnover (£m)	% of indie sector
1	IMG	221.7	10.94%
2	All3Media	202.5	9.99%
3	Endemol UK	160.0	7.90%
4	Shine	146.0	7.21%
5	Hit Entertainment	142.7	7.04%
6	Talkback Thames	140.0	6.91%
7	RDF	99.3	4.90%
8	Shed	71.8	3.54%
9	Entertainment Rights	68.0	3.36%
10	Tinopolis	66.0	3.26%
Total Top Ten		**1,318.0**	65.05%

***Source**: Mediatique, Broadcast, company accounts*
***Note**: Further detailed information on these companies is set out in the appendix to this report*

The distribution of the number of indies according to revenues generated has followed a consistent trend towards scale in the past 15 years, with more and more companies declaring revenues in excess of £5m.

Relative size of independent production companies, split by number of companies in three revenue categories



Source: Mediatique, Broadcast, Televisual

Since 1993, the proportion of the market represented by the largest companies has steadily increased, with those companies with turnover greater than £5m per annum increasing their share of the total number of companies from 19% in 1993 to 35% in 2007. Outlier years in the period 2003-07 appear to reflect the growth in companies winning just one or two commissions a year. The "middle bulge" of those companies with turnover between £2m and £5m peaked in terms of proportional numbers towards the end of the 1990s and currently represents 30% of the total. The "tail", which represents companies with turnover of less than £2m, has almost uniformly declined in terms of the overall number of independents, representing 35% in 2007.

In terms of ranking by revenues generated, the data tell a different story. From 2003 to 2007, the underlying trend of increased consolidation appears proven, with the top ten companies, all of which have made acquisitions in the period, increasingly dominating the sector in terms of overall revenue generation.

Split of indies, by size of revenue (2006-2007)

2006 - turnover: £1.92bn
indies: 750

2007 - turnover: £2.03bn
indies:700

Source: Mediatique, Broadcast, brokers estimates

The top ten companies together represented more than 65% of the sector's total sales in 2007, up from 63% in 2006. Of the remaining companies qualifying for independent status in 2007, more than 58% had revenues in excess of £2m. Put another way, approximately 39% of all independents active in 1993 had revenues in excess of £2m that year; by 2007, the comparable number had risen to 65% of all companies.[3] This increase is due to consolidation, well as organic growth in the sector.

The effect has been to create a recognisably and increasingly entrenched tripartite structure, which Mediatique has labelled the "super indies", the "middle bulge" and the "tail." The top tier has extended its market dominance through a combination of acquisition and organic growth, and in particular by buying companies from the middle bulge. This tier has grown in market power, and broadcasters have become more reliant on programmes supplied by these super indies.

The super indies have also improved their profit performance: the average operating profit of those bigger companies reporting full details is now nearly 12%, up from 8% in 2004.[4] However, this masks a huge array of profit profiles and these in turn reflect the relative positioning of companies in the context of genre: bigger companies tend to make higher-margin drama and entertainment programmes; smaller companies are more likely to make factual and lifestyle shows. Indeed, of all companies surveyed by PACT in 2007, those with more than £50m of revenues derived 80% of their business from drama and entertainment; those with revenues of less than £1m made virtually no drama or entertainment shows at all.

[3] Mediatique excludes all integrated production houses owned by the major broadcasters (ITV Productions, the BBC) but includes Talkback Thames (owned by the same parent as five, RTL) as the former is not run as an integrated production arm of five.

[4] Profitability is notoriously difficult to identify in the independent sector, as most players rely on the production fee from primary commissions – notionally 15% - but tend to relinquish some of this in order to win the commission in the first place. Of the top companies, able to generate secondary and tertiary revenues, profit margins have improved, but even here there is a wide range of outcomes. Shed earned pre-tax profits in the 16 months to 31 December 2007 of £10m on revenues of £63m. RDF, with revenues of £120m in the year to 31 January 2008, managed pre-tax profits of just £2m.

The super indies are also typified by having a more "professional" approach to their clients and to their shareholders. These are businesses, rather than "lifestyle" companies, and are dedicated to making profits. While such characteristics can also be found elsewhere in the sector, and in particular among aspiring companies in the "middle" bulge, it is the top 20 companies that embody the structural and cultural changes that are so evident in a review of the past five years.

The long tail continues to be significant in all but revenue terms: of the 700 PACT companies in 2007, most had limited revenues, relying on a handful of commissions at best, and with little prospect of significant secondary and tertiary income. Many of these have deliberately elected to maintain this size and culture, and do not aspire to "super-indiedom."

Meanwhile, the top 100 accounted for more than 98% of the sector's total revenues. The distribution is revealing: the top 20 by revenue posted revenues in the aggregate of £1.57bn in 2007, or 78% of the total. The next 60 companies in the sector had sales of just £375m, or less than 19%. Revenues for the next 20 in the league table were just £44m, less than 3%. The rest of the sector combined managed revenues of just £36m, less than 2%.

The market's development in the past five years has owed much to the rapid consolidation of ownership and the injection of external sources of capital. In 2003, two companies had revenues of more than £100m (HIT and Talkback Thames). In 2004, Endemol (UK) and All3Media joined this club; the former through organic growth; the latter helped by acquisitions. In 2005, TWI/IMG posted revenues of more than £100m, moving into the top five. In 2006, the same five companies made up the top ten, but in a different order: IMG moved to the top position (following acquisitions and a rapid growth of its sports programming business), followed by Endemol, All3Media, HIT and Talkback Thames. In 2007 Shine joined these companies at the top of the list as a result of having completed a number of significant acquisitions in short succession.

Super-indie top-10 (2004-2007)

2007		2006	
Name of indie	***% of sector***	***Name of indie***	***% of sector***
IMG	10.9%	IMG	11.0%
All3Media	10.0%	Endemol UK	9.0%
Endemol UK	7.9%	All3Media	9.0%
Shine	7.2%	Hit Entertainment	8.7%
Hit Entertainment	7.0%	Talkback Thames	7.6%
Talkback Thames	6.9%	RDF	5.2%
RDF	4.9%	Shine	5.2%
Shed	3.5%	Tinopolis	2.5%
Entertainment Rights	3.4%	Aardman	2.3%
Tinopolis	3.3%	Shed	2.3%
Total top 10	***65.0%***	***Total top 10***	***62.8%***

2005		2004	
Name of indie	***% of sector***	***Name of indie***	***% of sector***
All3Media	9.0%	Hit Entertainment	9.6%
Talkback Thames	8.3%	All3Media	8.7%
Hit Entertainment	7.3%	Talkback Thames	8.0%
Endemol UK	6.9%	Endemol UK	6.5%
TWI (IMG)	6.5%	TWI (IMG)	6.3%
TV Corp (Tinopolis)	3.9%	TV Corp (Tinopolis)	4.0%
RDF	3.7%	RDF	3.2%
19 Entertainment	2.8%	Tiger Aspect	2.7%
Ten Alps	2.6%	19 Entertainment	2.3%
Tiger Aspect	2.5%	Celador	2.1%
Total top 10	***53.5%***	***Total top 10***	***53.4%***

***Source**: Mediatique, Broadcast, company accounts*

Of the top 10 companies, by total revenue, all are backed by private equity or are directly or indirectly quoted companies. Of the next 10 companies, three are UK listed (Ten Alps DCD Media and 2WayTraffic, owner of Celador). Southern Star is the UK arm of Southern Star Broadcasting which was acquired by Fairfax Media in November 2007. Note that following the sale of Carnival to NBC, Southern Star will fall in the rankings. Of the remaining six companies, the biggest is Hat Trick (2007 revenues of £24.9m). The remainder includes Aardman, Twofour, Avalon, Optomen and Eyeworks. Speculation about the independent future of the remainder is a constant, and this group (at the heart of the "middle bulge") is believed to be the prime target in the next wave of consolidation.

