

MEDIATIQUE

From the Cottage to the City: the Evolution of the UK Independent Production Sector

An Independent Report commissioned by the BBC
September 2005

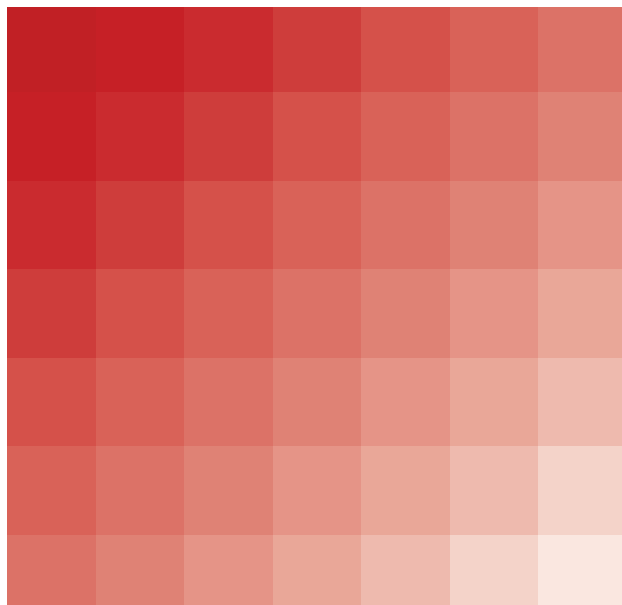


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1. Executive summary

The Independent Production Sector¹ in the UK (the 800 UK-based, non-broadcaster aligned companies that supply original television programming to UK and international broadcasters) has evolved significantly in recent years, and is now poised to enter a more professional and profitable period of development. Since its inception - in essence since the launch of Channel 4 in 1982 - the independent sector has grown from being a pure "cottage" industry of talented creatives, beholden to the main broadcasters, to one in which several leading companies now generate significant revenues and profits and have attracted the renewed interest of the City. The sector is forecast to generate revenues in 2005 of £820m from first-run commissions alone.

In its earliest days, the independent sector was characterised by "one-man bands" of talented programme makers, content to win a few commissions from broadcasters each year, and to cover their expenses. Today, there are seven companies with revenues in excess of £30m, and four significantly sized companies (The Television Corporation, Ten Alps, Shed Productions and RDF Media) with stock market listings². Private equity investors currently back Hat Trick Holdings, Zenith Entertainment, Shine and All3Media (all of them possible contenders for a stock market listing), and at least three non-broadcaster aligned production companies (All3Media, Endemol and HIT Entertainment) are likely to post revenues in excess of £100m in 2005. By 2011, the revenues generated by the sector from first-run commissions in the UK are likely to top £1bn. This does not take into account income generated from ancillary markets (syndication, format rights, mobile, interactive TV, etc.) nor the effects of the BBC's plans to out-source significant additional programming. All this suggests that the sector - certainly at the top end - is entering a period of greater professionalism and commercial stability.

'the sector can no longer be characterised as a cottage industry even if the bulk of independents continue to operate as "lifestyle" businesses.'

In summary, the sector can no longer be characterised as a cottage industry even if the bulk of independents continue to operate as "lifestyle" businesses. Of the forecast £820m expended by UK broadcasters on qualifying independent production in 2005, 30% will be generated by just two companies (Endemol UK and All3Media). Consolidation is likely to continue, moreover, as acquisitive companies such as All3Media buy other production companies and as others seek critical mass through mergers. While there will still be scope for small operators to succeed, merger and acquisition activity is likely to see as many as five companies emerge with revenues of more than £100m within five years.

This broad observation hides the wide range of performance across the independent sector. With 800 companies currently supplying programmes to UK broadcasters, there is a stark segmentation among the very large, integrated and professional independents, the "bulge" in the middle (generating reasonable revenues, and relatively consistent, if low, margins) and the "long tail" of small, talent-based companies surviving on a limited number of commissions. Moreover, this segmentation is set to intensify: the market trends analysed in this report are likely to confirm the split between professional, commercially minded independent companies, and those run as lifestyle businesses. This will have an influence on programmes seen on the screen. The big, integrated companies, supported by City money but required to deliver predictable growth, are likely to produce more homogenised programming in their quest to deliver year-on-year profit progression from multiple revenue streams. They will need, however, to continue to innovate in order to compete, even if the "bulge" in the middle, and the "long tail", may be the more important source of innovation. Perversely, the latter may also be likely to be the source of failure, as companies without critical mass struggle to compete.

How has the independent sector reached this point? The sector today looks radically different from that of the early 1980s. Channel 4 was set up in 1982 explicitly to source all its output from external suppliers. With its limited programme budgets in the early years, this was never going to create the conditions for a vibrant independent sector in and of itself. It was only through a number of subsequent developments that the independent sector moved beyond its "cottage" status.

¹ **Mediatique** uses the term "independent" or "IPC" in this report to classify those companies that qualify for independent status under the relevant legislation. This term excludes those companies that have significant ties to a UK terrestrial broadcaster such as TalkbackTHAMES (Five) and Granada Productions (ITV).

² **Mediatique** has excluded from its analysis listed independent companies with market capitalisations of less than £20m.

First, the number of channels that commission independent programmes has dramatically increased, particularly following the launch of digital television. In the early 1980s, independents had limited options. Only the BBC, ITV and Channel 4 commissioned programmes from the independent market. The BBC and ITV, moreover, depended to a large degree on their own in-house production capabilities. Today, with Five and the host of multi-channel operators (UKTV, Discovery, Flextech, etc.), there are many more buyers of independently sourced original programming.

Second, the regulatory and commercial environment has been altered on three fronts since the early 1980s. First, the introduction of the independent quota in the 1990 Broadcasting Act, under which 25% of qualifying hours of broadcast television must be sourced from qualifying independent companies, provided a huge, exogenous contribution to the sector. The relationship between the commissioning broadcasters

'in order to win commissions, independents routinely gave up their rights to secondary and tertiary markets'

and the independent sector remained unbalanced, however. In order to win commissions, independents routinely gave up their rights to secondary and tertiary markets, and were forced to rely on production fees

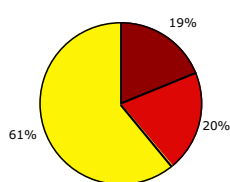
(usually 10-15%) as their sole source of income. This is now changing, with the second reform: the Communications Act (2003), as determined by media regulator Ofcom, outlined new terms of trade between broadcasters and programme suppliers, ensuring that independents will be able to retain ancillary rights, which were previously controlled by the broadcasters, to programmes they make. This is crucial at a time when non-first run revenue sources - multi-channel TV, mobile, merchandising, etc. - are proliferating. The ability to retain rights may well transform their prospects, although the lack of an effective independent distribution network in the UK may yet hinder the smaller companies. Finally, the BBC has outlined its Window of Creative Competition (WOCC). Under this initiative, the public-service broadcaster will make available up to 50% of its original programming budget to outside suppliers, rather than the minimum 25% required to be outsourced to qualifying independents under the relevant legislation.

Third, the City has re-discovered the independent production sector, and, as a result, companies have access to external funding on a scale unknown in previous years. This is important, as under the new terms of trade independents are still likely to require access to significant development capital if they are to maximise returns from their ability to retain and exploit rights. There have been two sources of City funding: private equity and the stock market. While there has been City interest in the sector in the past, the extent of the current "love affair" is unprecedented. This has been driven, in part, by the City's fixation on intellectual property rights (IPR), which are viewed as being the prime source of value in media. The US market is a good reference point: the equivalent "independent" sector there has created many millionaires.

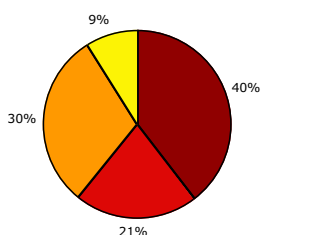
The confluence of these trends suggests that the independent sector will look radically different within a few years. Mediatique predicts a further concentration of the tripartite structure, with up to five "super-indies" (probably listed on the Stock Exchange), a condensed mid-market "bulge" - some of which may well be merged or financed by external investors - and a much reduced "tail" of talent-based independents. Mediatique's base case forecasts expenditure on first-run independent programming of up to £1.2bn by 2010, including the effects of the BBC's WOCC. Sector-wide, more than 10% of all revenues are forecast to come from non-traditional income such as mobile and interactive TV.

Mediatique's projections show the independent production market sector growing from £475m³ in 1993 to as high as £1.5bn in 2014, not counting traditional programme and format sales.

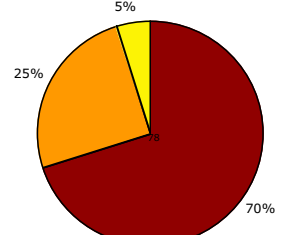
Independent market £475m turnover in 1993
(No. of independents: c. 1,000)



Independent market £780m turnover in 2004
(No. of independents: c. 800)



Independent market £1.5bn turnover in 2014
(No. of independents: <800)



³ Source: Mediatique and Televisual

2. Introduction

Mediatique was commissioned by the BBC to prepare an analysis of the independent production sector, with specific reference to recent changes in legislation and technology and their effect on the financial fortunes of companies active in the programme supply market. The aim was to investigate the way in which the independent sector has developed in recent years, to examine how access to external funding (through private equity and flotation) has transformed the fortunes of leading companies and to predict how this may change further in the future.

In this report, Mediatique reviews the history of the UK independent sector, the role of external funding, the implications of technological and regulatory change and the likely prospects for an industry that, within three to four years, is likely to generate in excess of £1bn in revenues from first-run commissions alone. The prospects for ancillary revenue generation are also explored. It is likely that the revenue streams from first-run commissions will be augmented by new sources of income, and that the split between commissioned and ancillary revenue will change significantly over time. This may have implications for the amount of money broadcasters invest in first run-rights.

Predictions as to the likely shape and size of the industry in the future can be found in the concluding section.

The Appendix contains detailed profiles of a range of leading independent production companies, as well as a detailed analysis of Mediatique's forecasts for the size of the sector over the next decade. The main companies analysed in this report include those summarised in the table below.⁴

UK Turnover Summary Independents	Period	Turnover (UK) £m	Growth vs. prior year	Programming	Notes
UK Turnover					
All3Media Group	year to 31 Aug 04	62.0	n/a	Midsomer Murders	(i)
Company Television	year to 31 Dec 03	20.4	78%	Shameless	(ii)
Lion Television	8 months to 31 Aug 04	10.9	-23%	Days That Shook The World	(iii)
Mersey Television	year to 31 Oct 04	34.6	-3%	Grange Hill, Hollyoaks	(iv)
Complete Communications	year to 30 Sep 04	20.2	-24%	Who Wants To Be A Millionaire?	(v)
Endemol UK	year to 31 Dec 04	93.1	5%	Big Brother	
Hat Trick Holdings	year to 30 Jun 04	19.6	58%	Have I Got News For You	
HIT Entertainment	year to 31 Jul 04	27.1	-2%	Barney, Bob The Builder	(vi)
RDF Media	year to 31 Jan 05	48.2	6%	Wife Swap	(vii)
Shed Productions	year to 31 Aug 04	14.3	5%	Bad Girls, Footballers' Wives	
TalkbackTHAMES	year to 31 Dec 03	121.3	0%	The Bill, X Factor	(viii)
Television Corporation	year to 31 Dec 04	33.9	22%	Question Time	(ix)
Ten Alps Communications	year to 31 Mar 05	31.2	96%	Elusive Peace	(x)
Tiger Aspect	year to 31 Jul 04	35.7	-13%	Murphy's Law	
Zenith Entertainment	year to 31 Jul 04	14.3	-21%	Byker Grove	
Notes	(i)	2004 is All3Media Group's first period of reporting, no prior year comparatives are available			
	(ii)	Acquired by All3Media in Jul 04, 2004 accounts not yet filed at Companies House			
	(iii)	Acquired by All3Media in Oct 04, prior period accounts for 12 months to 31 Dec 03			
	(iv)	Acquired by All3Media in Jun 05			
	(v)	Holding company for Celador Productions			
	(vi)	Includes income from Home Entertainment and Consumer Products			
	(vii)	Total Turnover - UK Turnover not separately disclosed by RDF Media			
	(viii)	Includes revenues from Talkback Productions, Thames Television, Grundy Productions and Regent Productions			
		2004 accounts not due for filing at Companies House until 31 Oct 05			
	(ix)	UK production turnover			
	(x)	Includes all UK revenues generated by group (including advertising agencies and event production)			

⁴ Mediatique has included TalkbackTHAMES in this analysis although it should be noted that, on the basis of the strict definition used throughout this report, the company, while an external supplier of programming to broadcasters, is not an "independent" producer owing to its ties, via its parent company FremantleMedia, to Five owner RTL.

