J.P.Morgan

North America Equity Research
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Disney

A Force to Be Reckoned With; A Deep Dive into the Consumer Products Division

As Disney continues to enhance and grow its franchise-focused, company-wide strategy, we believe the Consumer Products division has and will continue to benefit from success across all of Disney's divisions. Most notably, we believe the global launch of new *Star Wars* merchandise this Friday at midnight, branded "Force Friday," ahead of the first *Star Wars* film in a decade on December 18th has the potential to meaningfully accelerate the division's revenue and profit growth. In our analysis within, we estimate a ~200% increase in *Star Wars* global licensing and retail store sales could lead to ~$500m of incremental revenues and ~$200m of incremental operating profit in F2016 (see pages 28-30 for full analysis). In this report, we examine licensing and toy industry trends; analyze the Consumer Products strategy, growth opportunities, and risks; and profile the competitors. In our opinion, Disney not only has the best portfolio of intellectual properties but also is in the best position to monetize its IP – which is most notable in the Consumer Products division – with unmatched market and pricing power as the number one global licensor, a unique active licensing strategy, and its own retail stores that further help with branding. With many evergreen properties that consistently generate $1b+ in annual global retail sales, a strong upcoming slate of films that can feed into merchandise/products, and a history of success, we believe Disney's Consumer Products segment is poised for strong growth in the upcoming years.

- **Unparalleled market power as the #1 global licensor in 2014 with ~$45 billion in global retail sales for its licensed properties**. Disney towers over the #2 licensor which generated $18b of global retail sales and TWX, the next largest media company licensor with $8b of global retail sales. We believe Disney's distinct position as the market leader allows the company to have great negotiating power when striking deals with licensees and retailers. In a recent industry survey, respondents cited Disney as driving higher royalty rates and minimum guarantees in 2014. We also believe Disney has great relationships with retailers, allowing the company to negotiate for more/better shelving space in stores. Given Disney's large market share and must-have intellectual property, licensees and retailers are in a difficult position and are likely to accept Disney's terms, giving up some of the economics on their deals in order to drive higher volume, in our opinion.

- **Emerging markets likely to fuel future growth.** We believe emerging markets, with growing middle classes with increasing disposable incomes, will likely drive future growth in consumer products sales. By examining both population and disposable incomes, we find China and India to be the most lucrative markets for expansion. With the opening of its first retail store in China earlier this year and the Shanghai theme park early next year, Disney is poised to benefit especially from the Chinese market in the next few years, in our opinion.

- **Toy industry showing solid growth but further opportunity in new product categories.** While the global toy industry has been growing at a low-single-digit CAGR since 2008, we believe Disney is pursuing further growth by not only trying to grow market share but also expanding into new product categories.

Media

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See page 53 for analyst certification and important disclosures.

- **New franchises are additive to existing ones – Disney now has 11 franchises that generate $1b+ in global retail sales annually.** Disney benefits from not only its ability to generate new franchises, such as *Frozen* and *The Avengers*, which are the latest properties to join the $1b club, but also its ability to continue to capitalize on its 'evergreen' properties such as *Mickey & Minnie*, *Pooh*, and *Cars,* which continue to generate substantial licensing revenues even without major film release associations. Disney benefits from its vast corporate structure that allows constant branding across the Parks and Media Networks, which likely leads to continued consumer interest and retail sales that would otherwise fade shortly after a film leaves theaters.

- **Only media company to extensively own and operate its own retail stores, allowing control of the consumer experience and better brand building.** Disney operated 210 stores in North America, 73 in Europe and 45 in Japan as of FY2014. By owning its retail stores, Disney is able to create a great consumer experience, increase enthusiasm for its brands on an ongoing basis, and actively manage its brand. The stores also group products by franchise rather than product category, which has increased sales.

- **We expect the Consumer Products business to generate record earnings in F2016 with *Star Wars* film release in December a major driver.** We believe the increased sales of *Frozen* merchandise and roll-out of *Star Wars* merchandise this Friday ahead of the new film on December 18th will lead to $4.9b in Consumer Products revenues and $2.1b in operating income in F2016. In 1999, when the new *Star Wars* trilogy was released, sales of *Star Wars* licensed merchandise increased by 400%+ over a few months. Our analysis shows that a 200% increase in merchandise sales across licensees and the Disney retail stores could lead to an increase of ~$500m in revenues and ~$200m in operating income in F2016 with potential for further upside with greater sales, higher royalty rates on the lucrative property, or higher operating margins.

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Disney Consumer Products Driven by Strong Franchises

Consumer Products Greatest Beneficiary of Studio Success

Disney's Consumer Products had its best year ever in F2014, generating a record $4.0b in revenues, $1.4b in operating profit, and 34.0% operating margin.

Over the past five years, Disney's Consumer Product revenues have grown at a 10.4% CAGR, operating profits have grown at a 17.4% CAGR, and operating margins have expanded by 900bps. As Disney executed on its franchise-focused strategy over the past several years, with many franchises born out of the Studio Entertainment division (which we profiled in our previous report) and the cable networks, the Consumer Products division has benefited tremendously from success in the other divisions across the company. The substantial synergies across the company have allowed Disney to grow an impressive portfolio of franchise properties, making DIS the number one global licensor in 2014, capturing ~17.4% market share of licensing revenue out of the top 150 global licensors, compared to its closest media competitor, Time Warner's Warner Brothers, with just 2.3% market share. ***Supplemented with its own creative initiatives, an active licensing strategy unique for a media company, and a new retail store strategy launched in 2010, the Consumer Products division has increasingly become a noticeable source of growth for The Walt Disney Company.*** While this report mainly focuses on the Consumer Products segment, we note that Disney recently announced it will begin reporting the Consumer Products and Interactive divisions together in one segment beginning in F2016 as the two divisions already work closely together with back-office functions previously already consolidated.