5. Key drivers of the independent production sector

- *It's very scary being a small independent. They want to be innovative, but they also want to sell the next show. This means it makes sense to be part of bigger businesses: if you've got 10 businesses within the portfolio, then you can afford for a couple to have a bad year.* Chief executive, super indie
- *We're rapidly approaching a world where there are 4-6 indies with £100m+ revenues. There will be very little will be left in the middle, which is potentially a problem for the broadcasters: they'll have to go to the likes of [name deleted] and fight, or go to real boutiques, where there is lower guarantee on quality (but lots of love and care, which you won't necessarily get from [name deleted]).* Corporate development executive, super indie
- *Are there many examples of small indies organically growing into really big ones? No. It is important that the small can survive, but it is tougher than ever to do so.* Chief executive, "consolidated" indie

The major drivers of consolidation and market share growth for the independent sector have been: demand-side developments (multi-channel expansion, emerging media distribution); regulatory support (confirmation of the indie quota and the introduction of indie-friendly terms of trade); broadcaster strategies (the introduction of the BBC's Window of Creative Competition, increasing reliance by leading broadcasters on major suppliers, increased commissioning of reality programming and "event" television); and the pressures from external investors to seek top-line growth and improved margins.

The past 15 years in the UK have been typified by the growth of multi-channel (Sky, cable and – more recently – Freeview) and the related growth in the number of channels launched by the legacy broadcasters. The "pure" multi-channel pay market has matured, and programming budgets have been relatively stagnant. However, the legacy extensions market – in particular the "family" of channels made available by the BBC, ITV and Channel 4 – has seen an increase in budgets over all. Although many of these channels have tended to survive on repeats and acquired programming, there is a growing amount of original commissioning, particularly by the BBC. Taken together, multi-channel and legacy extension budgets for independent production have increased by 16% according to PACT.

At the same time overseas and new media opportunities have proliferated. A major source of income for leading independents has been the US market, where there has been high demand for UK-developed formats such as Shed/Ricochet's *Super Nanny* and RDF's *Wife Swap*. UK independents generated c£310m from the primary and secondary overseas markets in 2007, and nearly all of this came from the US.

The craze for reality entertainment shows such as *Strictly Come Dancing*, *X Factor* and *Pop Idol* (re-named *American Idol* on Fox in the US) has reinforced the UK's reputation as a source of innovative programming ideas; this trend has been amplified by the rapid integration of production companies into the operations of major networks and studios (arguably leading to less independent innovation) and the high costs of developing programmes for the US TV market.[5] There are also signs of growth in broadband, Video on Demand and mobile platforms. While these are still relatively small in the UK market, leading independents are seriously exploring emerging markets, with those owning popular formats particularly adept at creating ancillary revenue opportunities.

Despite these developments, the independent sector continues to rely on primary commissions as its foundation. While secondary and tertiary markets have grown in importance, particularly for larger, integrated players, the annual budgets of broadcasters, including those operating in the multi-channel sector, continue to be a prime determinant of financial success for UK indies.

Demand-side trends: broadcasting

Commissioning trends

- *Consolidation does not necessarily mean the end to the small, creative indies: the barriers to entry are still low, key talent from consolidated companies do leave and set up new companies. And large and consolidated doesn't necessarily mean less innovation: most genuinely innovative programmes come from the large indies (or at least from the vertically-integrated ones).* Chief executive, mid-sized indie
- *The programmes developed and produced by independents are as innovative and creative as the broadcasters want. Innovation is driven almost entirely by what the broadcasters ask for.* Chief executive, mid-sized indie
- *Of course we all want long running series. Look at the investment required to make a brand work. Why would you choose to pull it off and have to start again?* Senior executive, multi-channel broadcaster

Generally among mainstream broadcasters, there has been an increase in recent years in reliance on event and reality programming, much if it sourced from the independent sector. Much of this has come from the top tier of players, and there is widespread concern that broadcasters do not want to risk awarding complicated and big-budget commissions to small, if innovative, independents.

There is much debate about the effects of City interest in the independent sector. PACT and leading broadcasters reject the notion that reliance on the support of external shareholders leads to pressures on innovation and risk-taking, and encourages homogenisation of output. In particular, it is argued that size is neither a determinant nor an inhibitor of innovation.

It appears clear that innovation is a characteristic of both large and small companies in the sector. However, those with external shareholders, required to deliver profit growth year on year, and/or dependent on the vicissitudes of the stock market, are more likely to seek recurring income, re-commissions and long programme runs than to place greater emphasis on innovation and the approval of peers.

[5] The system of ordering expensive pilots prior to commissioning a programme for broadcast, and the payments made to talent in the US, combine to encourage network executives to look to other markets, and in particular the UK, to feed development slates. Major independents such as RDF, Endemol and Shed are all targeting the US, as is the BBC through its commercial arm, BBC Worldwide.

There is little doubt that the UK currently leads the world in terms of format creation – making more indeed than the US. This appears to be linked to demand trends, particularly in the US, where costs of developing programmes have been very high traditionally and where the cost-effective purchase of already-proven formulas has gained favour. This has been true in particular for "event" programming – celebrity dancing, talent contests, etc., which are proving popular for networks struggling to keep audiences for more traditional drama and comedy. But factual entertainment (typified by programmes such as RDF's *Wife Swap* or Shed's *Super Nanny*) is also proving increasingly popular, particularly as major broadcasters such as the BBC and ITV concentrate on drama and in-house soaps (*Heartbeat*, *Casualty*, and the perennials *Coronation Street* and *EastEnders*).

The domestic market, too, has been driven to a large degree by live programmes with mass appeal, and this has inevitably led to "me-too" programming, particularly for talent shows with a celebrity theme. This has strengthened the hand of those production companies most closely associated with live "event" programming – Endemol and Talkback Thames, for example.

The popularity of these programmes has been driven as much by the requirements of broadcasters as by the pitches made by independents. Proven formats have appeal with commissioners at mainstream broadcasters where mass market ratings are an important bulwark against audience fragmentation. As well, these programmes require logistical as well as conceptual skills, and commissioning editors appear to prefer to turn to those independents with a proven track record. But whatever the source, the growing prevalence of contests and high-concept formats has deepened the relationship between broadcasters and certain production companies: Endemol's *Big Brother* and *Deal or no Deal* are a prime example of how dependent broadcasters (in this case Channel 4) can become on a single source of programming. We return to the implications of these trends in the section "Future Evolution of the Independent Production Sector", below.

The strategies followed by the key UK broadcasters dictate to a large degree the context for trends in the sector, even if the bigger indies have developed enough leverage to, in turn, influence the broadcasters.

Broadcaster strategies

- *The main client base for indies is in flux – the BBC cutbacks, internal reviews at Channel 4 and Five and a new direction at ITV.* Chief executive, listed indie

An outline of the content strategies of the major broadcasters is set out below, including an indication of the relative scale of their programme budgets.