3. History of the independent production sector

The independent production sector in the UK, responsible for a projected £820m of original non-news British programming in 2005, has grown dramatically in size and professionalism since its early days as a cottage (or lifestyle) industry supplying Channel 4, the BBC and ITV.⁵ While the sector is still fragmented, with more than 800 PACT⁶ member companies directly involved in television production and distribution, there are now three non-broadcaster aligned companies that are likely to generate revenues of more than £100m in 2005, and another four with revenues of more than £30m.⁷ Two companies have already floated in 2005 on the Alternative Investment Market (AIM) - RDF Media and Shed Productions - and there are plans for further flotations this year and in 2006. At least four other companies are currently backed by private equity investors,⁸ while consolidation is continuing apace with acquisitions and mergers either announced or pending.

This section examines the history of the sector to date and analyses the key events and characteristics that have driven its evolution into a business that is currently a major focus of interest in the City.

Launch

The independent sector was effectively born in the early 1980s, following the launch of Channel 4 in 1982. The decision taken by Government to ensure that Channel 4 sourced virtually all of its non-acquired programming externally meant that many talented individuals previously employed by the BBC or one of the regional ITV companies left their jobs to establish independent companies to supply the newly created fourth channel.

Prior to the launch of Channel 4, the BBC and ITV produced the vast majority of their television output themselves. This created an institutional bias against outsourcing production, and the potential for independent production outside the broadcasters' studios was severely limited. A significant commercial inequality existed between the duopoly broadcasters and a struggling independent sector. The number of those companies that managed to obtain production commissions was small, and the sector was fragmented and financially insecure.

The publisher-broadcaster model of Channel 4 created an important stimulus to the development of a stronger industry of production companies, independent of the vertically integrated businesses of the BBC and ITV. However, this alone did not provide the basis for a flourishing independent sector, as producers were dependent on a small number of commissioning editors, lacked clout to derive the full value of the rights they created and could not expect any predictable earnings streams. In its first full year, Channel 4 spent c£90m on programming, including acquisitions of Hollywood product (this is now nearly £500m). In Channel 4's financial year to March 1987, a year before the first voluntary independent quota was agreed, Channel 4 bought programmes from 360 independents. Of these, only 13 received revenues of more than £1m, and 239, or 66%, made just one programme for Channel 4 that year. A similar percentage (67%) received less than £100,000 each in revenues from Channel 4.⁹

⁵ In this paper, the term independent production company includes all those suppliers that meet the qualification under the relevant legislation. While we discuss other external suppliers (for example TalkbackTHAMES, part of Five's shareholder RTL), the term "independent" refers only to those whose programming qualifies for the independent quota.

⁶ Producers Alliance for Cinema and Television.

⁷ Note that the revenues of each individual company are the aggregation of all revenues and not just those from primary commissions. HIT Entertainment, Endemol, TalkbackTHAMES and All3Media will top £100m each in revenues in 2005, but note that TalkbackTHAMES does not qualify as "independent" due to the ownership interests of its parent, RTL, in the UK terrestrial broadcaster Five. HIT is fundamentally a rights exploitation company, earning significant revenues from ancillary sources such as merchandising and DVDs. In the year to 31 Jul 04, 82% of HIT's revenues were generated outside the UK.

⁸ All3Media, Hat Trick, Shine and Zenith Entertainment.

⁹ Note that Channel 4's annual report no longer provides as detailed a breakdown.

Channel 4 Data (year end)	31 Mar 86	31 Mar 87	31 Dec 03	31 Dec 04
No of Independents providing programming analysed by amount paid by C4				
<£100k	236	242	n/a	n/a
£100-250k	44	56	n/a	n/a
£250-500k	29	34	n/a	n/a
£500-1,000k	15	15	n/a	n/a
£1,000k+	8	13	n/a	n/a
Total	332	360	312	305
No of commissions awarded by Channel 4 by production company				
1 commission	206	239	n/a	n/a
2-5 commissions	106	106	n/a	n/a
6-10 commissions	16	13	n/a	n/a
11+ commissions	4	2	n/a	n/a
Total	332	360	n/a	n/a
Commissions from Independents £m			238.6	271.6
% of output from qualifying independents			63%	85%

Channel 4 Analysis of spend with Independent Producers

Source: Channel 4 annual reports

With the BBC and ITV spending very little on independent programmes at this time, these figures underline the degree to which the sector was fragmented and insecurely funded.

Take-off

In 1990, the lobby group PACT, representing the independent production sector, succeeded in enshrining in that year's Broadcasting Act the independent production quota.¹⁰ This effectively ensured that 25% by volume of all non-news commissioned programming was sourced via independents, defined as any programme maker without significant ties to a broadcaster.¹¹

This led to a dramatic increase in the number of IPCs operating in the UK. Barriers to entry were (and continue to be) extremely low: this meant that virtually anyone with a phone and a PC could set up a production company. The result was a proliferation of a vast number of small companies, and the sector continued to be highly fragmented. By 1993, ten years after the launch of Channel 4, there were more than 1,000 IPCs in the UK. This number has actually decreased since then to c800, as companies retired from the sector or were subsumed through consolidation.

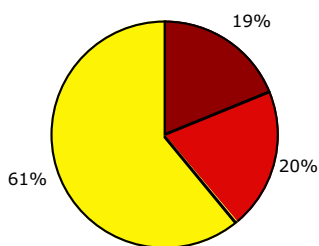
Over the course of the 1990s, the industry took on the shape that it retains today: characterised by a small number of high-revenue players (totalling no more than 15), a large "bulge" in the mid market, and a very long tail of small, highly targeted companies with minimal revenues. The charts on page 8, based on data from Televisual and Mediatique, summarise this.¹²

¹⁰ A voluntary quota was in place from 1988.

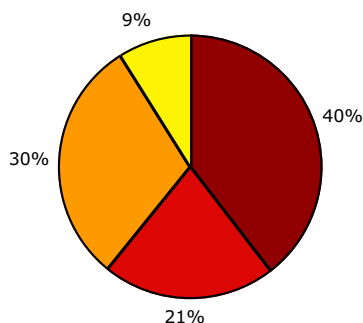
¹¹ "The Broadcasting Act 1990 (Sections 16(2)(h) and 25(2)(f)) requires all Channel 3 licensees, Channel 4 and Channel 5 to ensure that in each year not less than 25% of the total amount of time allocated to the broadcasting of qualifying programmes is allocated to a range and diversity of independent productions." - Independent Television Commission, ITC Notes.

¹² As throughout this report, unless otherwise stated, the independent sector revenues relate to income from commissions, and exclude programme, format and merchandising sales.

Independent market £475m turnover in 1993
(No. of independents: c. 1,000)



Independent market £780m turnover in 2004
(No. of independents: c. 800)



■ Players > £5m turnover ■ The Middle Group ■ The Tail

■ Top 5 Players ■ Next 10 Players ■ The Middle Group ■ The Tail

Notable for their absence today are some of the pioneers of the independent sector, including Cinema Verity and Uden Associates, whilst many others such as Mentorn, SelectTV and Chrysalis have been subsumed in successive waves of consolidation.

As the market developed, more and more talent was nurtured within the independent sector itself, and the number of staff at independents that came from a BBC or ITV background was reduced.¹³ The industry has been largely self-sustaining for some years now, not only developing its own producing and directing talent, but increasingly responsible for creating major, on-screen talent, particularly in the area of entertainment. The contribution today of the independent sector to the culture and ecology of UK television is on a par with that of the major broadcasters.

Failure to thrive

While the sector burgeoned in size, it did not thrive financially overall. Structural characteristics - primarily its fragmentation and dependence on its powerful broadcaster paymasters - made it fundamentally weak from a business point of view.

'The commissioning broadcaster was, in effect, the "gate-keeper" in the relationship... leaving most independent companies with a production fee and no further residual income'

For most of the sector's history, domination of the market by relatively few players (the BBC, ITV, Channel 4 and - from 1989 - multi-channel television and - from 1997 - Five) meant that the relationship between an IPC and a

broadcaster was slanted in favour of the latter. The commissioning broadcaster was, in effect, the "gate-keeper" in the relationship, able to impose onerous terms on suppliers, leaving most independent companies with a production fee and no further residual income. At the same time, of course, the broadcasters were fully financing the cost of the programmes they commissioned and in many cases had financed the development of the programmes as well. This left the broadcasters in control of the residual rights to the programmes, and, while many IPCs agreed so-called "back-end" revenue splits, in reality very little income found its way back to the external creators.

The business model for independents in the UK was essentially a "cost plus" production fee and only limited (if any) residual income from further exploitation of rights. Undoubtedly, good programming resulted under these arrangements, and winning one or two commissions a year was enough to finance many a lifestyle business. However, growth in margins beyond the production fee was difficult for management to achieve.

The production fee was set, nominally, at 15%, against which the operating costs of the production were offset. In reality, the fee could range anywhere from 4% to 15% depending on the programme genre and

¹³ However, downsizing at the BBC, in part a reflection of the introduction of the WOCC, is likely to create a renewed flow of talent to the independent sector.

the scale of the production. Additionally, it was not unknown for independents to cede a portion of their fee as part of the budget negotiations with the broadcasters in order to secure a commission. Thus the actual margins in the sector tended to be between 5% and 10% - i.e., far lower than might be normally expected for rights creators. Further, as private businesses, those that were profitable tended to operate in the most tax efficient manner possible, and re-charged to their businesses the fullest extent of the expenses allowed by the Inland Revenue, rendering their reported margins even lower.

The result of these structural weaknesses was evidenced in the independent sector's financial performance. In 2003, when first-run expenditure on the independent sector was c£750m,¹⁴ the profits generated were about £45m, implying an average margin of just 6%. This is extremely low compared to the margins generated by content creators in most other countries and market segments.

The average margin masks a considerable range of profitability in the sector. For example, Hat Trick generated operating profits of £1.6m in the year ended 31 Aug 04, on revenues of £22.4m, for an operating margin of 7.3%. Shed Productions posted margins of more than 10% the year to 30 Jun 04. At the other end of the scale, Tiger Aspect had operating profits of £0.9m on revenues of £39.9m, or a margin of just 2.3% in the year ended 31 Jul 04.¹⁵

There were a few other exceptions to the general rule. Companies such as RDF Media, funded by external investors, managed to develop and own various secondary and tertiary rights, particularly in the area of formats, to programmes such as *Wife Swap* and *Faking It*. Similarly, Celador Productions retained overseas rights to the highly popular *Who Wants to Be a Millionaire?*. Thus these companies managed to lessen their dependence on first-run commission income. Companies with links to creative talent – for instance Talkback Productions, the company owned by on-screen talent Mel Smith and Griff Rhys Jones – have also often managed to leverage better terms from broadcasters.

But, apart from these examples, the crucial lack of transparency in earnings and the difficulty associated with securing funding for rights retention meant that very few independents could rise through the ranks.

First time around for corporate finance in the independent sector

Early on, those independents who looked to the US market, where the value of the secondary (“syndication”) rights had made millionaires of many producers, sought to retain those rights in their negotiations with the UK broadcasters.¹⁶ They soon realised that, like their US counterparts, they would need, at the very least, to fund the early stages of project development in order to approach the broadcasters with any leverage. Thus they needed to secure outside finance.

However, the wide range of financial performance experienced in the independent sector, and perceptions of poor management skills among creative businesses, traditionally made it difficult for ambitious independents to secure financing from financial institutions. Indeed, the City has had a chequered history of involvement with the sector.

‘The City first fell “in love” with the independent sector in the 1990s. Circle Communications came to the market in 1996’

The City first fell “in love” with the independent sector in the 1990s. Circle Communications came to the market in 1996, linked to the distribution company Primetime. The company managed to raise approximately £7m on a valuation of £20m. Investors were convinced that the growth in multi-channel television, the growing recognition in major markets of the value of rights and the then relatively new independent production quota, would underpin Circle's growth. The company ultimately failed, however, in large part due to the fact that broadcasters continued to dominate the value chain. Circle was sold to the Australian media company Southern Star in May 1997 for a lowly £8.3m.

¹⁴ This does not include revenues derived from other sources, such as programme sales, DVDs and merchandising.

¹⁵ The practice among some independents has been to pay high directors fees in “good” years. For example in 2002, the directors of Hat Trick were paid nearly £3.8m in fees, a year in which the company posted a loss of £158,000 after tax. Likewise, Tiger Aspect's directors received £946,000 in fees in 2002 and £933,000 in 2003. Not all independents pay significant directors fees, however, and even those that do have had fallow years when little if any money was taken out.