Table 1: Global Top 10 Licensors, by 2014 Licensing Revenues

$ in billions

	Licensing Revenues					'10-'14	2014
Company	2010	2011	2012	2013	2014	CAGR	Market Share
The Walt Disney Company	$34.2	$37.5	$39.3	$40.9	$45.2	7.2%	17.4%
PVH Corporation	8.7	10.0	13.0	18.0	18.0	19.9%	6.9%
Meredith	NA	NA	11.2	16.6	17.7	25.7%	6.8%
Iconix Brand Group	12.0	12.0	13.0	13.0	13.0	2.0%	5.0%
Mattel	7.0	7.0	7.0	9.0	9.0	6.5%	3.5%
Sanrio, Inc.	5.0	5.0	7.0	8.0	6.5	6.8%	2.5%
Warner Bros. Consumer Products	6.0	6.0	6.0	6.0	6.0	0.0%	2.3%
Major League Baseball	5.0	5.0	5.2	5.5	5.5	2.4%	2.1%
Nickelodeon	5.5	5.5	5.5	5.5	5.5	0.0%	2.1%
Hasbro	3.7	5.2	4.8	4.4	5.1	8.1%	1.9%
Top 10 Total	**$87.1**	**$93.2**	**$112.0**	**$126.9**	**$131.5**	**10.8%**	**50.6%**

Source: License! Global, J.P. Morgan estimates.

Note: Disney 2010 revenues include Marvel. Meredith represents 2012-2014 CAGR. Highlighted represents media companies. Market share based on top 150 licensors.

We believe Disney's Studio Entertainment's franchise successes have had the greatest benefit to the Consumer Products division as strong brands can drive ancillary revenues with merchandise sales and high-margin licensing fees. For example, in the five quarters after *Frozen* was released in theaters, Disney's Consumer Products operating income increased 29%, and in the recent important December quarter, sales were the highest ever, while operating income increased 46% y/y, highlighting the success of the holiday season. Management likewise highlighted that *Frozen* has become the company's 11th franchise to register over $1 billion in annual retail sales, which we believe demonstrates the ability of Disney's vast retail and licensing infrastructure to quickly monetize popular IP.

Table 2: Disney Brands with $1B+ in Annual Global Retail Sales

Property	Origination
Pooh	Disney
Mickey Mouse	Disney
Monsters	Pixar
Star Wars	Lucasfilm
Spider-Man	Marvel
Cars	Pixar
Disney Junior	Disney
Princess	Disney
The Avengers	Marvel
Frozen	Disney Animation

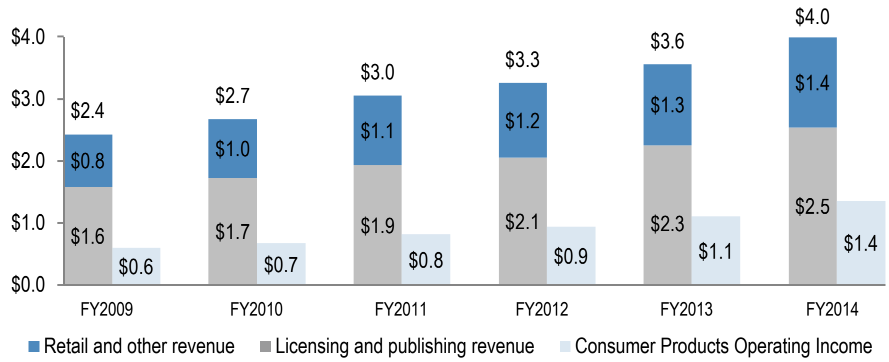
Source: Company, J.P. Morgan estimates.

In our opinion, the Consumer Products division should have continued success in years to come, driven by the company's evergreen properties including 11 franchises already generating more than $1b in annual global retail sales, new franchises, and ones yet to even be announced. In the near-term, we believe the most notable factors that will fuel success in the division include the recent releases of *Avengers: Age of Ultron* on May 1, *Inside Out* on June 19 and especially the upcoming release of the new *Star Wars* film on December 18th, as we believe there is significant built-up anticipation for the revival of this franchise. Disney has done a particularly good job of continuing its longer-running franchises, in our opinion, as it leverages its IP across all divisions of the company (Studio Entertainment, Consumer Products, Parks, Media Networks, Interactive), fueling significant continued licensing and retail revenues many years after the initial launch of a franchise. Within the Consumer Products division, Disney has also been expanding its reach into new categories beyond the traditional toys category, partnering with an increasing number of licensees, driving further monetization and brand-building opportunities.

We believe new franchises are additive rather than disruptive to the Consumer Products division. Therefore, despite difficult comps against *Frozen* in F2014, when segment revenues grew by 12.1% y/y and operating income by 21.9%, we expect this year's film slate with Marvel's *Avengers* and *Ant-Man*, Pixar's *Inside Out*, and the flow through of continued *Frozen* popularity will help lift FY2015 Consumer Products revenues another 13.4% y/y to $4.5b and operating income another 33.7% to $1.8b, helped by increases in high-margin licensing fees, strength in retail sales, and the global rollout of *Star Wars* merchandise on September 4th ahead of the release of the new film in December.

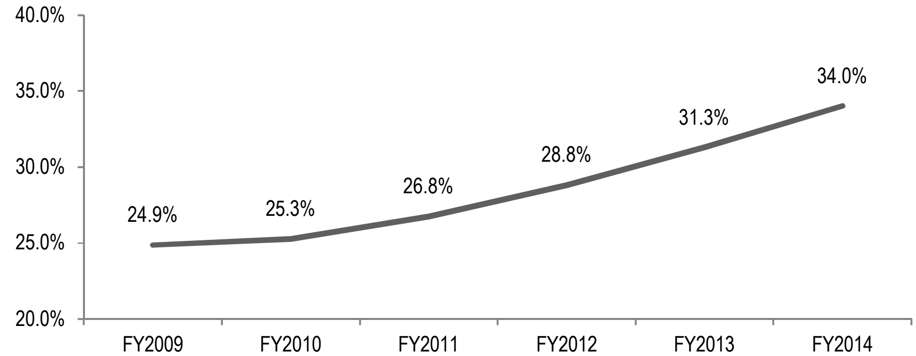
Figure 1: Consumer Products Historical Financial Profile

$ in billions



Source: Company reports and J.P. Morgan estimates.

Figure 2: Consumer Products Historical Operating Margin



Source: Company reports and J.P. Morgan estimates.