Summary of major broadcaster strategies

Broadcaster	Total programme budget	Main content suppliers	Content strategy
BBC	£1.8bn	Shine, IMG, Endemol, Talkback, All3Media	Fewer and better; WOCC; aggressive online distribution; multi-channel FTA; BBC Worldwide investing in independent production companies
ITV	£1.0bn	Talkback, All3Media, Southern Star, 2Waytraffic	More in-house; £200m acquisition fund; scheduling 9pm slot; focus on peak weekend
Channel 4	£528m	Endemol, RDF, All3Media, Shine, Olga TV	Review of "Vision"; emphasis on PSB and 1634 demographic; multi-channel FTA; funding solutions
Five	£210m	Tinopolis, Shine, Endemol, All3Media, IMG	Search for "home grown" hit; efforts to reduce continuing reliance on US imports during peak
Multi-channel	n/a	n/a	Slow incremental increases in original programming; non-PSB market dominated by pay (including US affiliates)

Source: Mediatique

The BBC

The BBC spent £436m in 2007 on independent productions across all its channels (the core terrestrials BBC1 and BBC2, as well as the extension channels BBC3, BBC4, CBBC and CBeebies). It bought from 279 independents, with the top ten indies league table (by expenditure) led by Shine's Kudos Films and Television (*Life on Mars*, *MI High*, *Hustle*), IMG's Tiger Aspect (*Robin Hood, Catherine Tate Show*), Endemol (*Ready Steady Cook, The One and Only*),Talkback Thames (*The Apprentice*) and Hat Trick (*Have I Got News for You*).

The BBC spends more than any other broadcaster on the independent sector but has not always enjoyed good relations. Indeed, despite improving its relationships with the independent sector in 2005 and 2006 (according to the Broadcast Survey), the BBC's popularity with indies again took a sharp downturn in 2007. The survey indicated that nearly half of the 150 largest indies think that the BBC is worse to deal with. This is particularly felt by the smaller companies, those with turnover of under £7m.

There is also widespread enthusiasm for the Window of Creative Competition (under which the BBC will seek to source up to 50% of its output (i.e., far more than the independent quota of 25%), the effect of which has not yet been fully felt, although very early indications are positive for the sector. In 2007 indies accounted for 44% of BBC output in terms of hours broadcast. Most indies agree that the real implications of the WOCC will only emerge in the course of the next few years, and that the impact will felt primarily in the factual and entertainment genres.

The cost-cutting regime at the BBC (following a less-than-hoped-for licence fee settlement) has seen the prime targets of the WOCC as News and Factual. The BBC's Director General, Mark Thompson, has said that the focus for the slimmed-down BBC will be drama and comedy, particularly in peak and particularly on BBC1. Thompson has said that the BBC will make or commission fewer but "better" programmes.

Despite the optimism over the exogenous effects of the WOCC, there is a concern that cost-cutting may lead to tighter programming budgets even in those areas primarily the focus of sourcing from the independent sector.

That fear has been exacerbated by moves by BBC Worldwide to acquire stakes in independent companies in a clear bid to secure talent to feed both the main channels and its distribution arm.

Channel 4

In absolute terms, Channel 4 is the second biggest commissioner of independent programming in the UK, spending £325m in 2007. As a proportion of its total budget, Channel 4's commitment to the sector is even bigger; it spends 75% of the BBC indie spend on an overall budget less than a third of that of the BBC. Channel 4 was established to support and foment the growth of indies, and it has done so throughout its 25 years. There are concerns now, however, that a reliance on a few large suppliers, led by Endemol and RDF, might have tipped the balance, and reduced Channel 4's ability to spread its budget as widely across the sector. The number of independent suppliers used in 2007 increased slightly from 296 to 312 – still larger than the number used by the BBC (279) or ITV (84). For the third year running, Endemol, RDF and All3Media dominate the top 10 supplier list.

Channel 4's profile with the independent sector has undergone a shift in the past five years, reflective of the inter-relationship of growing consolidation of supply (the growth of the super indie) and scheduling requirements. As a consequence, by nearly every measure, Channel 4's dependence on large indies has increased. Channel 4, has, however, committed itself to using a significant number of small and medium-sized independents as part of its Next on Four amibitions.

ITV

ITV has a much smaller commitment to the independent sector than the BBC and Channel 4, using 84 independents and spending about £285m. Fremantle/Talkback were the highest by spend (*Grease is the Word, WAG's boutique, X Factor, The Bill*). All3Media was again a major supplier with *Midsomer Murders* and Southern Star's Carnival Films provided several dramas (*Rosemary and Thyme, The Old Curiosity Shop, Whistleblowers*). By hours, however, 39% of ITV1's output was supplied by independents in 2007, with the rest sourced internally.

The biggest concerns expressed by the independent sector relate to ITV's stated objective of increasing the amount of programming sourced from its own production arm. This strategy is to be strengthened through ITV's stated objective of expanding its production operations via acquisition. This has already led to the purchase of 12 Yard, makers of *Eggheads* and other quiz programmes.

Five

Five commissions about half of its £210m budget from the independent sector, but has yet to discover/nurture a home-grown hit. As a consequence, it is less of a target for the independent sector.

Five does not provide expenditure totals, but only a ranking by hours. Its programming budget in 2007 was c£210m and 50% of its output (by hours) was acquired. The lead table (top five independent suppliers) is made up of Tinopolis's Sunset + Vine (cricket and late-night sports), Shine's Princess (*The Wright Stuff, Shocking Moments*), Endemol (*Brainteaser*) Town House TV (the *Trisha Goddard Show*) and IMG (*Megastructures, Paul Merton in China*).

Multi-channel

Multi-channel is a growing but still small part of the client base of independent production. UKTV's programming budget is c£80m, while Discovery has a budget of c£30m. Neither reveals the split between acquired and commissioned, although commissioned programming is still small. Sky One spends about 40% of its estimated £125m budget on commissions, and source this from 30 independents down from 40, led by Twofour Broadcast (*Are You Smarter Than a 10 Year Old?*), Love Productions (*Cirque de Celebrite*) and All3Media (*Premier League All Stars*). About 30% of total commissions were secured from Sky's top five contributors.

This snapshot of broadcaster expenditure on independents highlights the degree to which the sector has become more consolidated as to ownership and market share, and the growing importance of top indies to individual broadcasters. Three examples make the point starkly. Growing largely through organic expansion, and driven in recent years by long-running formats, Endemol UK is now the top external supplier (by hours) to Channel 4, the third biggest to the BBC and the third biggest to Five. From revenues in the UK of £90m in 2003, Endemol generated £160m in 2007, fuelled by the success of such juggernaut programme brands as *Big Brother* and *Deal or No Deal* and increased income from non-primary broadcast sources (games, programme sales, etc.)

A second revealing example is All3Media, one of a handful of groups in the UK dedicated to growing rapidly by acquisition (others in this category include IMG Media, Shine and, more recently, Shed). In 2003, All3Media had revenues of £93m, primarily from its stable of independent brands bought through its acquisition of Chrysalis TV. In 2004, this had risen to £134m on a pro-forma basis[6], following the acquisitions of Lion TV and Company Pictures. By 2006, after the addition of Mersey TV (now Lime TV), Maverick and Objective, the pro-forma revenues topped £173m and in 2007 were £202.5m.

The recent experience of the UK's largest indie group, IMG Media, provides further illustration of the major consolidation and growth trends. In 2003, the company had revenues of £72m, largely attributable to its TWI sports programming and agency business. By 2006, following high-profile acquisitions of Tiger Aspect and Darlow Smithson, revenues on a pro-forma basis were £217m, derived from a near doubling of the contribution of TWI (with 2,000 additional hours produced) and an additional £100m of annualised revenues from its acquisitions. In 2007 IMG achieved revenues of £221m.