¹⁶ Until 1993, networks in the US were not allowed to have investments in programmes sold to the syndication market. With the abolition of the so-called Financial and Syndication (“Fin-Syn”) rules, all US networks have aggressively entered the production market.

In the late 1980s, the Guardian Media Group expanded in the independent sector, buying Bazal and merging it with its Broadcast Communications. This was sold to the ambitious Dutch independent, Endemol, in 1990, and went on to become one of the most successful of the UK - and international - "super-indies". Endemol itself was then acquired by Spanish telecoms company Telefonica, in 2000 - at the height of the Internet boom - at a stratospheric valuation of \$5.3bn. Following the bursting of the Internet bubble, the valuation which Telefonica had placed on Endemol was seen to be vastly over-inflated, and the company's long-term ownership structure has been the source of speculation ever since.

Also in the late 1990s, The Television Corporation, a quoted TV content and services company, built on its Sunset+Vine independent production brand by buying Mentorn Barraclough Carey, makers of Robot Wars and Question Time.

There was considerable activity in the private arena as well. In the late 1990s and early 2000s, amid the excitement generated by the boom, a handful of private equity deals were concluded with independent production companies. Chief among these were 3i's backing of Shine, Sagitta's investment in RDF Media and Kleinwort Capital's investment in Hat Trick. The rationale for these investments was to use these companies as the vehicles from which to build larger entities (either through consolidation, international expansion, or ventures into new areas such as advertiser funded programming) which would eventually be sold or floated, providing a high level of return.

This "mini-run" of interest was effectively stalled after Talkback Productions was sold to Thames Television (now part of RTL) for £62m in June 2000 - a valuation at the top end of any sensible range, and one that put off would-be City investors as expectations had been raised to a level that made any return on investment difficult to achieve. Thereafter, funding sources effectively dried up, as the media recession of 2002-03 took hold - although one deal, a management buy-out of Zenith Entertainment, was effected by Beringea.

Why the City has been cautious about TV production

The £62m Talkback acquisition underlines a common tension in the City, that between the value ascribed by "trade" players to an asset and what a pure financial player might pay. The trade investor, for instance

another production company, can often see greater value in a complementary acquisition than a financial buyer can justify.

'the "creative industries" have often struggled in the glare of a public listing'

More broadly, the "creative industries" have often struggled in the glare of a public listing, as they so often deliver very lumpy financial performances. Like the music and film industries, the timing of key "releases", or broadcasts in the case of television, lies outside the direct control of the company, but can nonetheless have a dramatic effect on profitability within a given reporting period.

In general, the lumpiness of revenues has been hidden behind the private nature of most independents. It is only now, with the existence of a significant number of quoted independents (Ten Alps, The Television Corporation, RDF Media, Shed Productions) that the phasing of revenues (up and down) will be more evident to the public market.

The Television Corporation's (TTC) turbulent history provides a further case in point. TTC's business had been driven largely by programming, led initially by Sunset+Vine's significant sports specialism. The company has been making World Sport for Gillette for more than 20 years, and since the launch of Channel 5 (now Five), in 1997, has produced all of Five's overnight sports programming (baseball and basketball) and its live football.

In 1999, then chief executive Chris Rowlands delivered the acquisition of Mentorn Barraclough Carey, an independent production company with a track record in factual programming. Its best known programmes at the time were Question Time and Robot Wars (the latter in which Mentorn Barraclough Carey also had the format rights outside the UK), as well as high-quality documentaries made by George Carey and his team.

TTC's share price soared during the stock market boom of the late 1990s, when the company was worth, at the peak, £170m. The popularity of Robot Wars was one main reason for the excitement. A foray into speed boat racing, and expansion into sound and video post production in Los Angeles, together with the maturing of the Robot Wars franchise, led to financial problems in 2001-02. Today, the company's market capitalisation is just £27m.

Equally, Celador's experience with Who Wants to Be a Millionaire? shows how difficult it is to manage expectations in the public market. At the time of the programme's debut in 1999, Celador was owned 49% by Avesco, a listed audio-visual equipment and services company. On the back of Millionaire?, Celador became one of the first independents to successfully crack the US market, as well as most of the other major overseas markets. Earnings soared, and as the Millionaire phenomenon took hold in 1999, the City began, routinely, to expect ever higher contributions to Avesco from its stake in Celador. When the format began to tire, in 2001/02, the share price of Avesco was hit hard, suffering a drop of more than 90%.

The resurgence of City interest

All the same, the City seems again to be taking the independent sector seriously. The flotations of RDF Media and Shed Productions took place in the first half of 2005, and were both highly successful in raising funds. All3Media, backed by Bridgepoint, went on a buying spree, snapping up Lion, Company and Mersey TV. Why is the City again in love with independents?

Part of the attraction is clearly the increased professionalism evident in the industry. Taking a lead from the more profitable, foreign-owned production companies such as Endemol, several companies - including RDF Media, Shed Productions and Ten Alps - were set up with the stated aim of providing returns for their shareholders on the back of providing quality, popular programmes for broadcasters. RDF Media secured outside investment from the start, and set out to develop programmes that had a life beyond their initial broadcast, whether in the form of ancillary revenue or overseas format sales.

Shed Productions followed a different route with the same stated objective - profitability. Exiting secure, in-house positions at ITV, the team behind Footballers' Wives and Bad Girls set up Shed and secured a lucrative deal with their previous employer that allowed them to retain control over the rights to their shows, and then set up a production system focused on high volume, returning populist drama, with recourse to fresh, inexpensive, talent, enabling them to realise a better than average margin against the sector.

These and other examples of increased professionalism, together with a number of market trends, have converged to provide an impetus toward better management and financial health throughout the sector. These have had a direct impact on the ability of IPCs to attract the interest of financial backers.

'recent activity has led to the emergence of a credible sub-sector of listed independent production companies'

In the past two years, the sector has been characterised by mergers, investments from private equity firms and by public market-listings. The sector now boasts three qualifying companies with revenues higher than £100m

(HIT Entertainment, All3Media and Endemol), and two companies seemingly intent on reaching the £100m benchmark (RDF Media and Shed Productions) Note that TalkbackTHAMES's revenues also put it into the top ranks, but it does not qualify as an independent. There is the prospect of a fourth or even a fifth £100m-plus revenues company emerging from lower down the list of independents, following expected further mergers and acquisition activity in coming months.

The recent activity has led to the emergence of a credible sub-sector of listed independent production companies, now numbering five of size.¹⁷ Of these, one is a rights company with significant non-committed income - Entertainment Rights. The following table provides a snapshot of the listed sector as at end of August 2005, representing a number of traditional measures of valuation used in the City (enterprise value to sales, enterprise value to earnings before interest, tax, depreciation and amortisation and earnings before interest and tax). The most common valuation basis is share price to earnings (or the P/E ratio).

¹⁷ Mediatique has not included small listed companies with market capitalisations of less than £20m.

Company	Share Price (Local p/c)	EV (£m)	EV/Sales		EV/EBITDA		EV/EBIT		P/E	
			2004	2005	2004	2005	2004	2005	2004	2005
Ten Alps Communications	48	18	0.59x	0.46x	15.82x	7.24x	20.43x	7.15x	28.30x	11.32x
Entertainment Rights	28	131	5.12x	3.90x	19.78x	10.67x	61.38x	18.58x	57.70x	18.46x
TV Corporation	66	27	0.41x	n.a.	9.10x	n.a.	12.80x	n.a.	29.50x	18.58x
Shed Productions	109	55	2.83x	1.89x	14.94x	12.76x	21.04x	11.45x	21.80x	16.12x
RDF Media Group	160	53	1.11x	0.95x	11.14x	19.80x	13.37x	9.99x	39.20x	22.51x
Mean			2.01x	1.80x	14.18x	12.62x	25.80x	11.69x	35.30x	17.40x
Median			1.11x	1.42x	11.94x	11.72x	20.43x	10.52x	29.50x	18.46x
Low			0.41x	0.46x	9.10x	7.24x	12.80x	7.15x	21.80x	11.32x
High			5.12x	3.90x	19.78x	19.80x	61.38x	18.58x	57.70x	22.51x

UK quoted independent production companies

Source: Company accounts, London Stock Exchange, Mediatique estimates and analysis (Data as at 30 August 2005)

In addition, there have been a number of transactions in the sector in the past five years, and in particular since mid 2003, as the media sector began to recover and as funding sources began to consider the implications of regulatory changes arising from the Communications Act.¹⁸ While the valuations achieved in these transactions varied widely, Mediatique calculates that a range of 7-12 times earnings before interest and tax (EBIT) is applied in most cases where companies are in profit, with the higher multiples reserved for companies that out-perform on the measure of operating profit margin. The following table summarises recent transactions in the sector, on various valuation measurements.

Transactions in the Independent Production Sector										
Date	Company	Deal description	Consideration (£m)	% of target acquired	Implied total value (£m)	Enterprise Value (£m)	Sales (£m)	EBITDA (£m)	EV/Sales (x)	EV/EBITDA (x)
Jun-00	Talkback Productions	Acquired by Pearson Television	62.5	100%	62.5	62.5	32.4	3.5	1.9	17.9
Apr-01	RDF Media	Sale to Sagitta Asset Management	3.2	25%	12.8	14.9	19.7	0.9	0.8	17.1
Nov-02	Brook Lapping	Acquired by Ten Alps plc	4.5	100%	4.5	1.6	4.6	0.8	0.3	1.9
Mar-03	Zentix Entertainment	Acquired by MBO team and Beringea	10.0	100%	10.0	10.4	21.8	0	0.5	n/a
Jul-03	Hat Trick	Sale of 45% to Kinwot Capital	23	45%	51.1	47.9	15.3	1.6	3.1	29.9
Jul-03	Chrysalis TV Production	Sale of business to Bidgopoint	43.3	100%	43.3	50.8	87.0	5.2	0.6	9.8
Feb-04	3BM Television	Acquired by Ten Alps plc	1.1	100%	1.1	0.6	2.6	0.1	0.2	7.9
May-04	Bakeaway Production	Acquired by Ten Alps plc	1.0	100%	1.0	0.9	2.2	0	0.4	n/a
Jun-04	Lion TV	Acquired by A13 Media Group	n/a	100%	n/a	n/a	22.0	0	n/a	n/a
Oct-04	Company Pictures	Acquired by A13 Media Group	n/a	100%	n/a	n/a	20.4	0	n/a	n/a
May-05	HIT Entertainment	Acquired by MBO team and Apex	472.3	100%	472.3	575.3	151.7	51.7	3.8	11.1

Recent mergers and acquisitions in the independent production sector

Source: Company accounts, Mediatique analysis

The key reasons for the City's renewed interest relate principally to the regulatory and commercial changes that have occurred in the marketplace. In the following section, these core drivers of growth and profitability are explored in detail.

¹⁸ The regulatory changes are discussed in detail in the next section, 4. The current drivers of change.

4. The current drivers of change

There are five main drivers of change in the independent sector, each of which contributes to the increasing profitability of companies supplying independent programming. These, in turn, have been the cause of the renewed interest of the financial community.

- Rapid take-up of multi-channel services
- The BBC's intention to increase independent commissions (WOCC)
- Overseas programme sales
- New platforms
- Regulatory changes

Rapid take-up of multi-channel services

With the growth of Sky Digital and - in recent years - Freeview, multi-channel television has dramatically improved its reach and viewing, and hence its share of revenues. This, in turn, has fuelled increases in programme expenditure, some of which has been spent with IPCs.

While important to the independent sector, multi-channel television in the UK has developed primarily as a two-tier system that does not involve significant investment in independent production. Premium programming (effectively movies and sport) involved considerable investment in Hollywood product and in sports rights, particularly football. The second tier was dominated by repeats of acquired programming. Unlike in the US, where the market was big enough, and multi-channel penetration high enough to fund the required investment, UK multi-channel has not yet generated any significant amount of original programming. There is no "home-grown HBO".

All the same, multi-channel broadcasters such as UKTV (a joint venture between Telewest and the BBC), Discovery and Flextech have all increased their commissioning budgets, with Flextech-owned Bravo now spending 50% of its (admittedly small) budget on original programming, and this is likely to continue.

WOCC

In 2004 the BBC announced its intention to increase its external programme supply from 25% in volume terms to as high as 50% (the so-called Window of Creative Competition, or WOCC), introduced in the Autumn 2005 commissioning round. This increase in the volume of work for the independent sector will have a dramatic impact on revenue growth over the next few years. We have incorporated this factor in our projections (discussed in Section 5. The future size and

'The WOCC will have a dramatic impact on revenue growth over the next few years'

shape of the UK independent production sector). While the sector overall will benefit, it is difficult to predict the winners, as the process will be competitive (with in-house producers competing for funding against both independent and non-qualifying external suppliers) and will vary as to the genre of programming outsourced by the BBC. In general, however, it appears likely that drama, entertainment and low-end factual will be sourced increasingly from independents, and those companies with a specialism in these areas should see the benefit.