We believe Disney has the most significant brand equity out of our media coverage universe, which also helps drive retail sales and licensing partnerships as properties' association with the Disney brand likely leads to intangible benefits. According to Millward Brown's *BrandZ Global Top 100 Most Valuable Global Brands 2015*, Disney's brand value increased by 24% in 2015 to $43b, placing it at #19 and the only Media/Entertainment company on the list, up from #41 in 2010. The list also gives Disney a score of 5 on a scale from 1 to 5 for brand contribution, which measures the influence the brand alone has on a company's financial performance, up from a score of 4 in 2014 and 3 in 2012.

With the greatest marketing and distribution infrastructure in our media company coverage, in our opinion, Disney's integrated approach creates enormous synergies. The Consumer Products division not only benefits from the creation of new franchises across the company, but also helps to strengthen brands, which has additive effects on sequels/spin-offs in the Studio, ratings for branded shows at Media Networks, and enthusiasm for related attractions at the Parks. Disney is also the only media company to have an extensive retail store network, which further builds on the Disney brand as the stores create an immersive experience for the consumer and are more easily accessible ways for the average consumer to connect with the Disney brand and company.

In this report, we examine licensing and toy industry trends; analyze the Consumer Products strategy, growth opportunities, and risks; and profile the competitors. ***In our opinion, Disney not only has the best portfolio of intellectual properties but also is in the best position to monetize its IP with unmatched market and pricing power as the number one global licensor, a unique active licensing strategy, and its own retail stores that further help with branding.***

Disney Consumer Products Overview

Overview

Disney's Consumer Products division is composed of Merchandise Licensing, Publishing, and Retail.

Disney's Consumer Products division works with licensees, publishers, and retailers globally to design, develop, publish, promote, and sell a wide variety of products based on the company's intellectual property. The group is divided into Merchandise Licensing, Publishing, and Retail businesses. The group works with the broader company's film and television properties and also develops its own IP to be used across the company's divisions. The group sells products in 130+ categories, benefits from strong relationships with many of world's largest retailers, and is largely involved in product innovation.

Revenues at Consumer Products are generated from:

1) Licensing character/properties to third parties;
2) Publishing children's books, magazines, and comic books;
3) Selling merchandise at owned and operated retail stores;
4) Charging fees at English language learning centers; and
5) Selling merchandise on internet shopping sites.

The majority of Disney-branded products are produced and sold by independent licensees and Disney is not responsible for purchase orders, manufacturing, import, distribution, or sale of the products and does not determine the order price, quantity, delivery date, or products. However, Disney also has relationships with vendors for sourcing Disney-branded products for its own business including its retail operations, theme parks, and online.

The most significant costs of the business include costs of goods sold, distribution expenses, operating labor, and retail occupancy costs. Consumer Products also allocates costs for intersegment transactions to the Studio Entertainment division for royalties on revenue generated from products based on IP from Studio Entertainment.

The business is highly seasonal with the December quarter usually generating the highest revenues and operating margins due to spikes in retail sales/consumer spending during the holiday season.

Disney Consumer Products Overview

Merchandise Licensing:

- World's largest licensor
- Licenses characters from films, television, and other properties for use on third-party products
- Earns royalties usually based on fixed percentage of the wholesale or retail selling price
- Provides input on design of individual products

Publishing:

- World's largest publisher of children's books and magazines with 700 million+ products sold each year
- Extensive worldwide licensing structure as well as vertically integrated publishing imprints
- Includes an English language learning business, consisting of over 40 Disney English learning centers across China and a supplemental learning book program

Retail and other:

- As of F2014 owned and operated 210 stores in North America, 73 in Europe, and 45 in Japan
- Markets Disney, Pixar, Marvel, and Lucasfilm-themed products through retail stores operated under Disney Store name and through internet sites in North America (DisneyStore.com, MarvelStore.com), Western Europe, and Japan
- Offers merchandise the company designs/develops under wholesale arrangements

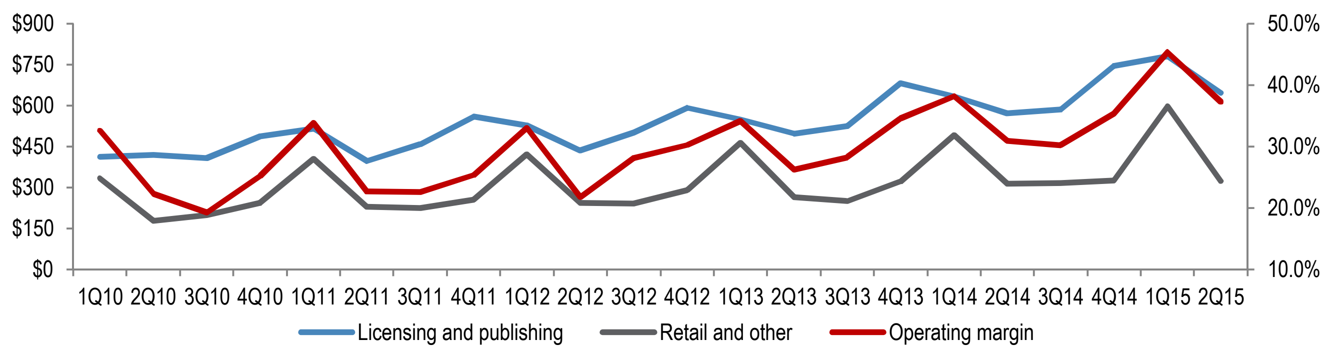
Interactive (to be reported together beginning F2016):

- Develops console, mobile, and virtual world games
- Disney Infinity, Tsum Tsum, Frozen Free Fall, Marvel Avengers Alliance, Club Penguin
- Other various functions

Source: Company filings, Company website.

Figure 3: Consumer Products Quarterly Financial Profile

$ in millions



Source: Company filings, J.P. Morgan estimates.