A major theme of recent years has been the growing importance to the independent sector of "non-primary commission" income. This has been particularly a focus of leading indies as there are growing fears that primary budgets may flatten out or even decline, owing to a host of factors. Most important is the double effect of audience fragmentation

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[6] Mediatique has stated revenues of companies that have acquired other indies as if the acquisition had already taken plan for the full year.

and declines in the growth of advertising income for broadcasters, owing in part to competition from alternative platforms such as the Internet.

Demand-side trends: secondary markets and new media

- *We keep a watching brief on VOD and other platforms, and have been speaking to the likes of Joost and Google. But nearly all the money to be made from TV programmes still comes from the traditional secondary markets and overseas, and we don't see that changing any time soon.* Chief executive, listed independent
- *One day they [emerging media rights] will be worth something but God knows if it'll be in my lifetime. However the broadcasters always want them because they don't want them to go to anyone else. It will be years before they are worth anything like the value of the broadcast rights*. Chief executive, super indie

For all these reasons, the top indies have sought to diversify from their reliance on commission income (particularly those, such as Endemol, that rely on a handful of very popular programmes and/or genres), and seek to generate revenues from a range of sources. The most important has been secondary market sales (to multi-channels and overseas buyers), although until recently most post-first run rights have been retained (and in some cases warehoused) by the broadcaster-client that commissioned the relevant programme in the first place. Changes to the terms of trade have begun to address the balance of power between broadcasters and independent production companies, and most big, integrated players seek to maximise returns on secondary and tertiary exploitation themselves. A second source of income has been alternative distribution platforms – initially video and DVDs, and increasingly other platforms such as VOD delivered via broadband. While the latter is a small market to date, independents believe it may grow substantially in the future.

Integrated indies with significant format rights have also sought to exploit their intellectual property rights via other means, including games and merchandising. Endemol, HIT and Celador have been leaders here, developing ancillary revenues such as children's toys, books, quizzes, interactive gaming (pubs, mobile, interactive TV).

The non-primary commission income for the independent sector totalled more than £700m in 2007; this revenue source has been enjoyed primarily by the biggest of the independent players, able to monetise the rights they retain through their own or third-party distribution. Of this amount, c. £310m was generated overseas (largely in the US), c. £150m on UK secondary markets, £40m through emerging media, c. £25m on corporate videos and other non-broadcast video and the rest through interstitials, talent agency, training, equipment hire.

Income from non-linear broadcast, still a tiny figure, may change as a result of the growth of catch-up TV and the launch (if and when approved by regulators) of the planned Kangaroo Video on Demand service.

The success of the BBC's i-player, which has gained considerable traction since its "hard" launch in December 2007, has underlined the appeal of "catch up" TV, and this has encouraged other broadcasters to increase their commitment to making programmes available online. The model seems likely to be advertising-funded, despite some limited success with downloads (to own and to rent). The proposed Kangaroo service, owned by the BBC, ITV and Channel 4, for example, is expected to be dominated by free programmes (to which video advertising will be inserted). This complicates the rights model for independent production companies, as they do not traditionally access a share of advertising and are therefore reliant on licence fees to cover their contribution to non-linear platforms such as Kangaroo. As the latter service has at any rate been referred to the Competition Commission, the actual business model, and indeed the structure of the offering, may well evolve.

Depending on how the market evolves, non-linear distribution may add a further revenue stream for independents, although the quantum remains in doubt.

The Quota and Terms of Trade

- *The debate to date has been about "how do we carve it up" when it comes to rights. What we'd like to see is a more interesting collaboration ahead – "how are we going to grow the value for us all?" We are at the start of that process, and we are hopeful. The world has changed and we need a more sophisticated approach. Broadcaster*

The confirmation in the Communications Act (2003) that independent production companies would continue to benefit from the operation of the indie quota was a crucial driver of recent revenue growth and the injection of external capital. Certainty that the overall indie sector would continue at least to grow in line with broadcast budgets provided the comfort sought by third-party investors.

But it was the new terms of trade that particularly attracted investor interest, and under-pinned non-traditional revenue growth in recent commissioning periods.

The ability of independents to monetise their rights beyond the initial broadcast window has been significantly strengthened by the new terms of trade agreed between PACT and the major broadcasters, under the supervision of industry regulator Ofcom (See details in the box, below). The new terms ensure that indies can exploit rights in specified windows and at specified times, providing them with the opportunity of generating income over and above the primary commission. The debate over the terms of trade for new media in particular was heated. Broadcasters argued that they were responsible for creating the initial value enjoyed by independent production companies through the primary commission, and that the secondary and tertiary value was wholly dependent on this initial investment. As a consequence, they were unhappy with rights agreements that would allow independents to exploit IPR in ways that risked reducing the value of the initial rights window, to the detriment of the broadcaster.

The resulting compromise, which will be reviewed again by Ofcom (in 2009 at the earliest), has led to greater transparency for independents over their revenue streams and a reasonable degree of certainty for broadcasters that their primary windows are safe from coterminous competition from other platforms. There remain some areas of concern from the perspective of broadcasters, however. In general terms, broadcasters are keen to ensure an equitable "partnership" with external suppliers, to ensure that there is a fair distribution of income along an income chain that now includes growing video on demand (catch-up TV, ad-supported "push-VOD"). All the major broadcasters now offer video via their online portals (BBC iplayer, itv.com, 4OD and demand five). The availability of programmes on these services reflects the current compromise between broadcasters and suppliers, with a "catch-up" window clearly delineated and subsequent distribution governed by negotiated agreements.

The non-broadcast distribution business remains very small in relation to traditional television, and hoped-for revenue models such as subscription VOD and pay-per-view have yet to gain any traction. As a result, TV content has been distributed on an ad-supported basis by commercial broadcasters, typically with adverts running prior to a streamed or downloaded programme online. This, at least initially, is intended to be the business model of the Kangaroo portal. Future models are unclear; in particular, will independent producers be able to create a direct distribution model on a revenue-enhancing basis (via alternative platforms such as broadband, IPTV, mobile delivery, etc.)?

One result of the early experiences under the revised Terms of Trade appears to be greater willingness on the part of both independents and broadcasters to work together to ensure that the value of ancillary rights is maximised and the upside shared equitably. Old debates about how the value should be divvied up in advance have been replaced with co-operative efforts to "grow the size of the pie."

The developments in new media have also strengthened the argument for better independent distribution of content in the UK. In the past, when broadcasters dominated the value chain (and tended to benefit disproportionately from secondary and tertiary market exploitation of programme rights), independents were unlikely to be able to tap significant revenues beyond the commission or re-commission income. This changed through the growth of the DVD market, where independents with rights to popular programmes have increased their market share. However, the UK TV DVD market is still dominated by broadcasters, whose distribution arms (in particular BBC Worldwide and ITV) continue to represent independents in the non-broadcast distribution of programming content.

With more distribution options, and a greater clarity over rights windows, this is already changing and the change is set to accelerate. However until very recently, there were few options for distribution of rights beyond the integrated broadcaster operations (BBC Worldwide, ITV, C4i), where independents long felt their product was not being exploited efficiently, if at all.