Overseas programme sales

During the last decade, IPCs and other external suppliers have had markedly increased success in delivering overseas programme sales (in particular in the US and continental Europe). UK programme exports have risen by 12.8% year on year between 1998 and 2003.¹⁹ This has been due in large part to the popularity of British formats such as Wife Swap (RDF Media), Who Wants to Be a Millionaire? (Celador) and Survivor (Castaway Productions). However, only the larger and better funded IPCs have been able to retain a significant share of the profits.

¹⁹ Rights of Passage - British Television in the Global Market, Television Research Partnership, February 2005.

New platforms

The growth in new platforms such as broadband, interactive television and mobile, is leading to the development of new business models. It is unclear how consumers will behave as the new services are rolled out. However, creating the right content to drive take-up will be crucial, and IPCs are seen as an important source of this content. According to Broadcast, 35% of IPCs surveyed in early 2005 had produced interactive programming in the previous year, and all companies with revenues of more than £20m annually did so.²⁰

Interactive television (iTV): iTV is now an important and growing sub-sector of broadcasting revenues. Mediatique forecasts that iTV revenues will increase from approximately £580m in 2004 to over £2bn by 2008.²¹ Such an increase is driven by a number of categories within the iTV market, including sports gambling, pay-to-play gaming, voting, competitions and personalised content (including chat, horoscopes and shopping).

Notwithstanding that the lion's share of iTV revenues will continue to accrue to broadcasters, IPCs can gain significantly from the growth in iTV revenues, both as they play a more powerful role in the commissioning process with broadcasters and as they seek to retain the rights to interactive formats.

To date, the iTV market has been dominated by incumbent broadcasters, particularly BSkyB, the BBC, ITV and Channel 4. As a result, the production sector has, until recently, been reliant on iTV commissions from a limited number of broadcasters who have historically relied heavily on tested formats that are most likely to deliver revenues or enhance the viewing experience. As increasing digital penetration continues to fragment the television landscape, existing broadcasters will face stiff competition for market share from new channels and, as an increasing number of broadcasters invest further in iTV, competition for formats is likely to increase.

IPCs have been highly successful in creating and syndicating interactive formats in the UK. Increased competition for such formats is likely to ameliorate the position of IPCs in negotiating to retain the rights to these formats.

Mobile TV: In the face of a maturing market for voice services in the mobile sector, mobile operators are hoping that the launch of 3G services will attract new customers and render existing customers more loyal. The launch of 3G capability offers vastly increased data rates and the improvement - towards broadband levels - of data services. Investec Securities estimate that the market for mobile content was worth approximately £400m in 2004. This is forecast to increase to over £950m by 2007, as content revenues as a proportion of total mobile revenues double from 3% to 6% over the period.

Further, for the first time, operators will be in a position to offer sufficiently high-quality video

'The growth in new platforms...is leading to the development of new business models.'

services to create an attractive TV-to-mobile offering, either in terms of re-transmission of existing linear narrative programming or, more likely, the emergence of bespoke, mobile-

friendly, rich video content. Globally, VisionGain forecast that 270m subscribers are likely to have TV functionality on their mobile phones by 2009.

Such developments present a key opportunity for IPCs to benefit from additional revenue streams. Mobile operators are generally inexperienced in terms of content creation and IPCs have a key role to play in shaping the substance of mobile content. This is particularly true in the mobile-TV market, as the most successful content is likely to be bespoke mobile applications that account for differences in viewing behaviour when watching television on a mobile platform.

²⁰ Indies 2005, Broadcast, 18 March 2005.

²¹ Internal Mediatique research.

Regulatory changes

The traditional "cost-plus" revenue model for IPCs, which was standard for the vast majority of independents, is now set to change, driven largely by the evolution of the regulatory framework that governs the broadcasting industry. The new legislation introduced in the 2003 Communications Act has reformed ownership rules and introduced a new regulatory regime for telecommunications and media through the creation of Ofcom. The introduction of new rules and powers covering the relationship between commissioning broadcasters and independent production companies has provided:

- *Confirmation of the independent production quota, which is to be viewed as a floor, not a ceiling;*
- *Transparent purchase of non-first run rights; broadcasters now pay a licence fee for transmission of the programme, and are required to negotiate separately for further rights. This is enshrined in the terms of trade which each broadcaster has published;*
- *Sanctions: complaints can be taken to Ofcom, when broadcasters misbehave, which has the power to enforce sanctions against them;*
- *Support for production in the Nations and Regions: the 2003 Act requires broadcasters to make a certain proportion (different for each one) of different types of their programmes in a range of centres outside the M25; and*
- *Stronger commitment to training across the sector.*

Ofcom has recently begun its first review of the sector following the introduction of the regulation, and is set to report in April 2006. The review will cover issues including the operation of the commissioning systems of the key broadcasters, the impact of the new codes of practice and terms of trade, and the extent to which the regulation in this area might need to evolve further.

Other factors

There are a number of other factors that have convinced many independents to become more commercially aware:

- *Even without the application of the new terms of trade, commissioning broadcasters had already been seeking to make their budgets go further, and have been more open to licensing only deals for the first-run rights;*
- *Multi-channel television is also growing outside the UK, providing additional outlets for independent output; and*
- *Broadcasters are increasingly dependent on established talent, including independents, to drive ratings, and if independent producers organise themselves carefully, they can leverage better terms from commissioners.*

For all of these reasons (technological, commercial and regulatory), the independent sector is poised for further growth. How big will the sector be in ten years' time, and how will it be structured? We turn to these questions in the next section.

5. The future size and shape of the UK independent production sector

Market size

Mediatique has forecast the sources of revenues for the independent production sector over the next decade, in order to determine the size of the relevant market. A summary of these forecasts is provided here. Further financial detail, as well as detailed assumptions, can be found in Appendix II: Market Forecasts. In particular, Mediatique's assumptions related to the BBC's Window of Creative Competition, the proposed increased out-sourcing of programming to the independent sector, as well as forecasts of ancillary revenues (such as mobile and interactive TV) can also be found there.

Mediatique's starting point for its "size of market" analysis has been forecasts for the digital TV marketplace, as this will help determine the revenues accruing to broadcasters, and the amount they will be able to spend on programming in general. Mediatique assumes that 90% of all homes will be digital by 2009, driven in particular by the continuing out-performance of the Freeview digital terrestrial platform. Multi-channel viewing, and revenue, will rise more sharply on a percentage basis than that generated by the mainstream terrestrial broadcasters. Mediatique forecasts that programming expenditure across all of UK television will grow on average by 4% a year between now and 2014.

'revenues from first-run commissions to the independent sector are forecast to exceed £1bn by 2011'

Total expenditure on programming in 2005, not including expenditure on premium sports and films (such as Sky Movies and Sky Sports), is forecast to reach £4.1bn. Of this, £820m is

expected to be spent on programming secured from the independent sector. In our base case, revenues from first-run commissions to the independent sector are forecast to exceed £1bn by 2011 (not including programme and format sales).

Mediatique has then looked at two further sources of revenue for the sector - the BBC's WOCC and non-traditional revenues.

Under the WOCC, the BBC has pledged to consider outsourcing up to 50% of its non-news original programming from external suppliers (i.e., not just independent companies), compared to the 25% minimum for independents mandated under current legislation and the 30% delivered in 2004. Calculating the effects of the WOCC is relatively complicated, as the amount of programming outsourced will vary from year to year, and the revenues generated for the independent sector will depend on what kind of programming (factual, drama, entertainment) is tendered externally owing to the differential costs of each programme genre.

A detailed analysis of the assumptions underlying Mediatique's forecasts can be found in Appendix II: Market Forecasts. In summary, Mediatique used as the basis of its analysis the BBC's own published figures on the percentage of hours of independent programming, by genre, transmitted in 2004 (supported by recent data published by Ofcom).

Assuming that the overall programme budget increases in line with the base case projections, and that the genre range and prices for out-sourced programming remain the same, the WOCC, at the full 50%, would be worth up to £240m in incremental revenues for the independent sector in 2007, and £320m in 2014.²²

For its base case, Mediatique assumes that 40%, on average, of BBC qualifying expenditure, goes to external suppliers. Up to 100% of this incremental expenditure could go to qualifying independents. The upside is summarised in the table below.

Summary	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Base Case production spend with independents	0.82	0.85	0.89	0.92	0.96	1.00	1.04	1.08	1.12	1.17
WOCC incremental impact (assuming 40% of BBC hrs)		0.11	0.12	0.12	0.13	0.13	0.14	0.14	0.15	0.16
Total Spend with Qualifying Independents	0.82	0.96	1.01	1.04	1.09	1.13	1.18	1.22	1.27	1.33

Mediatique UK independent production sector estimated impact of WOCC

Mediatique analysis

²² See Appendix II: Market Forecasts for a full description of Mediatique's workings on the WOCC.

Currently, most independent production companies earn the lion's share of their revenues from commissions from broadcasters. While a few IPCs have managed to create ancillary revenue streams (Celador's format sales from Millionaire and HIT Entertainment's income from DVDs), these are the exception rather than the rule (and have not been reviewed as part of the current analysis).

However, with the new terms of trade, there is likely to be further growth in non-traditional revenues for the more innovative companies - particularly from new businesses such as mobile and interactive TV. Further details about our assumptions can be found in Appendix II. In summary, if we assume that ancillary revenues account for 12% of the total by 2010 (reflecting the fact that most companies will generate no such income and others will manage the 30% enjoyed by sector leaders in other markets), the incremental revenues would be £120m sector wide by 2010.

In summary, the independent sector could be generating revenues of £1.25bn from commissions and non-traditional revenues by 2010, and £1.47bn by 2014. This is in addition to any revenues generated through programme, format, DVD and other sales.

Summary	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Base Case production spend with independents	0.82	0.85	0.89	0.92	0.96	1.00	1.04	1.08	1.12	1.17
WOCC incremental impact (assuming 40% of BBC hrs)		0.11	0.12	0.12	0.13	0.13	0.14	0.14	0.15	0.16
Ancillary spend			0.02	0.05	0.08	0.12	0.12	0.13	0.13	0.14
Total Spend with Qualifying Independents	0.82	0.96	1.03	1.09	1.17	1.25	1.30	1.35	1.40	1.47

Mediatique UK independent production sector forecasts - consolidated summary

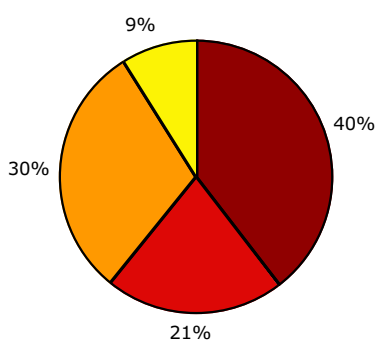
Mediatique analysis

Market shape

With the prospect of such a large market by 2014, how will the sector be structured to deliver on its potential? Mediatique's view is that the independent sector in coming years is likely to be dominated by the bigger players with access to the currency of a stock exchange listing or to external funds from private equity groups. The most likely candidates are Endemol UK (possibly as a separate, listed entity), All3Media (very likely to seek a listing), Shed Productions and RDF Media. These companies are currently best placed to take advantage of the trends that are likely to prove positive for IPCs in the new broadcasting environment. These companies' dominance of the sector is likely to increase on Mediatique's estimates. The top 20 IPCs in 1993 represented about 20% of the total market for commissioned programming from the independent sector. In 2004, the top five companies were responsible for 40% of the relevant market. By 2014, on Mediatique's estimates, the top five players will represent around 70%, and both the mid market and the long tail will be smaller in terms of numbers of companies. Note that the market size in 2014 is derived from Mediatique's base case for independent programme commission income, plus the full effect of the WOCC at 40%²³ and new revenues from non-traditional sources.