Merchandise Licensing

Disney licenses its characters from films, television, and other properties to third parties for use in products and earns royalties usually based on a fixed percentage of the wholesale or retail selling price. The company's major licensed properties include *Mickey/Minnie, Marvel properties, Disney Princess, Cars, Monsters, Star Wars,* and most recently *Frozen.*

Disney aligns its business around five strategic brand priorities: Disney Media, Classics & Entertainment; Disney & Pixar Animation Studios; Disney Princess & Disney Fairies; Lucasfilm; and Marvel. Disney licenses properties across many different categories including toys, apparel, home décor and furnishings, stationery, accessories, health and beauty, food, footwear, consumer electronics, and more.

Unlike other media companies, however, Disney employs an "active licensing" strategy in which the company provides input on the design of individual products and helps to create exclusive themed and seasonal promotional campaigns for retailers based on the company's characters, movies, and TV shows.

According to *License! Global's Top 150 Global Licensors Report*, Disney was the #1 licensor in 2014 with $45.2b in total retail sales of licensed products worldwide, an increase of nearly 10% ($4.3b) over 2013 driven by success from *Frozen*, *Guardians of the Galaxy*, and *Avengers*. Disney had 17.4% market share of global licensing revenues in 2014 (out of the top 150 global licensors) compared to the next leading media company, Time Warner, with only 2.3% share and Viacom with 2.1%. Furthermore, while Time Warner's Warner Bros. Consumer Products division and Viacom's Nickelodeon had flat growth from 2010 to 2014, Disney grew at an impressive 7.2% CAGR as it folded in the Marvel and Lucasfilm acquisitions, contributing to its growing scale. The top 150 global licensors generated $259.9b in global retail sales in 2014 compared to $251.8b in 2013 with Disney accounting for more than half of the increase.

Licensing is a very high margin business, allowing the Consumer Products division to have the second-highest operating margin within Disney behind Cable Networks.

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Publishing

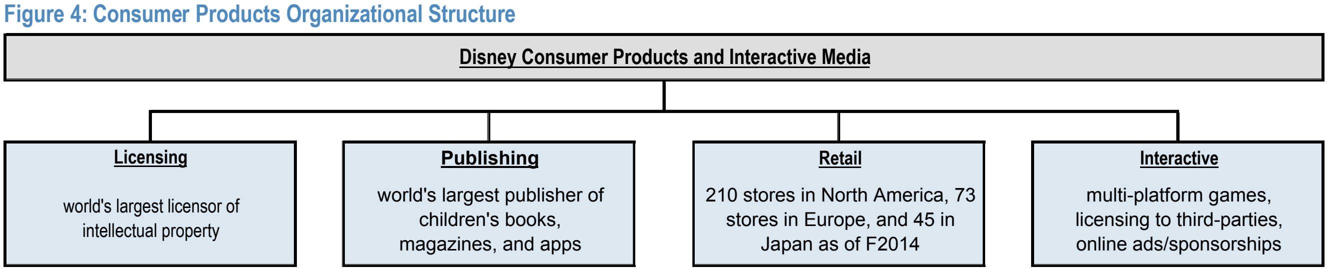
Disney Publishing Worldwide (DPW) is the world's largest publisher of children's books, magazines, and apps. The Core Publishing business creates and distributes books and magazines both vertically in-house in the U.S. and through a worldwide licensing structure in multiple countries/languages in key and emerging markets. DPW works with its licensees in both the U.S. and internationally to create children's comics and magazines, including *Sofia the First*, *Topolino*, *Le Journal de Mickey*, and *Aku Ankka*. Core Publishing also includes partworks and direct mail businesses internationally. DPW publishes books, magazines and digital products in 85 countries and 75 languages.

The Digital Publishing business creates content in the form of eBooks, apps, digital comics, enhanced eBooks and digital magazines. It has launched hundreds of eBooks, 170+ top-ranking apps, 1,500+ comics worldwide, and hundreds of franchise-based digital magazines.

DPW also operates Disney Learning, which is dedicated to the educational development of children worldwide and includes the flagship learning brand, Disney Imagicademy, as well as Disney English, Disney Educational Productions, and more. The group uses Disney characters to introduce curriculum-based content to help children learn. Disney English develops/delivers English language learning curriculum for Chinese children using Disney content in 33 learning centers located in nine cities across China.

Marvel Publishing creates/publishes comic books and graphic novel collections of comic books in both print and digital primarily in North America. Marvel Publishing also licenses the right to publish the translated versions of these comic books primarily in European and Latin American markets.

Figure 4: Consumer Products Organizational Structure



Source: Company reports and J.P. Morgan.

Retail

The Retail business markets Disney, Pixar, Marvel, and Lucasfilm-themed products through its owned and operated retail stores as well as through internet sites in North America (DisneyStore.com, MarvelStore.com), Western Europe, and Japan. The Disney Store retail chain was launched in 1987 in Glendale, CA. As of F2014, Disney owned and operated 210 stores in North America, 73 stores in Europe, and 45 in Japan. Online stores include www.DisneyStore.com, www.DisneyStore.co.uk, www.DisneyStore.fr and www.DisneyStore.de. The group also offers merchandise it designs/develops in-house under wholesale arrangements.

In the beginning of the century, Disney was facing difficulties with its retail stores as strong sales were offset by the rising costs of sales and operations, and the business lost some key executives. In 2002, Disney sold its Japanese operations to The

Oriental Land Company and in 2004 sold or licensed most of its stores to The Children's Place in North America. While The Children's Place intended to open new stores, specifically targeting outlet stores that have lower operating costs and higher margins, the company eventually decided to exit the business, finding the operation difficult to run under Disney's strict licensing agreement that required significant investment in remodeling stores.

In 2008, The Children's Place sold 231 Disney Stores in North America back to Disney. Disney subsequently announced the company would re-launch and re-brand the stores under a new strategy that would be integrated into Disney's company-wide franchise strategy. Whereas previously the stores used a merchandising philosophy and store layout similar to most retail stores where products are showcased by category, in 2010, Disney unveiled a new store format where it showcases products by franchise instead and only displays the most important company franchises, which led to a 25% reduction in stock keeping units (SKUs). The Oriental Land Company also sold back the 48 Japanese Disney Stores to the company in 2010.