There are now some significant distribution players outside the mainstream broadcasters. RDF, IMG, All3Media and Shed have all prioritised distribution, not only for their own product but for third parties wary of dealing with the big, integrated distributors. While smaller indies remain somewhat suspicious even of these independent distribution arms (as they fear their product will be sold less aggressively than content produced by the super indie owner), the barriers are coming down. Further consolidation of the independent sector looks likely, moreover, as the amount of independent production requiring market distribution overseas and on multiple platforms is growing. Digital Rights Group, a distributor owned by Ingenious Media, which operates a fund to invest in media, particularly content, has recently bought C4i, the distribution business sold by Channel 4. This followed the acquisition of Portman Films and Television and ID Distribution, both of which are backed by Ingenious.

Summary of UK PSB Terms of Trade

New terms of trade between the PSBs and independent broadcasters (negotiated by industry body PACT) were implemented in January 2004.

These enshrined the principle that in commissioning an independent to produce a programme, the broadcaster took no ownership over the programme produced. Instead, the commission amounted to the purchase of a licence; a package of *primary rights*, typically lasting five years, which allowed for a certain number of broadcasts, and specified costs for extra repeats, during the licence period.

All other rights, including distribution rights, remained with the producer, and all rights reverted to the producer at the end of the licence term.

The terms agreed at this point did not explicitly deal with new media rights, and in 2004, the PSBs entered into further negotiations that resulted in amended terms of trade, covering all media, finalised in 2006. Though each broadcaster conducted separate negotiations, and achieved slightly different terms, the principles governing each agreement were roughly as follows:

Inclusive VOD window:

The primary rights now include the right to distribute the programme on a VOD (video-on-demand) basis, either free or paid for, for a period of time following initial broadcast (30 days for Channel 4, Five and ITV, 7 days for the BBC). For Channel 4 and Five, these rights are available on a "use or lose" basis. All the commercial broadcasters have the right to impose a subsequent 5-month blackout on rights exploitation, after which the rights can be exploited by both producer and broadcaster, subject to agreed revenue-sharing.

Series are subject to "series stacking", which means the broadcaster can continue to offer episodes on a VOD basis while the series is still being broadcast, subject, again, to some variation by broadcaster (e.g. the BBC cannot "stack" more than 13 weeks' episodes of a series at any one time).

More flexibility with so-called "hold-backs":

Under certain conditions, the producer is able to licence programmes to the UK secondary distribution market (i.e. on other UK channels) within the primary rights window (but from 6 months after initial broadcast).

Revenue share:

Producers are entitled to receive payment for the inclusion of their content in a broadcaster's VOD service. For SVOD (subscription VOD) and free VOD services, the producers share a "pot" of money according to the content that is included in the VOD offering. For revenues that are shared directly with the broadcaster, for paid-for VOD, producers split the revenues generated with the broadcaster, with shares varying by broadcaster.

In addition, the commissioning PSB is entitled to a similar share of revenues generated by secondary broadcast distribution during the primary rights window.

Download-to-own (DTO)

Producers own DTO rights outright. This enables them to distribute their programmes on a DTO basis within a short period after initial broadcast (between 8-30 days for single programmes, longer for series, depending on the broadcaster).

External funding and market consolidation

- *A listing puts pressure on the top and bottom lines and doesn't encourage a risk-taking culture.* Corporate development executive, super indie

The increasing importance of external shareholders and funders in the independent sector has been both a reaction and a contributor to the changing characteristics of the industry. Encouraged by the increasing value of "content" in an era of fragmentation and consumer promiscuity, investors (both through public listings and private equity) have backed a range of independent producers. This, in turn, has created a far more professional and efficient ethos, upon which broadcasters have grown to depend. The first wave of consolidation following the Communications Act appears to be over, and the recent decline in share prices of quoted companies and indeed moves by some to exit the public markets suggests the City is taking a breather. However, there are several sizeable middle ranking companies reportedly up for sale, and there is likely to be appetite for another wave, when credit markets begin to improve.

The increasing dominance of the top tier is perhaps the major theme of the sector in the past 10 years. These companies are all, in some way, now influenced by the presence on their shareholder registers of external parties – private equity, media companies or institutional investors. They no longer operate in the "cottage industry" of independent production, nor are they the "lifestyle" companies identified by John Harvey-Jones in 1993.

In this section, we look specifically at the changes for these externally funded companies, and how they have evolved. To a large degree, these top-tier players set the agenda for the sector as a whole: they show how real businesses can be made out of supplying TV programmes, how independent producers can earn personal wealth, how to respond to technological changes and new media developments, and how to answer to outside shareholders.

The externally funded independent sector sub-set exhibits a number of characteristics that differentiate it from the "middle bulge" and "tail". Quoted companies in this sector are judged by news flow and semi-annual financial performance, and the share price is a reflection of these judgements on an on-going basis. Two examples make the point eloquently: both RDF and Shed have seen their share prices depressed through adverse newsflow, RDF as a result of "Crowngate"; Shed through the loss of two commissions, despite having offset this through replacement commissions. Companies without a listing, but which answer to private equity owners or controlling shareholders, equally find that they must justify operating performance on a regular basis.

As a result, repeatable and transparent income streams may be more important to these companies than other measures of success. The consequence is that the bigger companies are increasingly reliant on handful of programmes and formats, and these remain a focus of attention in terms of programme development.

M&A activity

Since the publication of the Mediatique report in 2005, there has been significant mergers & acquisition activity in the UK independent sector. The largest single deal affecting the UK market was the purchase by original founder Jan de Mol of Endemol from previous owners Telefonica for €3.5bn, with the financial support of Goldman Sachs. Within the UK-based sector, largest transaction was the £490m acquisition by private equity firm Apax of HIT Entertainment, the kids programming, formats and merchandising company that holds the rights to Bob the Builder and Barney. The second most expensive UK transaction, the acquisition of All3Media by Permira for £320m, confirmed the appetite of private equity investors for independent production. Finally, Amaze TV by Dutch independent D&D, was explicitly pitched as the foundation of a super-indie acquisition vehicle, with a "war chest" of £180m to buy other indies. Amaze is the new company set up by Brighter Pictures founder Remy Blumenfield, which was sold to Endemol, while D&D owns format and production companies.

Of the remaining transactions, Shine's purchase of three independents – Kudos, Princess and Firefly - for an aggregated £65m was the most significant. In February 2008 Shine also completed its $200m (£101m) acquisition of US counterpart Reveille, maker of *Ugly Betty* and *American Gladiators*. IMG's acquired Darlow Smithson and Tiger Aspect for a combined consideration of £50m and Shed's purchased (in separate deals) Ricochet and Twenty Twenty for a combined £44m and Wall to Wall for £25m. The other deals of note involved DCD, formerly Digital Classics, an Aim-listed company born in the Internet boom of the late 1990s, and since transformed into an independent production company. DCD owns independents Done and Dusted (set up by former MTV producers), Iambic Productions, Box TV and – as a result of the recent acquisitions – September Films, Prospect Pictures and West Park. It also continues to be active in its legacy market of classic music video distribution, through Nbd TV and Digital Classics.

A complicating factor has been the entry into the independent sector in recent months of both the BBC and ITV, and the purchase in summer 2008 of Carnival by NBC Universal, marking a potential trend toward the further integration of broadcasters and independents.

Detailed information on recent transactions in the independent production sector is set out in the following table, including a comparison of valuation metrics.