Independent market £780m turnover in 2004

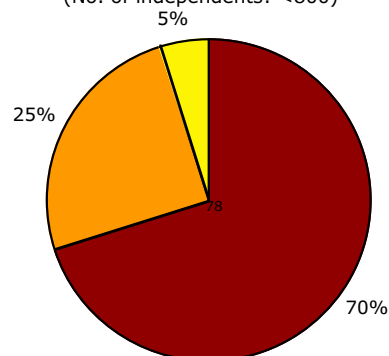
(No. of independents: c. 800)



■ Top 5 Players ■ Next 10 Players ■ The Middle Group ■ The Tail

Independent market £1.5bn turnover in 2014

(No. of independents: <800)



■ Top 5 Players ■ The Middle Group ■ The Tail

²³ Assuming all the WOCC incremental revenue accrues to qualifying independents

Recent corporate activity has also created new expectations of value creation from independent producers. Some potential acquirers have complained privately about the high expectations. However, the extent of corporate activity, and in particular the recent flotations, suggest that valuations will continue to be aggressive, for as long as the current funding “window” remains open. This, in turn, reflects the positive

‘Recent corporate activity has also created new expectations of value creation from independent producers.’

news surrounding the sector - new regulations, digital channel growth, new revenue streams and the BBC's WOCC.

The likelihood of capital flows into the sector is also increased by the probability of investment by broadcasters and media companies. All the major US broadcasters have expressed an active interest in the sector in the past year. Currently, UK broadcasters would only be able to own an IPC if they were prepared to lose access to the independent quota. However, Ofcom has previously indicated that it favours a period of market intervention to support the growth of the sector, but that any intervention should be reviewed once the sector has had the opportunity to mature. There is a precedent for this, again in the US, where for years the networks were required by regulation to commission all of their non-news programming from independent sources in order to ensure a diversity of supply.²⁴ Since the abolition of these restrictions in 1993, virtually all of the larger, successful independent companies have been acquired by the networks, who in turn are connected to the Hollywood studios. The same may happen in the UK, were government policy on the independent quota to change.

Is there any reason to believe that the current City interest will be sustained? There are arguably more reasons today to believe that the independent sector is indeed going through a transforming period of growth, and that changes (including technology and regulation) will accelerate that growth. However, the independent sector remains volatile, and subject to wide fluctuations in revenues and profits. While the advantages of the WOCC, new technology and the new terms of trade will be positive for the sector as a whole, the experience across IPCs will vary to a large degree. Larger and well-organised IPCs should be able to grow market share; but not necessarily in the predictable way so loved of institutional shareholders. The very nature of the commissioning and broadcasting cycles leads to revenue lumpiness and this makes it challenging for IPCs (even the large ones) to meet financial targets.

In practice, the increasing dominance of key players may be achieved in different ways. Critical mass brings with it its own advantages in terms of relationships with commissioners and the ability to use market leverage. Companies may also use their superior earnings flow to finance acquisitions, thereby growing further in size. They may also become “talent magnets”, attracting talent from elsewhere in the sector (thus helping to hasten the decline of the “long tail”).

The broadcasters themselves have significant influence over the development of the sector, and not just because they remain the key paymasters. Depending on how they manage their relationships with their suppliers, they are in a position to encourage investment in innovation - in the direction which suits their needs - and to ensure continued sector training, with benefits to the whole industry.

Mediatique has identified three models for how IPCs may develop in the independent sector. The first, best exemplified by All3Media, is centred on consolidation and leverage. Since buying Chrysalis TV for £45m (plus contingent deferred consideration) in 2003, All3Media went on to acquire Company, Lion and Mersey TV. The company now has pro-forma revenues in excess of £200m, making it by far the largest IPC in Britain. The aim is to use critical mass as a production company to deliver cost savings on joint overhead, and also to leverage its position as the largest UK IPC in its dealings with commissioning broadcasters.

The second, best exemplified by Shed Productions, involves the creation of high-margin returning series (Bad Girls, Footballers' Wives), with a stated intention of concentrating on links with external talent (writers, directors, actors, etc.) rather than necessarily buying other production companies.

²⁴ The Financial and Syndication Rules.

The third, best exemplified by RDF Media, is to use the strength provided by external funding to develop programming that will be aggressively marketed to non-UK broadcasters following their successful debut in the UK. RDF Media is one of a select group of UK IPCs which have proved their ability to “crack” the US market with, in particular, the success of formats such as Wife Swap and Faking It.

There is an argument to be made for each model; each one will persist and each has found backing from institutional investors convinced it will provide the required level of return for their shareholders. Of the three, Shed Productions is undoubtedly the most UK focussed in its activities, and therefore, ultimately the most dependent on the continued interest of the UK broadcasters and regulators in ensuring a healthy market for UK original production.

Whilst there will inevitably be pressure on production budgets as audiences fragment, the broadcasters, especially the terrestrial networks as we have seen in the US, will continue to rely on quality original programming from the best sources available to ensure market position.

The development of the regulator's role may be a different matter. Currently the political will is in place to support the continued commercial development of the independent sector. As we have seen elsewhere (again taking the US as an example), once the sector is perceived as having achieved commercial success, there will inevitably be political as well as commercial pressure brought to bear on removing the favourable legislation put in place to nurture what was an underdeveloped, but culturally important industry.

The models of All3Media and RDF Media, with their greater diversity of genres and more international focus, are likely to be less reliant on these circumstances going forward.

‘Not all rights have equal value, and business models are not yet clear in new media’

Inevitably, independents will seek to maximise their new ability to generate ancillary revenues - on broadband, mobile and interactive TV platforms. However, the outcome will be extremely varied. Not all rights have equal value, and business models are not yet clear in new media. The broad entertainment formats will continue to generate significant value. Wife Swap has far greater appeal internationally than a sitcom or a costume drama.

If profits in the independent sector are to be maximised, access to a strong, independent distribution network is required. Aside from the BBC Worldwide, Granada International and Channel 4 International, the distribution businesses in the UK lack critical mass. All3Media is attempting to address this, as is RDF Media. However, there is still no sizeable unaffiliated distribution company able to help independents maximise their exploitation of rights.

6. Conclusions

With the recent raft of flotations, mergers and external funding, and in light of the continuing expansion of multi-channel TV and the emergence of new markets for broadband, interactive and mobile TV, the independent sector is now well on its way to being a highly developed and sophisticated supplier of programmes not only to UK broadcasters but to international channels (including multi-channels) and new platforms. Mediatique predicts that programming expenditure represented by the independent sector could rise to nearly £1.5bn by 2014, fuelled in part by the BBC's commitment to increase its reliance on external suppliers under its much-discussed WOCC (this does not include overseas programme and format sales).

Not all independent production companies are equal. The range of trends analysed in this report is likely to perpetuate a tripartite structure in the sector, with a handful of strong, well-funded and professionally managed IPCs, a long tail of small, targeted and creative "one-man bands" and a number of mid-market players, with little hope of creating critical mass despite ambitions to break into the top league. It is this last category that will be most at risk if the trends described here continue to develop but the long tail, too, is likely to see its share of failures. However, some companies in each of the middle bulge and the long tail may find a home within the more dominant companies in the sector.

The top four qualifying independents - All3Media, Endemol UK, The Television Corporation and RDF Media - will together generate UK revenues in 2005 of well in excess of £300m, against an independent sector total (first-run commission only) of £820m. Further consolidation is likely to lead to the emergence of a privileged top tier of independents, numbering no more than five, all of which are potential candidates for listing on the Stock Exchange. It is likely that these "super indies" will be able to leverage their programming skills to

'programming expenditure represented by the independent sector could rise to nearly £1.5bn by 2014'

ensure that they derive greater value from their relationships with broadcasters, to further develop their new media and international

businesses, and to secure revenues from an increasing variety of sources - all of which should lead to a more lasting love affair with the City this time around. However, their output is likely to become increasingly similar - entertainment formats to the fore - and, with published financial targets to meet, they will be much less likely to take risks. It will be the mid market and long tail where most innovation among independent production companies is likely to take place. It will also be these sub-sectors most at risk of failure. From a height of 1,000 in the early 1990s, and the current level of 800, the number of independent production companies is likely to decline yet further as the leading players take an increasing share of the market. This is likely to manifest itself either through consolidation (with small companies swallowed up or talented creatives taking up employment with the market leaders) or simply through the winding up of unviable IPCs. This may well place even greater pressure on the in-house production teams at the BBC and ITV to ensure that innovative programmes continue to be made for the British market.

These trends may also lead to efforts by broadcasters to pay less for first-run rights, as they may argue that the independent sector is better able to exploit its secondary rights and that the broadcaster should not "subsidise" independents' increasing share of the value chain.

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²⁵ Main sources of information include: PACT, Televisual, Ofcom, Enders Analysis, Companies House, Broadcast, London Stock Exchange, Investec Securities, Bridgewell Securities, Mediatique and published company accounts.

Appendix I: Profile of key players in UK independent production sector

All3Media Ltd

All3Media was created following a £45m²⁶ management buy-in of the former Chrysalis Television Group in 2003. The MBI was led Steve Morrison, Jules Burns and David Liddiment, and backed by Bridgepoint Capital. All3Media is comprised of a number of production companies from across the UK, The Netherlands and New Zealand, with operations in the US. It also has a distribution operation, All3Media International, which represents third-party producers and broadcasters as well as All3Media's own production companies.

The group acquired Lion Television in Jul 04, Company Television in Oct 04 and Mersey Television in Jun 05. The combined impact of these acquisitions will deliver group turnover in excess of £200m in 2005.

Key Staff	Steve Morrison Jules Burns (Chief Operating Officer) David Liddiment (Creative Director) Bob Phillis (Non executive Chairman)
UK Operating Companies	Chrysalis Television Companies Assembly Film & TV (comedy and entertainment) Bentley Productions (drama) Cactus TV (entertainment features) North One Television (sports and factual) Acquisitions Company Television (drama) Lion Television (history, factual entertainment) Mersey Television (drama)
Key Titles	Bentley Productions <i>Midsomer Murders</i> (ITV) <i>Ultimate Force</i> (ITV) Cactus TV <i>Richard and Judy</i> (Channel 4) Company Television <i>Shameless</i> (Channel 4) North One Television <i>Formula 1</i> (ITV) <i>5th Gear</i> (Five)

²⁶ £45m is the initial cash payment on completion of the acquisition, further deferred cash payments of up to £5.8m are due (£1.8m on determination of completion accounts, £3.0m 18 months following completion and £1.0m in equal instalments 30 and 36 months after completion).

Financials

	2001 £'000	2002 £'000	2003 £'000	2004 £'000
All3Media Group (Year end 31 Aug)	----- Chrysalis plc accounts -----			
Turnover				
UK	n/a	n/a	n/a	62,026
Overseas	n/a	n/a	n/a	34,442
Total	61,862	88,946	86,995	96,468
Cost of Sales	n/a	n/a	n/a	-74,817
Gross Profit	n/a	n/a	n/a	21,651
EBITDA	n/a	n/a	8,418	6,979
Operating Profit (Loss)	2,555	3,561	6,629	3,739
Retained Profit (Loss)	n/a	n/a	n/a	-908
Net assets (liabilities)	3,496	48	n/a	539

* UK Turnover - year ended 31 Aug 04 - £62m

Source: Company accounts

The most recent filed accounts for the acquired companies, Company Television²⁷, Lion Television²⁸ and Mersey Television²⁹, show revenues of £20.4m, £10.0m (£21.2m for year ended 31 Dec 03) and £34.5m respectively.

²⁷ Year ending 31 Dec 03.

²⁸ 8 month period ending 31 Aug 04.

²⁹ Year ending 31 Oct 04.

Complete Communications Corporation Ltd (Celador)

Complete Communications was created in 1988 as a holding company for Celador Productions, Complete Video and The Edit Works, a facilities company. Complete Video and a majority share in The Edit Works were sold to their respective management teams in 2001. Celador Productions focuses on light entertainment productions, most notably *Who Wants To Be A Millionaire?*, which launched in 1999 and is still broadcast today in the UK and many international territories.

Complete Communications' subsidiaries today are Celador Productions, Celador Films and Celador International. InvestinMedia plc³⁰ owns 49% of the share capital of Complete Communications.

Key Staff	Paul Smith (Chairman) Danielle Lux (Joint Managing Director Celador Productions) Adrian Woolfe (Managing Director Celador International)
Operating Companies	Celador Productions Celador Films Celador International
Key Titles	<i>Who Wants to Be A Millionaire?</i> (ITV) <i>You Are What You Eat</i> (Channel 4) <i>The Big Call</i> (ITV)

Financials

	2001 £'000	2002 £'000	2003 £'000	2004 £'000
Complete Communications (Year end 30 Sep)				
Turnover				
UK	25,366	24,848	26,488	20,178
Overseas	28,385	27,418	17,251	13,061
Total	53,751	52,266	43,738	33,239
Cost of Sales	-29,339	-29,907	-28,697	-20,202
Gross Profit	24,412	22,359	15,041	13,037
Operating Profit (Loss)	17,563	11,448	6,308	4,540
Profit (Loss) after tax	13,077	8,633	4,526	3,590
Net assets	7,772	8,190	8,116	8,106

Source: Company accounts

The impact of international sales of *Who Wants To Be A Millionaire?* is reflected in the accounts up to 2002. Overseas revenues in 2000 comprise mainly of US sales; in 2001 there was a shift to income from European territories. The benefit from Millionaire begins to diminish in 2004.