Disney cites two significant advantages to owning/operating Disney Stores: the ability to launch/nurture new franchises such as Disney Princess, Fairies, and Baby in-store as well as the ability to leverage sell-through data across its licensee and retail network. The company found that the new, differentiated strategy of displaying products by franchise rather than by category strengthens the emotional connection kids have with franchises and also allows the stores to have more interactive entertainment. After the initial rollout of the new store formats to selected stores, Disney cited traffic in the new stores was 20% higher compared to existing stores and 25% more productive on a sales and margin basis. Furthermore, many guests surveyed in North America and Europe said that the new store design improved their perception of the Disney brand.

The flagship Disney Store in Times Square, New York City opened in November 2010 with 20,000+ square feet of space, making it the largest store in North America. 11,000+ guests visit the store everyday, and the store offers 1,850+ products.

Over 200 million consumers visit Disney stores each year. By owning the stores, Disney is able to have control over consumers' in-store experiences to ensure visits are in line with Disney's standards and desired brand perception. Disney describes a "fully immersive" retail experience for its guests at the stores, which include a Pixie Dust Trail, Magical Trees, a Disney Store Theater and Storytelling Neighborhoods featuring Disney, Marvel, and Star Wars product statements, and free daily activities and events.

More recently, Disney opened its first Disney Baby store in Glendale, CA in September 2012 and opened its first retail store in China earlier this year, which was immensely popular.

Disney Interactive Overview

Disney's Interactive division generated F2014 revenues of $1.3b with an operating margin of 8.9%.

Disney's Interactive segment, which will be reported with the Consumer Products division beginning in F2016, creates and delivers branded content across various interactive media platforms including the production and global distribution of multi-platform games, licensing of content for games and mobile devices, website management and design for Disney's other businesses, and development of branded online services. Interactive competes with other game software publishers including other online sites and products.

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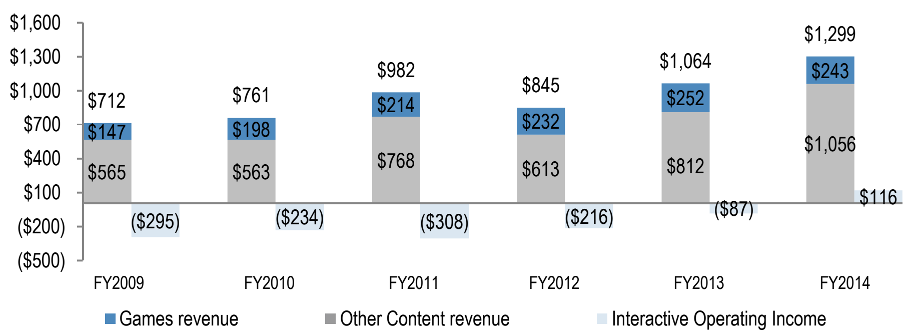
The segment's revenues are generated from:

1) Sale of multi-platform games to retailers/distributors, micro transactions, and subscription fees;
2) Licensing content to third-party game publishers and mobile phone providers; and
3) Online advertising and sponsorships.

Similar to the Consumer Products segment, Interactive revenues generally fluctuate based on seasonality with holiday selling periods as well as the timing and performance of game releases, which are somewhat tied to theatrical releases and cable programming broadcasts on which the games are based. The major costs associated with the segment include product development, cost of goods sold, marketing expenses, and distribution expenses.

Figure 5: Disney Interactive Historical Financial Profile

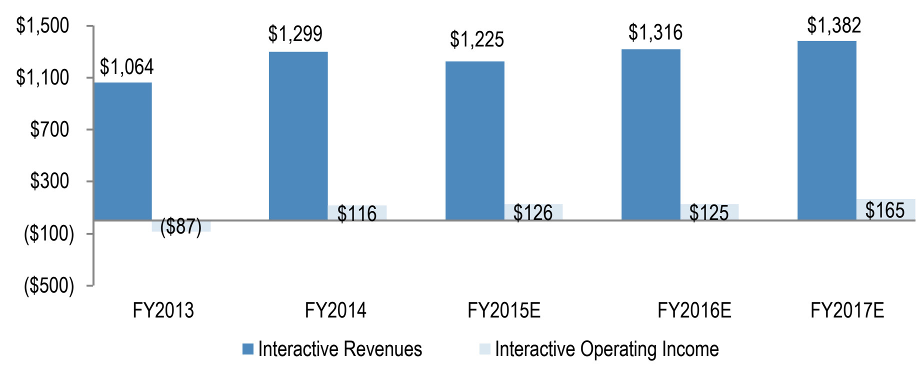
$ in millions



Source: Company filings, J.P. Morgan estimates.

Figure 6: Disney Interactive Financial Outlook

$ in millions



Source: J.P. Morgan estimates.

The segment reports revenues as "Games" and "Other Content." "Games" revenues are generated from the development of console, mobile, and virtual world games that are subsequently marketed and distributed worldwide. In F2014, Disney's significant console game release was Disney Infinity, which utilizes Disney's content and features a game world that combines physical toys and story-driven gameplay.

Mobile games include Tsum Tsum, Frozen Free Fall, and Marvel Avengers Alliance. Club Penguin is Disney's virtual world game. Disney also licenses certain properties to third-party video game publishers.

"Other Content" includes the licensing of Disney properties and content to mobile phone carriers in Japan; developing, publishing, and distributing interactive family content through platforms such as Disney.com, Disney on YouTube, and Babble.com; and developing and publishing apps for moms and families. Finally, the segment provides website maintenance and design for other Disney businesses.

The segment also allocates costs for intersegment transactions to the Studio Entertainment division for royalties on revenue generated by the division for products based on IP from Studio Entertainment films; however, these costs have been nearly negligible in recent years, in contrast to those of Consumer Products. In the fiscal years 2012-2014, Interactive recorded charges of $21m, $11m, and $44m, respectively, primarily related to severance costs for organizational and cost structure initiatives.

Focus on Branded, Franchise Content

Disney owned 7 of the top 10 entertainment/character franchises based on 2013 global licensed retail sales.