Selected transactions in the independent production sector (2005-08)

Date	Company	Acquiror	Consideration (£m)	Sales (£m)	EBITDA (£m)	EV/Sales (x)	EV/EBITDA (x)	Notes:
Dec-04	MPC	Thomson	52.7	49.1	5.6	1.1	9.4	1
Jun-05	Mersey Television	All3Media	35.0	32.5	-	1.1	NA	2
Nov-05	Richochet	Shed	25.0	15.3	2.1	1.6	11.9	3
Dec-05	IWC	RDF	8.4	17.6	0.7	0.5	12.1	4
Apr-06	Presentable	RDF	5.2	2.4	0.4	2.2	13.1	5
Apr-06	Darlow Smithson	IMG Media	20.0	20.0	-	1.0	NA	6
Apr-06	Tiger Aspect	IMG Media	30.0	44.2	1.5	0.7	20.2	7
Aug-06	Foundation TV	RDF	7.6	5.0	1.1	1.5	6.9	8

Selected transactions in the independent production sector (2005-08)

Date	Company	Acquiror	Consideration (£m)	Sales (£m)	EBITDA (£m)	EV/Sales (x)	EV/EBITDA (x)	*Notes:*
Aug-06	The Comedy Unit	RDF	6.5	5.4	0.8	1.2	8.4	*9*
Oct-06	Diverse	Zodiak	8.0	13.1	-	0.6	NA	*10*
Dec-06	Firefly	Shine	10.0	4.7	-	2.1	NA	*11*
Dec-06	Princess	Shine	20.0	18.0	-	1.1	NA	*12*
Dec-06	Kudos	Shine	35.0	32.0	-	1.1	NA	*13*
Feb-07	The Mill	Carlyle Group	59.0	40.1	6.6	1.5	9.0	*14*
Jun-07	Maverick	All3Media	20.0	8.0	-	2.5	NA	*15*
Jul-07	West Park Pictures	DCD	3.0	1.1	-	2.7	NA	*16*
Jul-07	Prospect Pictures	DCD	7.1	7.5	1.2	0.9	5.7	*17*
Jul-07	September Holdings	DCD	9.1	7.3	0.7	1.2	12.8	*18*
Aug-07	Objective	All3Media	45.0	23.0	-	2.0	NA	*19*
Sep-07	Twenty Twenty	Shed	19.0	9.4	2.0	2.0	9.5	*20*
Nov-07	Wall to Wall	Shed	25.0	19.5	2.0	1.3	12.5	*21*
Dec-07	12 Yard	ITV plc	35.0	11.5	2.4	3.0	14.6	*22*
May-08	Tinopolis	MBO	44.7	66.0	3.6	0.7	12.4	*23*
Jun-08	2Waytraffic	Sony Pictures	114.3	-	22.3	NA	5.1	*24*
Aug-08	Carnival	NBC Universal	30.0	21.5	-	1.4	NA	*25*
					Average	**1.5x**	**10.9x**	

Notes (including detailed information on information sources)

1 Company accounts and press release
2 Addleshaw Goddard press release June 2005
3 Regulatory News Service November 2005
4 Regulatory News Service December 2005
5 Brand Republic, 4 April 2006; Broadcast 7 April 2006
6 Broadcast, 13 April 2006
7 Hollywood Reporter, 6 June 2006
8 RDF website; The Independent, 4 August 2006; Hollywood Reporter 4 August 2006
9 RDF website, The Western Mail 1 September 2006
10 Broadcast, 28 August 2006
11 Broadcast, 14 December 2006
12 Broadcast, 14 December 2006
13 Broadcast, 14 December 2006
14 Company accounts and press release
15 All3Media website; Broadcast, 21 June 2007;The Sun, 22 June 2007
16 Regulatory News Service 1 October 2007; DCD Media Plc shareholder circular
17 Regulatory News Service 1 October 2007; DCD Media Plc shareholder circular
18 Regulatory News Service 1 October 2007; DCD Media Plc shareholder circular
19 All3Media website; Broadcast 16 August 2007
20 Regulatory News Service September 2007
21 Shed Media press release, 29 November 2007
22 ITV press release, 5 December 2007; Broadcast, 4 December 2007
23 Broadcast, 9 May 2008
24 FT.com, 4 June 2008
25 C21 media, 20 August 2008

The average EBITDA multiple for acquisitions in the 2005-2008 period is lower at 10.9x than the average between 2000-2004, which Mediatique calculated as 13.7x. Sales multiples are slightly higher, at 1.5x compared to 1.3x in that period. This indicates that while there has been a general, if modest, improvement in margins, deals have been more keenly priced in recent years.[7]

Listed companies

The quoted sector has had mixed fortunes in the period 2005-08, for both market-general and company-specific reasons. In general terms, the stock market, in particular AIM, has under-performed, fuelled since the summer of 2007 by pressures related to the troubled credit markets in the US. The sub-sector of independent companies, which remains relatively small, has seen volatile conditions, driven by newsflow, particularly for RDF and Shed.

For RDF, the controversy surrounding the trailer for its programme on the Queen's photo shoot led to the departure of senior executive Stephen Lambert and a moratorium on all commissions by the BBC and ITV. "Crowngate" cast a long shadow; in January 2008, the company issued a profit warning as commissions continued to lag expectations, and pre-tax profits fell to £2.0m for 2007 compared to £6.2m for the previous year. The result of these pressures has been the decision by RDF management to seek to take the company private, retreating from the glare of public ownership.

Shed, likewise, has suffered, owing in large part to its loss of two key commissions – *Footballers' Wives* and *Bad Girls*, despite winning new commissions to replace the losses and the acquisition of Twenty Twenty Productions in September 2007 and Wall to Wall in early 2008.

Despite these conditions, Boomerang, the Welsh independent came to the market in November 2007, and raised £3m in new equity on a multiple of 1.33x 2006/7 turnover.

With the planned departure of RDF from the public market, and the privatisation of Tinopolis, the publicly quoted sector has been much reduced. In current market conditions, it is unlikely that independents will regain favour, despite relatively positive developments surrounding their rights position and the continuing value of content even as audiences fragment and non-linear TV gains early traction.

[7] Note that multiples normally relate to trailing year income, which does not fully capture superior growth. In addition, profit margins are often minimised to minimise tax and maximised in the lead up to corporate transactions to maximise headline figures.

6. The future evolution of the independent production sector

- *We have to keep a strong independent sector. We don't want to go down the road of the US, where the big studios dominate, but the people on the ground are salaried and not entrepreneurial. There is a good reason why US networks come to Britain for ideas. We are more entrepreneurial, and real programme makers are still active.* Chief executive, listed independent company

Based on the trends analysed in the first part of this report, a number of predictions might be made about how the sector is likely to evolve in the future.

In sum, the trends identified in this report point to the likelihood of further consolidation, increased reliance on formats and long-run programmes, greater reliance by broadcasters on key suppliers, and a bifurcation in terms of genre between larger companies concentrating on higher margin drama, event and comedy programmes and smaller companies subsisting on factual and factual entertainment.

The underlying structural changes that have an impact on the independent production sector are unlikely to dissipate in the medium term: multi-channel penetration continues to be driven by a combination of the roll-out of Freeview and Freesat in advance of the planned switch off of the analogue signal by 2012; meanwhile, pay-TV operators, and in particular Sky, continue to market aggressively in a bid to win new customers.