³⁰ InvestinMedia plc was previously called Avesco plc; in Feb 04 the company de-merged its core service businesses into a new company, also quoted on AIM, which was then renamed Avesco plc.

Endemol BV (Telefonica)

Endemol was established in 1994 as the result of a merger between the two major TV producers in the Netherlands: Joop van den Ende Productions and John de Mol Producties.

Endemol UK's³¹ television production brands are Endemol UK Productions, Initial Film and Television, and Brighter Pictures. In addition, Endemol UK owns the multi-platform comedy producer Zeppotron, Victoria Real, a digital media company and Hawkshead, a corporate production company.

The history of Endemol UK can be traced back to 1999 when Broadcast Communications was acquired by the Guardian Media Group (GMG). In 1990 GMG had acquired two independent production companies, Bazal, and Hawkshead (now re-positioned in the business communications sector). This was followed by the acquisition of the music and live event TV producer Initial in 1992.

In 1998 Endemol BV, by then Europe's largest independent producer, took a 50% stake in Broadcast Communications; in 2000 Endemol BV bought out GMG's remaining 50% stake, and Endemol BV was acquired by Spanish telecoms and media giant Telefonica.

In 2001 the UK group purchased 100% of independent producer Brighter Pictures, and in 2002 its largest production brand Bazal changed its name to Endemol UK Productions.

Key Staff	<p>Endemol UK Group Peter Bazalgette (Chairman) Tim Hincks (Chief Creative Officer) Richard Johnston (Joint Managing Director) Lucas Church (Joint Managing Director)</p> <p>Endemol UK Tom Barnicoat (Chief Executive)</p> <p>Endemol UK Productions Nikki Cheetham (Managing Director)</p> <p>Initial Malcolm Gerrie (Chief Executive) Laurence Jones (Managing Director)</p> <p>Brighter Pictures Remy Blumenfeld (Creative Director)</p>
Operating Companies	<p>Endemol UK Productions Initial Film and Television Brighter Pictures (entertainment programming) Zeppotron Hawkshead (non broadcast production) Victoria Real (interactive media production)</p>
Key Titles	<p><i>Ready Steady Cook</i> (BBC) <i>Changing Rooms</i> (BBC) <i>Ground Force</i> (BBC) <i>Big Brother</i> (Channel 4) <i>The Farm</i> (Five) <i>Fame Academy</i> (BBC)</p>

³¹ Previously Broadcast Communications

Financials

	2001 £'000	2002 £'000	2003 £'000	2004 £'000
Endemol UK plc (Year end 31 Dec)				
Turnover				
UK	50,471	64,511	89,045	93,144
Overseas	2,301	702	783	4,251
Total	52,772	65,213	89,828	97,395
Cost of Sales	n/a	-55,419	-74,039	-78,343
Gross Profit	n/a	9,794	15,789	19,052
Operating Profit	-880	3,547	1,824	-5,188
Profit (Loss) after tax	-2,238	722	786	-5,077
Net assets (liabilities)	-2,176	-1,454	-668	-5,745

Source: Company Accounts

The group accounts for Endemol UK contain the results of the operating entities Endemol UK Productions and Initial, and consolidate the results of its subsidiaries Brighter Pictures, Hawkshead, Victoria Real and Zeppotron. The group has seen consistent revenue growth as lifestyle programming (*Changing Rooms*, *Ground Force*, *Ready Steady Cook*) and reality television (Big Brother, The Farm) have come to dominate UK schedules.

Endemol UK plc is owned by Endemol UK Holding Ltd, which in turn is owned by Endemol BV (incorporated in Holland). The ultimate parent is Telefonica SA.

FremantleMedia (RTL Group)

FremantleMedia is the content production arm of RTL Group, Europe's largest television and radio broadcast company. RTL Group is 90% owned by Bertelsmann AG, and has interests in 31 television channels and 33 radio stations in ten European countries.

The group's history can be traced back to 1995. Following the acquisition of Grundy Productions (the Australia-based producer of game shows and daily serial dramas such as *Neighbours*), Pearson PLC combined all its television assets in one division, Pearson Television. The division's assets included stakes in BSkyB, Yorkshire Television and a number of production companies including the UK's largest independent, Thames Television, which had been acquired in 1993 following the loss of its broadcast franchise. With Greg Dyke at the helm, Pearson then acquired SelectTV (Alomo and Witzend Productions) in 1996 and All American Television (owner of classic formats including *The Price Is Right* and *Family Feud*) in 1997. Talkback Productions (founded in 1981 by Mel Smith & Griff Rhys Jones) was acquired in 2000 for £62m.

In 2000 Pearson Television merged with CLT-UFA to form RTL Group, the pan-European broadcaster which then owned 23 TV channels and 17 radio stations. In 2001, Pearson PLC sold its 22% stake in the business to Bertelsmann AG for £944m³², Bertelsmann, which now owns 90% of the company re-named Pearson Television as FremantleMedia internationally, but retained the name, Thames, for the UK.

The operations of Talkback Productions and Thames Television were combined in 2003 to create what was at the time the largest independent production company in the UK, TalkbackTHAMES, which now produces over 850 hours of programming a year.

Note that TalkbackTHAMES does not qualify as independent under the relevant legislation by virtue of RTL's holding in Channel 5 Television Group Ltd.

Financials

Key Staff	Key Staff Tony Cohen (CEO - FremantleMedia) Lorraine Heggeseey (CEO - TalkbackTHAMES)
Operating Companies	FremantleMedia TalkbackTHAMES Grundy Productions Regent Productions
Key Titles	<i>The Bill</i> (ITV) <i>Family Affairs</i> (Five) <i>The Lost Prince</i> (BBC) <i>Never Mind The Buzzcocks</i> (BBC) <i>Pop Idol</i> (ITV)

³² The transaction valued Pearson's 34 million RTL shares at 44 Euros per share

UK group accounts are not prepared for FremantleMedia. Operating companies are split between production (TalkbackTHAMES group) and distribution (FremantleMedia). RTL's shareholding in Five is held within the TalkbackTHAMES group.

Revenues for the key production subsidiaries within the TalkbackTHAMES group are as follows:

	2000 £'000	2001 £'000	2002 £'000	2003 £'000
TalkbackTHAMES - Revenues (Year end 31 Dec)				
Talkback Productions	31,014	29,823	37,386	34,355
Thames Television	71,182	65,355	66,071	72,380
Grundy Productions	15,332	11,895	14,266	11,668
Regent Productions	4,031	3,130	3,202	2,913
	121,559	110,203	120,925	121,316

Source: Company accounts

Thames Television revenues are underpinned by *The Bill*

Ancillary revenues are licensed to Fremantle International (overseas sales) and Fremantle Licensing (telephone and other interactive) on a commission basis.

Hat Trick Holdings Ltd

Hat Trick Holdings specialises in comedy and entertainment programming. The company was founded in 1986 by Denise O'Donoghue and Jimmy Mulville, who remain Joint Managing Directors. Hat Trick is responsible for successful, long running series such as *Have I Got News For You* and *Whose Line is it Anyway?*, and has had some notable international success with the likes of *The Kumars at No. 42*.

Early on, Hat Trick took a decision to retain the secondary rights to its programmes, a policy with which it has had some success due to its strong negotiating position with the broadcasters on the back of its long running series. Ownership of these rights made the company an attractive target for outside investors, and in 2003 Kleinwort Capital took a 45% stake in the company for £23m.

Armed with outside investment, the company talked of plans to expand through acquisition and joint ventures. In March 2004, Broadcast Magazine reported that Hat Trick was in talks to buy Shed Productions, producer of *Footballers' Wives*. The deal never materialised, and Shed Productions has since floated on the Alternative Investment Market (AIM).

Key Staff	Jimmy Mulville (Joint Managing Director) Denise O'Donoghue (Joint Managing Director) Hilary Strong (Commercial Director)
Operating Companies	Subsidiaries Hat Trick Productions (production) Hat Tick International (distribution) Joint Ventures 12 Yard Productions Gasp Productions
Key Titles	<i>Have I Got News For You</i> (BBC) <i>Father Ted</i> (Channel 4) <i>Drop The Dead Donkey</i> (Channel 4) <i>The Kumars at No. 42</i> (BBC) <i>Whose Line Is It Anyway?</i> (Channel 4)

Financials

	2001 £'000	2002 £'000	2003 £'000	2004 £'000
Hat Trick Holdings (year end 30 Jun)				
Turnover				
UK	10,897	16,727	12,423	19,633
Overseas	1,670	3,656	2,873	2,807
Total	12,567	20,383	15,296	22,441
Cost of Sales	-8,432	-13,216	-9,688	-15,954
Gross Profit	4,135	7,167	5,608	6,486
Operating Profit (Loss)	-37	841	1,438	1,644
Profit (Loss) after tax	-160	-158	779	-57
Net assets	1,608	1,450	2,227	2,163

Source: Company accounts (Hat Trick Productions 2001- 03, Hat Trick Holdings 2004)

The company experienced significant revenue growth in 2002 immediately prior to the investment by Kleinwort Capital. During this period overseas began to provide a significant contribution, and UK revenues were buoyant, with a number of simultaneous commissions secured from different UK broadcasters. Hat Trick Productions and its subsidiary companies were acquired by Hat Trick Holdings in Jul 03 coinciding with the investment by Kleinwort Capital.

HIT Entertainment Ltd

HIT Entertainment is one of the UK's leading children's entertainment companies whose portfolio of programmes includes *Bob the Builder*, *Thomas the Tank Engine*, *Barney* and *Pingu*.

Founded by Peter Orton in 1989, HIT has since developed into a "mini studio" with activities spanning television and video production, distribution, publishing, consumer products licensing and live events. With operations now in the UK, US, Japan, Germany and Canada, approximately 45% of the company's revenues come from Home Entertainment sales with another 45% deriving from consumer product licensing.

HIT controls a library of over 1,000 episodes of programming, making it one of the largest distributors and licensors of children's product both in the UK and the US.

The company began trading on the Alternative Investment Market (AIM) in 1996, and achieved a full listing on the London Stock Exchange in 1997.

In 2004 HIT announced that it would partner with Comcast Corporation, PBS and Sesame Workshop to launch a digital, pre-school channel in the US, due to launch in September 2005. Also in 2004, after a difficult few years trading which was blamed on a lack of exposure for its key brands on US Television, and therefore disappointing retail sales of its licensed products, HIT parted company with its CEO, Rob Lawes.

On 21 Mar 05 the company released its interim results (for the six months ended 31 Jan 05), and at the same time recommended that its shareholders accept a cash offer of 300p for the issued share capital from funds managed by Apax Partners. Following a period of further interest in HIT from other parties including Lion's Gate Entertainment, the company was finally acquired by Apax, and its shares de-listed, on 25 May 05.

Key Staff	<p>Greg Dyke (Chairman) Bruce Steinberg (CEO)</p>
Operating Companies	<p>HIT Entertainment Gullane Entertainment HIT USA Productions Guinness World Records</p>
Key Titles	<p><i>Barney</i> <i>Bob the Builder</i> <i>Thomas the Tank Engine</i> <i>Pingu</i> <i>The Wiggles</i> <i>Guinness World Records</i></p>

Financials

	2001 £'000	2002 £'000	2003 £'000	2004 £'000
HIT Entertainment (year end 30 Jul)				
Turnover				
UK	12,636	19,202	27,811	27,119
Overseas	39,680	101,783	141,080	121,025
Total	52,316	120,985	168,891	148,144
Cost of Sales	-28,815	-51,716	-64,288	-62,306
Gross Profit	23,501	69,269	104,603	85,838
Operating Profit (Loss)	3,358	19,483	20,411	18,504
Profit (Loss) after tax	868	11,053	15,346	6,669
Net assets	223,467	232,894	289,851	308,630

Source: Company accounts

HIT revenues have grown primarily as a result of acquisitions. UK revenues comprise both production revenues and royalties on DVD/Video sales from its key brands. In 2004 58% of revenues were generated in the US with 44% of group revenues derived from consumer products and 43% from Home Entertainment.

RDF Media Group plc

Established in 1993, RDF Media is one of the UK's leading independent production companies, specialising in factual and entertainment programming. Among the company's best known programmes are *Wife Swap*, *Faking It* and *Scrapheap Challenge*.

RDF Media has also had considerable success in transferring its formats to the US where its clients include the major network broadcasters, ABC, NBC and Fox.