Disney's Consumer Products division, in line with the company's overall strategy, is aligned with franchises and branded content, primarily leveraging the success from the Studio and Media Networks to license and sell products through its retail stores. According to *The Licensing Letter*'s "$100 Million Properties" issue in November 2014, ***Disney owned 7 of the top 10 entertainment/character properties based on 2013 global licensed retail sales***, demonstrating the strength of Disney's franchises in terms of consumer products power. In the preschool property category, *Winnie the Pooh* was the only brand with $1b+ in global licensed retail sales with $2.8b in 2013, and second place *Thomas the Tank Engine* from HIT was far behind at $926m. More recently, *Frozen* and *The Avengers* became the latest Disney properties to begin generating $1b+ in annual global retail sales. According to estimates from *The Richest*, Disney also owns 6 of the top 10 film franchises in terms of lifetime merchandise sales as of August 2014 including the top three properties: *Star Wars* at $12b+ in retail sales, *Cars* at $10b in sales, and *Frozen* at $5.3b – we note that these totals, especially *Frozen*, would be higher after the 2014 holiday season.

Table 3: Entertainment/Character Properties with $1B+ in Global Licensed Retail Sales, 2013

$ in billions

Property	Owner	Retail Sales
Mickey & Friends	Disney	$4.0
Hello Kitty	Sanrio	3.9
Disney Princess	Disney	2.9
Winnie the Pooh	Disney	2.8
Cars	Disney	2.3
Star Wars	Lucasfilm / Disney	2.2
Angry Birds	Rovio	1.9
Monsters University	Disney	1.5
Spider-Man	Marvel / Disney	1.3
Peanuts	Iconix	1.2

Source: The Licensing Letter, J.P. Morgan estimates.
Note: Highlighted represents Disney-owned properties.

Table 4: Top 10 Film Franchises by Lifetime Merchandise Sales, through August 2014

Film Franchise	Retail Sales
Star Wars	$12,000+
Cars	10,000
Frozen	5,300
Transformers	3,000
Toy Story	2,400
Teenage Mutant Ninja Turtles	450
Batman	245
Despicable Me	230
Spider-Man	155
The Avengers	150

Source: The Richest, J.P. Morgan estimates.
Note: Sales based on total sales from movie accumulated over time as of August 2014.

Table 5: Disney Acquisitions
$ in billions

Acquisition	Purchase Price	Date Announced
Pixar Animation Studios	$7.4 billion	Jan 24, 2006
Marvel Entertainment, Inc.	$4.0 billion	Aug 31, 2009
Lucasfilm Ltd.	$4.1 billion	Oct 30, 2012

Source: Company reports and J.P. Morgan estimates.

Disney has two types of franchises: 1) evergreen franchises such as *Mickey* and *Princess* that perform well every year, which tend to be more profitable and sustainable, and 2) cyclical franchises such as *Pirates* that tend to spike around theatrical releases.

Although Disney had several evergreen franchises already, the company began to look to build an even stronger franchises business beginning in 2006 with its acquisition of Pixar, which gave birth to the *Cars* and *Toy Story* franchises. According to management's previous commentary, *Cars* brings in $2b+ in global retail sales annually, making it one of the company's biggest franchises. The acquisition of Marvel in 2009 and Lucasfilm in 2012 also brought very valuable franchises to Disney – *Star Wars* is estimated to have generated the highest lifetime merchandise sales out of any film franchise.

Meanwhile, Consumer Products also used Disney's classic IP to create franchises such as *Princess* and *Fairies*, which became extremely successful in the division. The *Pirates of the Caribbean* franchise initially was a theme park attraction turned into a film, which eventually flowed through to the CP division. Disney Channel created franchises such as *High School Musical*, *Hannah Montana*, and *Phineas and Ferb*, which have generated solid consumer products sales. Finally, even Disney's online game gave birth to *Club Penguin*.

We believe that Disney's franchise-focused strategy will fuel further growth in the Consumer Products segment with a strong movie slate for the next several years focused on many Marvel films and the revival of the *Star Wars* franchise in theaters. We believe franchises have the strongest licensing potential.

Table 6: Disney Film Slate, 2015E-2019E

	2015 potential slate			*2016 potential slate*			*2017 potential slate*		
	Title	**Studio**	**Release**	**Title**	**Studio**	**Release**	**Title**	**Studio**	**Release**
Q1	Cinderella (2015)	Live-Action	3/13	The Finest Hours	Live-Action	1/29	Beauty and the Beast (2017)	Live-Action	3/17
				Zootopia	Disney Animation	3/4			
Q2	Monkey Kingdom	Disneynature	4/17	The Jungle Book (2016)	Live-Action	4/15	Guardians of the Galaxy 2	Marvel	5/5
	Avengers: Age of Ultron	Marvel	5/1	Captain America: Civil War	Marvel	5/6	Star Wars: Episode VIII	Lucasfilm	5/26
	Tomorrowland	Live-Action	5/22	Alice in Wonderland...Looking Glass	Live-Action	5/27	Toy Story 4	Pixar	6/16
	Inside Out	Pixar	6/19	Finding Dory	Pixar	6/17			
Q3	Ant-Man	Marvel	7/17	Pete's Dragon	Live-Action	8/12	Pirates of the Caribbean 5	Live-Action	7/7
Q4	The Finest Hours	Live-Action	10/9	Doctor Strange	Marvel	11/4	Thor: Ragnarok	Marvel	11/3
	The Good Dinosaur	Pixar	11/25	Moana	Disney Animation	11/23	Coco	Pixar	11/22
	Star Wars: The Force Awakens	Lucasfilm	12/18	Rogue One	Lucasfilm	12/16			
				Untitled (TBD)	Pixar	2016			

	2018 potential slate			*2019 potential slate*		
	Title	**Studio**	**Release**	**Title**	**Studio**	**Release**
Q1	Untitled (TBD)	Disney Animation	3/9			
Q2	Avengers: Infinity War - Part I	Marvel	5/4	Avengers: Infinity War - Part II	Marvel	5/3
	Untitled Han Solo Film (TBD)	Lucasfilm	5/25			
	Untitled (TBD)	Pixar	6/15			
Q3	Black Panther	Marvel	7/6	Inhumans	Marvel	7/12
Q4	Captain Marvel	Marvel	11/2	Star Wars Episode IX	Lucasfilm	2019
	Untitled (TBD)	Disney Animation	11/21			

Source: Boxofficemojo, J.P. Morgan estimates.