One effect of the increased digital penetration is to support an increase in the programming budgets of multi-channels, including those launched and nurtured by the leading Public Service Broadcasters. These are the channels whose programming budgets are on the increase, unlike those of the core broadcasters, where budgets are under threat owning to a range of factors (modest advertising revenue growth since 2004, following several years of "super inflation," the lower-than-expected licence fee settlement for the BBC, leading to cost cutting, particularly in news and factual, lingering doubts over the funding arrangements of Channel 4, which are still under review, and ITV's aim to reduce its reliance on external suppliers in order to derive greater value from in-house production).

At the same time, the BBC has promised greater spending on external suppliers, under the WOCC. While this initiative is likely to have a greater impact on the BBC's factual and factual entertainment output, which is normally delivered at lower margins, this is where the independent sector as a whole is relatively strong, and in revenue terms at least the sector should be a significant net beneficiary of the WOCC.

The increased pre-occupation of the independent sector, and in particular the top companies, with new media opportunities is set to continue, bolstered by enabling regulatory intervention on rights and windows. From the very low levels of 2005, new media revenues for independent companies grew by *75*% (from the admittedly low level of £24m) to £42m in 2006, moderating slightly to £39m in 2007.

These trends are likely to lead to increased friction between UK commissioning broadcasters and independent production companies. Under the "old" model, broadcasters were prepared to pay the full cost of production (with a production fee) as they could be assured of getting the full value of the commission (either through the primary window alone, or through sharing in secondary and tertiary market sales). The new terms include a narrow definition of the primary licence period, hold back rights and some agreed windows (between 7 and 30 days) during which commissioning broadcasters can offer so-called "catch-up" services. Thereafter, indies are able to exploit their rights on new media platforms such as mobile TV, broadband (VOD) – although usually with a percentage share going to the commissioning broadcaster.

While it is still too early to say how big these non-traditional markets might become, there is already some tension between the major broadcasters and indies over the true implications of the new window definitions. Broadcasters argue that the value of windows following the initial transmission is only realisable owing to the original broadcaster's support (in terms of brand, marketing and distribution to a mass audience). They fear that distribution too close to the original window will erode the value of the initial transmission. Why, they argue, should broadcasters pay the full costs of making a programme only to lose the benefits through aggressive selling by indies of the content in adjacent, sometimes coterminous, markets? PACT is already reporting a rise in the number of commissions (particularly involving bigger indies) that are agreed at a lower than production cost, with the supplier having to finance the "gap".

"Gap" or "deficit" funding has long been a feature of the UK commissioning landscape, but (with very few exceptions) only for those very big and well-funded groups able either to expense the shortfall through internal resources or able to secure financing from third parties. The overwhelming majority of commissions involved the payment by broadcasters of 100% of production budgets – even if broadcasters sometimes offset this by arranging joint-production agreements with, for example, US or Australian partners. This may well change, as broadcasters seek to reduce their commitment to new programming in line with the value being "transferred" to independents in adjacent exploitation windows. And increasingly, indies themselves – at the least the top-tier players – have the relationships and access to finance to secure such joint ventures themselves, thereby cementing their control over ancillary rights.

If deficit funding continues to develop, this is likely to strengthen the hand of those independents able to secure the gap – largely the bigger players. Smaller players may end up continuing to sell their non-first run rights to the very broadcasters that commissioned programmes in the first place. This is one of many trends that are likely to underpin and bolster the tripartite nature of the industry.

In the interim, broadcasters are seeking a more equitable share of new media markets, working in partnership with the independent sector. They are marshalling arguments to show that a co-operative approach on rights exploitation will create a "bigger pie" to be divided on a fair basis between the commissioning broadcasters and the ultimate rights owner. Many independents are responding with suggestions that broadcasters will have to consider sharing their advertising revenues in the new media space, as the business models appear to be leaning toward an ad-funded model rather than subscription or pay-per-view. This may become less controversial if advertising-funded programming (AFP) gains further traction, as the income may be more transparent and capable of being shared. Broadcasters have been traditionally extremely protective of their airtime sales income, arguing that this is "their" market, and cannot be part of any revenue share.

A significant effect of the evolving rights landscape in UK production is the growing importance of distribution. Traditionally, this has been dominated by arms of the core broadcasters (the BBC, ITV and, more recently, Channel 4). Today, many independents have large and growing distribution arms – not only for their own product but for third parties. All3Media, RDF and Shed Media have all recently strengthened their distribution businesses, and Ingenious Media, through its development fund, appears to be targeting the market aggressively, having bought C4's international distribution arm.

These integrated businesses are not always trusted by medium-sized and smaller indies, as they fear their product will not be as assiduously marketed as that of the controlling independent.

These various trends – related to programming budgets, new media rights and distribution – are all likely to accelerate the professionalisation of the independent production sector, certainly at the top tier. The requirement to fund budget deficits, the need to emphasise multiple revenue streams and the reliance on distribution pipelines will continue to pre-occupy indie management. These pressures will be all the more apparent for those companies with significant external shareholdings or with a stock market listing. The need to meet annual, even quarterly, earnings targets has already encouraged some independents to focus more on longer runs, repeatable programming strands and content that has the potential to be exploited via other distribution platforms.

One avenue that may be pursued by independents (and, indeed, is already being tested in a small way by some) is a direct distribution model for programming (for online commissioners, content aggregators and even dedicated "channels" for independent UK productions).

These pressures have encouraged a "dash for growth" by some independents, whose backers appear to believe that underlying economic trends – new media revenue growth, pressures on the audience performance of mass market broadcasters, improving profit margins for larger indies able both to create and distribute programmes – will favour size.

IMG and All3Media have already pushed through the £200m revenue line, and Endemol UK is not far behind. These three already account for more than a quarter of the sector's total revenues, and all three are seeking more and more diversification of revenue sources – online and overseas.

This is likely to underpin yet further consolidation of ownership, with the top ten companies becoming ever more dominant. There are several ways this is likely to occur.

The rapid consolidation that typified the period 2003-2007 is seen by many as having been only the first phase of the current wave of mergers and acquisitions. There is still scope for consolidation involving the middle bulge – those independents with revenues of between £10m and £50m. A number of companies, supported by external shareholders, are apparently still in the market for bolt-on acquisitions, despite their already significant size: RDF, Shine, All3Media, IMG and D&D are all in this category.

Another source of deepening concentration relates to the "incubation" of small companies by larger ones. D&D's purchase of start-up venture Amaze TV is one example of this, as is the minority stake taken by RDF in small documentary producer Blast Films. In essence, some larger independents are setting themselves up as "talent magnets" in addition to their role as more traditional consolidators, buying significantly sized companies.

Finally, broadcasters themselves are looking anew at the independent sector, despite the fact that any outright acquisition will render the acquired company ineligible for indie status under the legislation. ITV Productions has already bought 12 Yard Productions, and has a fund of £200m earmarked for similar acquisitions. The BBC, via its commercial arm, BBC Worldwide, has also been active in the market. The BBC has to date appeared to seek a maximum of 25% direct shareholding, to ensure that acquired companies remain "independent" in terms of the quota.

Finally, the acquisition by NBC Universal of Carnival may presage greater interest by non-UK broadcasters in the UK independent sector.

These trends will not necessarily alter the economics at the tail-end of the sector, where small companies reliant on 1-3 commissions a year continue to exist and – on some measures - even thrive. Indeed, the very low barriers to entry – talent with a computer and a fax machine can set up an independent production company – suggests that the sector will continue to replenish itself at the tail.