RDF Media differs from most other UK independents in that the company had outside investment from its inception, initially from so called "business angels" (high net worth individuals investing private funds), and from 2001 in the form of private equity investment from Sagitta Private Equity, now called Bowmark. In May 2005 the company was publicly listed on AIM at a valuation of £49m.

RDF Media is one of the UK's fastest growing companies, and is the only television production company to feature for the last three years running in the Sunday Times Fast Track 100 Companies list.

In 2002 and 2004, RDF Media won the UK's Broadcast magazine award for best independent production company, and in both 2002 and 2003 RDF Media won the Indie award (as voted by PACT members) given to the UK's most outstanding independent production company.

Key Staff	David Frank (Chief Executive) Stephen Lambert (Chief Creative Officer) Grant Mansfield (Director of Programmes) Joely Fether (Chief Operating Officer)
Operating Companies	RDF Media Ltd RDF Media Inc Touchpaper Television (Associate Company)
Key Titles	<i>Faking It</i> (Channel 4) <i>Holiday Showdown</i> (ITV) <i>Wife Swap</i> (Channel 4)

	2002 £'000	2003 £'000	2004 £'000	2005 £'000
RDF Media (Holdings) (Year end 31 Jan)				
Turnover	24,390	32,588	45,404	48,214
Cost of Sales	-18,139	-23,829	-34,561	-33,904
Gross Profit	6,251	8,760	10,843	14,310
Operating Profit (Loss)	700	1,024	1,882	4,093
Profit (Loss) after tax	361	609	1,197	2,900
Net assets	2,793	3,422	4,134	5,525

Financials

Source: Company accounts

Prior to its listing on AIM, RDF Media has achieved consistent year on year revenue growth, doubling within 4 years. In the year ended 31 Jan 05, turnover comprised £36.9m of production sales and £10.9m of rights exploitation, an increase from prior year levels of £2.9m and £1.1m respectively.

Shed Productions plc

Shed Productions specialises in producing long running, contemporary, drama series. The company was established in 1998 by Eileen Gallagher, Brian Park, Ann McManus and Maureen Chadwick, an experienced team which originated at Granada Television.

Shed Productions now has a programme library of over 150 hours of completed (and commissioned) productions. Full retention of the rights attached to its productions has been central to the company's business model, and its programmes are now distributed to broadcasters in over 25 major territories.

Shed Productions floated on the Alternative Investment Market (AIM) in March 2005, achieving a valuation of £55m, well above analysts initial expectations. The management team is highly rated by institutional investors, who responded well to the company's first interim results which were released in June 2005.

To date Shed Productions has relied largely on commissions from its main client, ITV. At the time of its listing the company stated its intention to grow its client base in the coming year; Shed Productions has now secured its first commission from the BBC for Waterloo Road, a six part children's drama series.

Key Staff	Eileen Gallagher (Managing Director) Brian Park Ann McManus Maureen Chadwick
Operating Companies	Shed Productions
Key Titles	<i>Bombshell</i> (ITV) <i>Bad Girls</i> (ITV) <i>Footballers' Wives</i> (ITV)

Financials

Source: Company accounts

	2001 £'000	2002 £'000	2003 £'000	2004 £'000
Shed Productions (Year end 31 Aug)				
Turnover				
UK	9,917	13,391	13,558	14,292
Overseas	361	708	638	606
Total	10,277	14,099	14,196	14,898
Cost of Sales	-9,662	-11,552	-11,544	-11,201
Gross Profit	615	2,547	2,652	3,697
Operating Profit (Loss)	1,069	3,241	1,618	1,869
Profit (Loss) after tax	790	2,308	1,133	1,264
Net assets	n/a	4,065	5,198	6,462

Steady revenues from 2002 reflect consistent re-commissioning of Shed Production's key series, *Footballers' Wives* and *Bad Girls*.

The Television Corporation plc

The Television Corporation is a listed public company based in the UK, with two branded independent programming arms (Sunset+Vine and Mentorn).

Mentorn produces factual and entertainment programmes with around 300 hours shown in the UK in 2004; Sunset+Vine produces sports programmes and has contracts with many of the UK terrestrial channels including the BBC (horseracing) and the majority of Five's sport output (1,500 hours per year), as well as the world's biggest international sports magazine show, *Gillette World Sport*. In 2004 Sunset+Vine added rugby, curling, poker and sailing to its production portfolio, though it has since lost its previously lucrative contract to produce Channel 4's cricket coverage from 2006, when the broadcast rights go to BSkyB.

Other group companies include Hawk Eye (ball tracking technology) and Venner TV (independent producer of badminton and cycling).

Following a turbulent few years when the company invested in activities as varied as post production and the acquisition of speed boat racing rights, The Television Corporation decided to re-focus its activities on its core production business. Since then a number of group companies have been sold or closed including Molinare (2003); On The Fastrax (2003) and Visions (2005). The sale of Visions generated £16.8m³³ and combined with the proceeds from equity fund raising of £5.9m in Apr 04 the group was able to repay its debt.

The Television Corporation is once again operating profitably, and is publicly seeking to build its production output under the leadership of newly appointed CEO, Peter Salmon.

Key Staff	<p>Tom Chandos (Chairman) Peter Salmon (Chief Executive) Jeff Foulser (Director of Sport) George Carey (Director of Programmes) Charles Thompson (Managing Director - Mentorn)</p>
UK Operating Companies	<p>Mentorn Sunset+Vine Venner</p>
Key Titles	<p>Mentorn <i>Britain's Worst...</i> (Five) <i>Question Time</i> (BBC) <i>Robot Wars</i> (BBC)</p> <p>Sunset+Vine <i>Gillette World Sport</i> <i>Cricket</i> (Channel 4) <i>Live Football</i> (Five)</p> <p>Venner <i>Tour de France</i> (ITV)</p>

³³ The sale of Visions was announced in Dec 04 and completed in Jan 05.

Financials

	2001 £'000	2002 £'000	2003 £'000	2004 £'000
Television Corporation (Year end 31 Dec)				
Turnover	77,256	68,298	66,907	67,342
Cost of Sales	-59,829	-49,922	-56,067	-55,511
Gross Profit	17,427	18,376	10,840	11,831
Operating Profit (Loss)	-793	-8,877	-1,629	2,140
Profit (Loss) after tax	-2,128	-10,477	-8,913	866
Net assets	40,517	23,901	12,602	19,369
Production Turnover	46,417	43,266	50,348	52,260
Production Turnover - UK	32,805	29,860	27,660	33,870

Source: Company accounts

UK Production Turnover growth in 2004 is attributable to strong performance from Mentorn.

Ten Alps Communications plc

Ten Alps Communications is a five-year-old TV production company (listed on AIM) which also owns an advertising agency and events organisation division. The company produces a wide range of programmes for broadcast television, mostly in the factual genre, as well as having a number of commercial clients. Ten Alps was founded in 1999 by Alex Connock, Bob Geldof and Des Shaw. In 2001 the company effected a reverse takeover of AIM-listed advertising agency Osprey Communications PLC, raising £2.9m cash.

Ten Alps' operating companies include Brook Lapping (acquired in Nov 02), Blakeway Productions (acquired in May 04) and 3BM TV, producing documentary and docudrama programmes for all major UK broadcasters. In the year ending 31 Mar 05 the company delivered over 50 programmes to major broadcasters almost doubling revenue year on year.

Though Brook Lapping, Ten Alps holds a 70% interest in the consortium producing the Teachers' TV channel for the Department for Education and Skills. The channel launched successfully in Feb 05.

Key Staff	Alex Connock (Chief Executive) Brian Walden (Non Exec Chairman) Bob Geldof (Non Exec Director) Philip Caldwell (Non Exec Director)
Operating Companies	Production Brook Lapping (factual programming) Blakeway Productions 3BM TV (acquired 2004) Other Teachers TV (launched 2005, budget of £60m over 4yrs) Ten Alps RMA (Advertising Agency) Ten Alps MTD (Advertising Agency) Ten Alps Events
Key Titles	<i>Geldof In Africa</i> (BBC) <i>The Long War</i> (Channel 4) <i>Zero Hour</i> (Five / Discovery)

Financials

	2002 £'000	2003 £'000	2004 £'000	2005 £'000
Ten Alps Communications (Year end 31 Mar)				
Turnover				
UK	9,736	12,326	15,960	31,217
Overseas	710	733	772	3,536
Total	10,446	13,059	16,732	34,753
Cost of Sales	-6,763	-8,779	-11,955	-27,755
Gross Profit	3,683	4,280	4,777	6,998
Operating Profit	425	44	76	567
Profit (Loss) after tax	444	88	149	232
Net assets	6,534	6,622	6,772	7,184

Source: Company accounts

The company's results for the year ended 31 Mar 05 showed considerably improved revenues and margins, and forecast significant continued growth on the basis of contracted productions. However, the company has not historically split out the results for its production division, making this difficult to track.

Tiger Aspect Productions Ltd

Tiger Aspect Productions produces programming across a broad range of genres including comedy, drama, entertainment, factual, animation, wildlife documentaries (Tigress Productions) and feature films (Tiger Aspect Pictures).

The company has created flagship programming for the UK's main terrestrial and non-terrestrial broadcasters; its credits include mainstream successes for ITV and BBC 1 such as *Mr Bean*, *Harry Enfield and Chums*, *Murphy's Law*, *The Vicar of Dibley* and *Fat Friends* as well as a slate of somewhat edgier programmes for BBC2 and Channel 4 such as *Teachers*, *Omagh*, and *Gimme Gimme Gimme*.

Key Staff	Peter Bennett-Jones (Chairman) Andrew Zein (Managing Director) Claudia Lloyd (Head of Animation & Children's) Clive Tulloh (Head of Comedy & Entertainment) Greg Brenman (Head of Drama) Paul Sommers (Head of Factual Group)
Operating Companies	Tiger Aspect Productions Tiger Aspect Pictures (Feature Films) Tigress Productions (Wildlife documentaries)
Key Titles	<i>Lenny Henry In Pieces</i> (BBC) <i>Mr Bean</i> (ITV) <i>Murphy's Law</i> (BBC) <i>Teachers</i> (Channel 4) <i>Thin Blue Line</i> (BBC) <i>The Vicar Of Dibley</i> (BBC)

Financials

	2001 £'000	2002 £'000	2003 £'000	2004 £'000
Tiger Aspect Holdings (Year end 31 Jul)				
Turnover				
UK	38,264	49,608	40,813	35,658
Overseas	282	593	2,739	4,197
Total	38,546	50,201	43,552	39,855
Cost of Sales	-32,184	-43,368	-37,448	-32,671
Gross Profit	6,362	6,833	6,104	7,184
Operating Profit (Loss)	-62	366	73	920
Profit (Loss) after tax	198	226	499	548
Net assets	3,245	3,512	3,814	4,251

Source: Company accounts

Group turnover reached a peak of £50m in 2002, though this has since been in decline, particularly in the UK. The fall has partially been offset by strong growth in international sales.

Zenith Entertainment Ltd

Zenith Entertainment was established in 1984. From its origins in feature films and television drama, Zenith has diversified into a number of core genre divisions producing around 300 hours of programming each year:

- Entertainment,
- Music and Comedy (through its Blaze TV brand),
- Adult Drama,
- Children's Drama/Animation, and
- Factual programmes, (including Documentary, Lifestyle and Leisure titles).

In 2003, a management buy-out team backed by a syndicate of investors, including Beringea Limited and Genesis Investments, announced the acquisition of Zenith. Reported as a management buy-out, it was more accurately a combined buy-in/buy-out as new management was injected. The incumbent management team was lead by Ivan Rendall, the Managing Director of Zenith Productions.

The acquisition of Zenith was undertaken at a valuation of approximately £4.1m, a multiple of revenues (from continuing operations) of 0.22.

The funds were raised to accelerate the company's expansion in the business of rights exploitation as well as production. It was reported at the time that follow on funding would be available for further acquisitions though these have yet to materialise.

Key Staff	Ivan Rendall (Managing Director) Alan Fairholm (Director of Production) Conor McAnally (Director of Programmes - Blaze TV)
Operating Companies	Zenith Entertainment Blaze TV
Key Titles	Zenith <i>Two Thousand Acres of Sky</i> (BBC) <i>Byker Grove</i> (BBC) <i>55 Degrees North</i> (BBC) Blaze <i>Cd:UK</i> (ITV)

Financials

	2001 £'000	2002 £'000	2003 £'000	2004 £'000
Zenith (year end 31 Jul)	--- Zenith Entertainment accounts ---			
Turnover	23,882	21,750	18,212	14,317
Cost of Sales	-20,824	-21,207	-16,211	-12,085
Gross Profit	3,058	543	2,001	2,232
Operating Profit (Loss)	-1,380	-5,431	-1,333	-200
Profit (Loss) after tax	-1,406	-7,099	6,832	-264
Net assets (liabilities)	4,293	-2,763	-4,469	-4,733

Source: Company accounts

Zenith Group Ltd was incorporated in Aug 02 and acquired the assets of Zenith Entertainment in Mar 03. The company's revenues have steadily declined since 2001.