Active Licensing Strategy Sets Disney Apart

Disney's active approach to licensing is unique in the media industry.

While all movie merchandising programs experience steep revenue decay curves after the films' DVD releases, Disney's goal is to minimize the falloff of revenues through an active licensing strategy, which combines product innovation, active product line management, and retail mapping at the stock keeping unit (SKU) level. ***We believe that Disney's active licensing strategy sets the company apart from other media companies in our coverage and has been incredibly successful in helping to drive growth at Consumer Products.*** Whereas in a passive/traditional licensing model the licensor is focused primarily on signing deals with licensees, Disney collaborates with its licensees by providing input on the design of individual products and helping to create exclusive themed and seasonal promotional campaigns for retailers based on the company's characters, movies, and TV shows.

Until 2000, Disney employed a passive licensing strategy, which was standard industry practice for entertainment licensing. Under this strategy, the licensee is responsible for product line and key account management. Although the margins under this strategy are very high, Disney believed that the strategy inhibited sustained growth and did not maximize lifetime value of franchises but instead led to spikes in revenues and profitability tied to the timing of major film releases. In addition, once deals were signed, Disney was limited to only signing additional IP licensing deals or raising royalty rates for its existing licensees in order to generate growth.

Once Disney decided to move to an active licensing strategy, the company made its licensing teams responsible for brand and product line management instead of passing the responsibilities on to licensees. The teams also develop growth plans by franchise, by SKU, and across licensees/retail networks. Whereas this business model was novel for media/entertainment companies, it is standard for traditional consumer products goods companies to employ this strategy. Furthermore, Disney's central creative team was broken down and embedded into each category. These teams were viewed as an extension of the R&D capabilities of licensees, allowing Disney Consumer Products employees to actually help design many products, allowing the company to have greater control over building its brand equity and growing market share.

Finally, Disney even opened field sales offices close to its key accounts worldwide. For example, Disney has offices adjacent to Walmart in its headquarters in Bentonville, AR; Target in Minneapolis, MN; Toys-R-Us in Wayne, NJ; Tesco in Welwyn Garden City, UK; and Asda in Leeds, UK. Most of these offices allow Disney employees to drive to a licensee's office in fewer than five minutes and clearly allows the company to develop deeper relationships with its counterparties.

As an example of how the strategy works in practice, the team responsible for *Disney Princess* works across licensee and retail networks. The segment 'Princess' is divided into sub-categories such as Fashion Dolls, Small Dolls, Large Dolls, and Role Play. Each of these sub-categories will have a lead licensee based on expertise or proposals by each licensee. The team will also constantly look for new ways to grow market share in existing categories or potentially create new categories. For example, Princess & Me took Disney into an entirely new category of dolls in terms of age, scale, price point, and play pattern and also brought new opportunities for different types of accessories. The team also develops cross-categorical design schemes at key selling periods, which creates an opportunity for each *Disney Princess* licensee to refresh their product lines simultaneously. This helps unify the look at retail and focuses the ad dollars of key licensees on a central theme.

Under this strategy, however, the teams must manage the product line plans of all key licensees/accounts and work with many various parties, each of which have exclusive licensing rights for specific categories of toys or merchandise, which can become very complicated.

There are several examples of how the active licensing strategy has successfully impacted the division's revenues and profitability. For example, in 2005, *Toy Story 3* generated $500m+ in toy retail sales in North America, which was twice the size of toy sales associated with *Toy Story 2* in 1999 when Disney was operating a passive licensing strategy. When *Cars* debuted in theaters in June 2006, the Consumer Products division benefited with a $40m increase in revenue that year from the film. However, the franchise continued to sell, increasing its revenue contribution to the division to $220m in F2008, $216m in F2009, and $240m in F2010. The franchise's ability to sustain high levels of revenue since the film's release is impressive and is likely partially attributable to Disney's active licensing model, in our opinion.

We believe that by becoming more involved in the operations after signing a licensing agreement, Disney is better able to generate growth of its licensed properties and minimize revenue/profit volatility around film releases. The strategy also allows Disney to develop closer relationships with licensees and retailers, generating revenue synergies by utilizing its power/leverage with retail distributors for better terms such as shelf space. Disney has developed a unique marketing platform for each key account and has secured permanent shelf space at all of them, which ensures more stability in the business.

Marvel

Disney's top Marvel properties are *Spider-Man* and *The Avengers*, each generating $1b+ in annual global retail sales.

Marvel Acquisition Provided Consumer Products Synergy Opportunities

Disney's acquisition of Marvel in 2009 brought significant potentially monetizable IP to Disney, which Disney has capitalized on with the release of several new Marvel films that have subsequently led to increases in consumer products sales. The Marvel universe was immensely valuable with a tremendous amount of brand equity and successful films already released at the time of the acquisition. However, Disney executives saw great opportunity to pump Marvel's franchise properties through its various divisions. In particular, one of the main areas of value management cited for the acquisition was the ability of Disney to leverage its own sales/distribution infrastructure and licensing relationships, domestically and particularly internationally, to generate greater consumer products revenues.

At the time of the acquisition, international represented a little less than 50% of Marvel's licensing revenue compared to Disney, which was meaningfully above 50% internationally. Marvel was able to utilize Disney's licensing, sales, and distribution infrastructure as well as key account relationships to drive higher returns on the IP in consumer products. While Marvel was already a highly valued property with many attractive licensing/distribution agreements for several of its best-known properties, Disney saw great opportunity in the international markets and for its lesser-known properties. As part of the acquisition, Disney assumed the current licensing agreements that were in place but as the deals concluded, Disney could decide to bring the rights in-house, pursue deals with alternative third parties, or extend the terms of the deals. Marvel did not have principal operations in certain markets internationally or direct relationships with certain key retailers, allowing Disney to more broadly expose and develop these properties. Disney enhanced both the breadth and nature of Marvel's relationships. Disney also had the ability to enhance Marvel's operations in the comic book space, in which it had low- to mid-40s (%) market share, by utilizing Disney's children's publishing business.