The real pressures are likely to fall on the "middle bulge" of companies, with revenues of between £10m and £50m, significant overheads and reliance on a few talented individuals. It is this segment of the market that is most likely to be subsumed by bigger players – trade or, when market conditions improve, private equity - or to retrench and/or fail. Much of this is driven by fear of failure and by the attractiveness of a bigger group to provide protection against market forces. Very small independents do not need, necessarily, to develop multiple revenue streams; medium sized players do. The very small independent may rely on relationships with just one or two commissioning editors; the middle bulge needs a wider market in which to operate if fixed costs are to be covered. Broadcasters may not always trust a medium sized independent to deliver a complicated and expensive show; being part of a larger group provides greater certainty of execution. Bulking up or selling out are seen by some in the middle bulge as the only options.

The next wave of consolidation, bolstered by growing secondary and new media markets, is likely to accentuate these trends yet further. A clear effect has been, and on current trends will continue to be, an increasing reliance of major broadcasters on a dwindling number of independents. This is not to suggest that a wide range of independents will not continue to win traditional commissions. However, sector wide, the balance of power has clearly shifted, and the economics of the market suggest that this will continue.

What are the longer term prospects for the sector? There are now a significant number of independents owned at least in part by private equity groups, and these will seek an exit from their investments – typically within five years. Exit via a trade sale is still an option: the BBC, ITV (and even US broadcasters such as NBC) are all potential buyers of independents. The quoted sector is currently quite small and getting smaller (and has been struggling in light of market and sector-specific newsflow); an exit by way of a stock market listing for private equity owners remains, however, an obvious route. Much will depend on profitability in the sector. While profits generally are improving, the sector is still struggling as a whole to exceed operating margins of 10% - very low for media investors more used to 20%-plus margins. The listing of RDF and Shed in early 2005 marked what many thought was the beginning of a wider trend, accelerated by positive newsflow such as the new terms of trade and developments in new media. The sub-sector's disappointing performance in the past year – driven in part by company-specific newsflow – has put some investors off, and the overall stock market is likely to remain weak for some time yet.

All the same, the underlying value of content, particularly as media markets fragment further, will not be eroded, even if the distribution models appear fractious. Current stock market malaise will not last forever and the City will again look on content players with interest. The rate of technological change and resultant shifts in consumer behaviour will not moderate anytime soon and an emphasis on core value creation – the creative instinct – will remain. In responding to the shifting focus of their main customers and the implications of consumer demand, the independent sector has grown up.

7. Appendix: Detailed information on top-10 indies

The following table gives an overview of the key statistics, major shows and ownership structures of the top -10 independent production companies (by turnover).

Indie	Sub brand	Turnover (£m)	Pre-tax Profit (£m)	Hours of programming	No. Staff	Key Shows	Ownership
IMG							**Forstmann Little Private Equity**
	Tiger Aspect	76.9	-	310	104	Charlie and Lola, Robin Hood 2, Gangs	
	TWI	116.6	-	2,855	475	European Tour, America's Cup, Premier League	
	Darlow Smithson	20.0	-	77	93	Beckoning Silence, Claham Junction, Situation Critical	
	Tigress	8.2	-	117	16	The One Show, Everest, Shark Island	
		221.7	-				
All3Media							**Permira Private Equity**
	Company Pictures	30.9	-	37	27	Shameless, Wild At Heart, Skins	
	North OneTV	30.0	-	473	75	Formula 1, Premier League All Stars, Fifth Gear	
	Cactus TV	12.5	-	176	9	Richard & Judy, Saturday Kitchen, Galaxy British Book Awards	
	Lion TV	33.4	-	205	100	The Big Day, The Real Cherie, Guarding the Queen	
	Lime Pictures	41.7	-	154	347	Hollyoaks, Grange Hill, Bonkers	
	Bentley Productions	22.1	-	10	5	Midsomer Murders	
	Maverick Productions	8.1	-	46	123	How to Look Good Naked, Embarrassing Illnesses	
	Objective	24.0	-	148	50	Peep Show, The Real Hustle, Star Stories	
	South Pacific Pictures	-	-	-	-	The Man Who Lost His Head, Outraqgeous Fortune	
		202.5	-				
Endemol UK							**Mediaset, John de Mol, Goldman Sachs**
	Cheetah	-	-	-	-	Deal or No Deal, Ready Steady Cook	
	Zeppotron	-	-	-	-	Would I Lie To You?, Nathan Barley,8 Out Of Ten Cats	
	Initial	-	-	-	-	Living With Kimberly Stewart, Comic Relief Does Fame Academy	
	Brighter Pictures	-	-	-	-	Big Brother, Big Brother's Little Brother	
		160.0	-				
Shine							**3i Private Equity, Sony Pictures, News Corp**
	Shine	22.0	1.0	204	45	Celebrity Masterchef, Greatest Britons 2007	
	Firefly	10.0	1.2	36	26	Kill It, Cook It, Eat It, Britain's Deadliest Addictions	
	Kudos	49.0	4.0	45	47	Life on Mars, Spooks, MI High	
	Princess	17.0	-	453	130	The Wright Stuff, Friday Night Project	
		146.0					
Hit Entertainment		**142.7**	58.6	36	345	Barney and Friends, Bob the Builder, Wobblyland	**Apax Private Equity**

Indie	Sub brand	Turnover (£m)	Pre-tax Profit (£m)	Hours of programming	No. Staff	Key Shows	Ownership
Talkback Thames		**140.0**	-	2,855	475	X Factor, The Bill, Britain's Got Talent	**RTL Group**
RDF							**AIM quoted**[8]
	RDF	-	-	-	-	Wife Swap, Holiday Showdown, Faking It	
	IWC	-	-	-	-	Location, Location, Location, Fallen Angel	
	Touchpaper	-	-	-	-	The Queen's Sister, Rocket Man	
	Radar	-	-	-	-	Banzai, Christian O'Connell's Sunday Service	
	Foundation TV	-	-	-	-	Basil Brush, Eureka TV	
	Presentable	-	-	-	-	Late Night Poker Ace, Late Night Poker Masters	
	The Comedy Unit	-	-	-	-	Still Game, The Karen Dunbar Show	
		99.3	7.1				
Shed							**AIM quoted**
	Shed Productions	-	-	-	-	Waterloo Road	
	Ricochet	-	-	-	-	Supernanny USA, It's Me Or The Dog, Extreme Dreams	
	Wall to Wall	-	-	-	-	New Tricks, Who Do You Think You Are?	
	Twenty Twenty	-	-	-	-	The Choir, Evacuation, Family Brat Camp	
		71.8	9.6				
Entertainment Rights		**68.0**	7.9	-	156	Postman Pat, Rupert Bear, Caspar the Friendly Ghost	**LSE listed**
Tinopolis							**AIM quoted**[9]
	Tinopolis	-	-	-	-	Wedi 7, Wedi 3	
	Mentorn	-	-	-	-	30 Minutes, A Very Social Secretary	
	Sunset + Vine	-	-	-	-	Racing from Ascot, Cricket on Five	
	Redback	-	-	-	-	Alice Springs Masters website	
	Folio Productions	-	-	-	-	Armed and Dangerous, ASBO Fever, Car Wars	
	Daybreak Pictures	-	-	-	-	The Trial of Tony Blair, Britz	
	Music Box	-	-	-	-	BPM, Raw Power, Buzz	
		66.0	2.6				

Source: Broadcast, Televisual, brokers estimates, Mediatique estimates
Note: Figures for the most recent reported year have been used. For the quoted companies, brokers' estimates for the current financial year have been used.

[8] Pending private equity backed management buy-out and cancellation of listing.
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