Appendix II: Market forecasts

Mediatique has forecast programming expenditure in the UK over the next decade, enabling it to produce projections for the share of revenues accounted for by the independent production sector.

Base case projections

Mediatique's integrated UK TV broadcasting model is used as the basis for these projections, which includes forecasts of the trends in the TV market by platform over the next ten years. The forecasts show the penetration of digital television exceeding 90% of TV homes by 2009 due in particular to continued strong growth of the Freeview platform

Digital TV Forecasts	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
year end	m	m	m	m	m	m	m	m	m	m
Satellite	8.3	8.7	9.1	9.4	9.7	10.0	10.2	10.4	10.5	10.7
Cable	2.7	2.9	3.0	3.2	3.3	3.3	3.4	3.4	3.4	3.4
DSL	0.1	0.1	0.2	0.3	0.4	0.5	0.6	0.7	0.8	0.9
Terrestrial	6.4	7.8	9.0	9.9	10.7	11.3	11.6	11.8	11.9	11.7
Total Digital Homes	17.4	19.5	21.3	22.8	24.0	25.1	25.8	26.3	26.6	26.6
% Pay TV Penetration (vs. All TV Homes)	43.4%	44.5%	45.6%	46.5%	47.4%	48.5%	49.5%	50.3%	51.2%	51.9%
% Digital Penetration (vs. All TV Homes)	67.3%	75.1%	81.5%	86.8%	91.3%	95.0%	97.5%	98.9%	100.0%	100.0%

Mediatique UK TV platform forecasts

Mediatique analysis

Mediatique's model forecasts total UK TV production spend to be about £4.1bn in 2005, not including spending on premium sports and movies (principally Sky Movies and Sky Sports). Of this, the share taken by independents is estimated to be £0.82bn. Mediatique forecasts that the overall average programming expenditure by all channels will grow by 4% a year, with the independent share growing in line with this. Even without the increased spending on external programming commissioned by the BBC under its WOCC programme, the independent share of programme expenditure is therefore set to exceed £1bn by 2011. Taking into account the WOCC, Mediatique's base case suggests that total spending on independent production by 2010 could exceed £1.2bn. Note that this projection does not include non-qualifying commissioning revenues (i.e., in-house or from external non-qualifying players such as TalkbackTHAMES) nor those revenues generated in secondary and tertiary markets or on other platforms (mobile, broadband, etc.)

The following table summarising forecasts of programming expenditure by broadcaster.

Production spend	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
BBC1 / BBC2 (incl. regional)	1.5	1.5	1.6	1.6	1.7	1.8	1.8	1.9	2.0	2.1
BBC digital services	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3
ITV1 (incl. regional)	1.1	1.1	1.2	1.2	1.3	1.3	1.4	1.4	1.5	1.5
Channel 4	0.5	0.5	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6
Five	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3
ITV other (GMTV/digital)	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Other multichannel	0.6	0.7	0.7	0.7	0.7	0.8	0.8	0.8	0.9	0.9
Premium channels (Sky Sports/ Movies)	1.2	1.2	1.3	1.3	1.4	1.4	1.5	1.5	1.5	1.6
Total production Spend	5.3	5.5	5.7	6.0	6.2	6.5	6.7	6.9	7.2	7.5

Mediatique forecasts for UK independent production sector revenues - base case

Mediatique analysis

Mediatique analysis of the impact of WOCC

The BBC's introduction of a Window of Creative Competition is likely to have a significant impact on the size and growth rate of the independent production sector. It is beyond the scope of the present report to judge the minimum level of in-house production required to ensure that quality and training levels are maintained at the public service broadcaster; we have, instead, looked at the range of possible outcomes were the BBC to tender externally for programmes³⁴ at various percentage points between 25% (the current quota) and 50% (the maximum set under the proposed WOCC). Note that the BBC's WOCC will be open to all external suppliers, including "tied" producers such as Granada and SMG TV Productions and non-qualifying independents such as TalkbackTHAMES.

To estimate the impact of the application of the WOCC on the independent production sector Mediatique assessed what might have occurred had the WOCC had been in place in 2004, to provide a basis from which to forecast outer years.

In determining its forecasts, Mediatique first calculated what percentage of the BBC's total budget of £1.62bn³⁵ was to be the basis for the WOCC calculation. This was done by subtracting news, weather, acquired programming and sports rights, to give a net figure of just over £1bn.

We then looked at genre prices per hour, as published by the BBC. These were then considered in light of the total number of hours externally sourced by the BBC in 2004. In summary, the 2,600 hours commissioned externally in 2004, based on the genre allocations, generated £0.320bn of independent commissions in that year, out of our total estimate of £720m for the independent sector as a whole. This represents 30.8% of qualifying spend by value and 30.3% by volume (hours). These genre prices and hours assumptions are summarised in the following table.

³⁴ Excluding News/Weather and acquired programming hours.

³⁵ This number is an estimate based on the 2003/04 and 2003/05 Annual Reports. The BBC reports on its financial year to March 31, while the independent production quota is assessed on a calendar year basis.

BBC 2004 Production expenditure

	Hours	Av cost	Total
	'000	p/hr	spend
		£m	£bn
2004 Production Expenditure			
Qualifying Hours (see below)		0.13	1.06
News / Weather		0.01	0.24
Acquisitions		0.07	0.08
Total Originated Programming		0.05	1.62
Analysis of Qualifying Hours			
Factual and learning	1.6	0.11	0.18
Current Affairs	0.4	0.12	0.05
Entertainment	0.8	0.20	0.15
Sport	1.4	0.04	0.06
Childrens	0.4	0.09	0.04
Drama	0.5	0.51	0.24
Music/Arts	0.2	0.15	0.03
Other	0.2	0.11	0.02
BBC1/ BBC2	5.5	0.14	0.76
Digital Channels	1.7	0.09	0.15
Nations/Regions	1.4	0.11	0.15
BBC Total 2004	8.5	0.12	1.06
Total Hours			
Qualifying Hours	8.5		
News/Weather	20.4		
Acquired	1.2		
	30.1		

Mediatique estimate of BBC qualifying programming spend - 2004

Mediatique analysis (based on BBC Annual Report 2003/04 and 2004/05, Ofcom Review of Communications Market - 2005 and Mediatique estimates)

Mediatique assumes in this analysis that the proportions of independent productions by programming genre are fixed based on the 2004 out-turn throughout the model period although in practice commissions by genre are likely to vary year to year depending of a variety factors, including consumer taste. This could have an impact on the proportion of spend with the independent sector as the various genres are delivered at varying costs per hour (for example, costume drama is more expensive than low-end factual). Mediatique has used the BBC's own published programme tariffs for each genre, as detailed in the annual report.

Mediatique thus calculated the 2004 out-turn had the WOCC be in place, generating an incremental effect on revenues for the external supply sector at each five percentage point increase in the WOCC, from 35% to 50%.

The computations for this exercise are set out in the following table.

Estimated Impact of WOCC - 2004

BBC Total

Qualifying Originated Production Spend	£bn	1.06
Qualifying Originated Hours	'000	8.5

(Source - Mediatique Estimate)

Independent Sector (qualifying)

Total Spend	£bn	0.32
% of spend		30.8%

(Source - BBC Press Release 13 Jun 05)

Total Hours	'000	2.6
% of hours		30.3%

(Source - BBC Annual Report 2004/05 Quota Disclosure)

Potential Incremental Spend with Independents vs. 2004

(% of qualifying hrs commissioned from independent sector)	Incremental	
	hours	Spend
	'000	£bn
25% of hours (0% from WOCC)	(0.5)	(0.05)
30% of hours (5% from WOCC)	(0.0)	0.00
35% of hours (10% from WOCC)	0.4	0.05
40% of hours (15% from WOCC)	0.8	0.11
45% of hours (20% from WOCC)	1.3	0.16
50% of hours (25% from WOCC)	1.7	0.21

Mediatique UK independent production sector forecasts - impact of WOCC 2004

Mediatique analysis (based on BBC Annual Report 2004/05, Ofcom Review of Communications Market - 2005 and Mediatique estimates)

On this basis, Mediatique then forecast the effects of the WOCC over the next ten years. For the base case, it is assumed that the WOCC, on average, leads to a 40% external out-sourcing by the BBC.

Assuming the average effect of WOCC increases by 4% per annum over the forecasting period, Mediatique's computations show that if 40% of the BBC's qualifying production hours (excluding news/weather programming) are tendered externally, this would generate up to £0.12bn in incremental spend with qualifying independents by 2007 - although again, note that some of this might go to non-qualifying external suppliers. This will result in a potential total UK production spend with independents of almost £1.0bn in 2007.

The results of this analysis show that WOCC will lead to significant growth in the sector, with additional annual revenues of up to £0.24bn, at 50% external production quota by 2007, an increase of nearly 15%.

Estimated Incremental Impact of WOCC

	2007	2008	2009	2014
(% of qualifying hrs commissioned from independent sector)	£bn	£bn	£bn	£bn	£bn
25% of hours (0% from WOCC)	(0.06)	(0.06)	(0.06)		(0.08)
30% of hours (5% from WOCC)	0.00	0.00	0.00		0.00
35% of hours (10% from WOCC)	0.06	0.06	0.07		0.08
40% of hours (15% from WOCC)	0.12	0.13	0.13		0.16
45% of hours (20% from WOCC)	0.18	0.19	0.20		0.24
50% of hours (25% from WOCC)	0.24	0.25	0.26		0.32

Projections assume total annual growth in production spend of 4%

Mediatique UK independent production sector forecasts - impact of WOCC 2007-14

Mediatique analysis (based on BBC Annual Report 2004/05, Ofcom Review of Communications Market - 2005 and Mediatique estimates)

When assessing the potential benefit by value to the sector, cost per production will vary enormously. Drama commissions, for example, will account for a greater percentage of the outside spend than low-end factual, and therefore independents securing commissions in serial drama will benefit to a greater extent than those specialising in one-off documentaries.

Non-traditional revenues

Currently, the first-run commission income represents the lion's share of revenues generated by independents. This will change over time, as other revenue sources grow in proportion. We have not attempted to predict the quantum of these new revenues in detail, as, in practice, the residual value between programmes varies enormously. Indeed, in common with many other countries outside the US, up to 70% of locally produced original programming has no secondary value beyond its first run.

If, for the purposes of this report, we assume the independent sector were able to grow its non-first run, non-traditional income to 12% of total revenues, reflecting that certain companies will earn up to 30% (in line with international benchmarks) and others will not secure these revenues at all, this would provide a welcome broadening of their income streams, as well as more predictable cashflows. This would imply extra revenues of to the sector as a whole of £0.14bn by 2014.

By the same token, broadcasters might well be able to commission programmes at lower rates for first-run rights, in acknowledgement of the increasing ability of external suppliers to generate ancillary revenues elsewhere along the value chain.

Ancillary Revenues	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Projected Production Spend	5.27	5.49	5.70	5.95	6.23	6.46	6.69	6.92	7.19	7.46
Estimated Production Spend with Independents	0.82	0.85	0.89	0.92	0.96	1.00	1.04	1.08	1.12	1.17
Ancillary spend %			2.0%	5.3%	8.7%	12.0%	12.0%	12.0%	12.0%	12.0%
Ancillary spend (with independents) £bn			0.02	0.05	0.08	0.12	0.12	0.13	0.13	0.14
Total Spend with Qualifying Independents £bn			0.91	0.97	1.04	1.12	1.16	1.21	1.25	1.31

Mediatique UK independent production sector forecasts - ancillary revenues

Mediatique analysis

Summary

Taken as a whole, Mediatique forecasts that the independent production sector could achieve revenues of nearly £1.5bn by 2014, representing growth of nearly 100% since 2004.

Summary	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Base Case production spend with independents	0.82	0.85	0.89	0.92	0.96	1.00	1.04	1.08	1.12	1.17
WOCC impact (assuming 40% of BBC hours)		0.12	0.12	0.13	0.13	0.14	0.14	0.15	0.15	0.16
Ancillary spend			0.02	0.05	0.08	0.12	0.12	0.13	0.13	0.14
Total Spend with Qualifying Independents	0.82	0.97	1.03	1.09	1.17	1.26	1.31	1.36	1.41	1.47

Mediatique UK independent production sector forecasts - consolidated summary

Mediatique analysis



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