Furthermore, by including Marvel's portfolio of properties into the Disney umbrella, the latter was likely able to generate further revenue synergies as the inclusion of Marvel properties increased Disney's leverage with retail distributors for terms such as shelf space. By going to the market with an even broader set of "must-have" properties, Disney is able to ask for better terms with its counterparts.

Marvel has implemented an impressive consumer products strategy with Marvel toy sales in the U.S. up 13% in 2014. However, we believe there is much more opportunity ahead as Marvel expands its existing franchises into new geographies and product categories as well as creates and promotes entirely new franchises.

Spider-Man First Property to Generate $1B+ in Annual Global Retail Sales

Spider-Man was the first Marvel property to generate annual global retail sales of over $1 billion. According to *The Licensing Letter*, the franchise generated $1.3 billion in global retail sales in 2013 and was the world's most profitable superhero in terms of licensing. In 2014, the strength continued as licensed product sales from the franchise once again contributed significantly to Consumer Products, driven by Sony's *The Amazing Spider-Man 2*, the *Ultimate Spider-Man* animated series on Disney XD, and the launch of a *Spider-Man* franchise site on MarvelKids.com.

Furthermore, after Disney and Sony announced a deal earlier this year in which the *Spider-Man* character will appear in some Marvel films including *Captain America: Civil War* next year and Disney will help Sony with a new *Spider-Man* film, Disney has been more active in licensing opportunities for the property, looking at new licensees and target markets. According to The NPD Group, *Spider-Man* product sales spiked following the announcement, demonstrating the increased interest in the property. While Sony will continue to finance and distribute *Spider-Man* films and have creative control over the franchise, Disney owns 100% of the *Spider-Man* merchandise licensing rights and will benefit from a successful film revival and ongoing branding of the franchise.

Guardians of the Galaxy Received Support Despite Being Unproven

Despite *Guardians of the Galaxy* being an unproven franchise before its film release in August 2014, Disney was able to sign deals with 50+ licensees including Hasbro, Lego, Mad Engine, KIDdesigns, New Era, Rubies and Disguise. Typically, the first film in a potential new franchise, especially a summer film, will not attract as many licensees as the risk is high for a film being less popular than expected, which may lead to retailers holding substantial unsold merchandise. However, Marvel benefited from its history of success, such as with the *Iron Man* franchise, which released successful films in 2008, 2010, and 2013, leading to a combined $2.4b in worldwide box office receipts and strong merchandise sales. Therefore, for *Guardians of the Galaxy*, Marvel was able to negotiate favorable terms with retailers. For example, Walmart gave *Guardians* merchandise prime placement in its stores, and Party City and Target joined with Walmart to promote the characters during the back-to-school season.

Avengers: Age of Ultron Became Disney's Most Integrated Retail Program

Following the success of the first *Avengers* film in May 2012, Disney decided to implement a much broader strategy for its *Avengers: Age of Ultron* film, which hit theaters in May 2015. Disney looked to expand its target consumer base by expanding more to women and fans of individual superheroes rather than solely the whole team. As Paul Gitter, senior vice president of licensing for Marvel said, "For the first film, we primarily focused on the *Avengers* property and the group shots. Now we're broadening the line and scope to create skews that focus on the team and the individuals characters, as well," generating a licensing program that was "significantly broader in scope" in terms of both types of products sold as well as number of retailers selling them, an example of expanding consumer products offerings and driving even greater sales.

The product rollout was Disney's most integrated retail program at the time with partners each overseeing pieces of brand awareness advertising, social media, digital, in-store, and in-theater advertising rather than all partners pushing the same type of campaign. While the *Avengers* franchise generated $1b+ in retail sales in 2014, we expect that the franchise will generate even more in 2015 as Disney continues to build on the popularity of the franchise by expanding its product offerings, retail partners, and marketing strategies.

Captain America: Civil War Unsurprisingly Receiving Strong Merchandising Support

In the beginning of June at the 2015 Licensing Expo, Marvel announced the 2016 film *Captain America: Civil War* licensees, which include Hasbro, Lego, Funko, Hot Wheels, Rubies, Mad Engine, C-Life, Jay Franco, Global Brand Group, Kellogg's, Hallmark and American Greetings. Unsurprisingly, Disney plans to expand into a large breadth of categories for the film, signing on many licensing partners that each specialize in certain merchandise types. The merchandise will hit store shelves approximately eight weeks prior to the film's May 6, 2016 opening. The campaign will also feature a celebration of Captain America's 75th anniversary limited to higher-end retailers. Disney will aim to expand both the popularity of newer characters such as War Machine, Falcon, Vision, Black Widow, and Black Panther as well as the product lines offered such as healthy living and travel.

Additional Marvel Opportunities

Going forward, we believe Marvel has much more merchandising potential not only with the upcoming film slate but also with its slate of Netflix series and the rising popularity of characters such as Luke Cage and Jessica Jones, animated series on Disney XD, new comic books, and other initiatives.

Along with the premiere of the first series in its Netflix partnership, *Daredevil*, Marvel released a small line of products that caters to a more adult audience, in line with the show's target audience. According to Gitter, the merchandise would be "somewhat limited in scope" and targeted "more on teens and adult fans with that shop at specialty stores or outlets like Hot Topic." Despite the unproven series, several licensees were interested in partnering with Marvel given its strong brand and history of successes. Along this same strategy, Marvel has also started to create properties around its animated series on Disney XD and content on its Marvel Kids website in order to generate interest for its characters year-round.

Marvel is also involved in the comic book space with its latest *Secret Wars* released in May 2015, an eight-issue mini-series in which the Marvel Universe combines with various other alternate universes. The series ran twice each month until June 2015, after which it is running monthly until October. The release of the comic books was also supported by consumer products targeting teens and adult collectors.

Lucasfilm

Lucasfilm Acquisition Brings Invaluable Intellectual Property

***Star Wars* is one of the best-selling licensed merchandise brands worldwide, recently the second highest grossing global toy license (behind *Frozen*), generating an estimated $12b+ in merchandise sales over its lifetime.**

When Disney acquired Lucasfilm in 2012, an important aspect of the deal was based on the further consumer products and licensing potential of the *Star Wars* franchise, similar to the Marvel acquisition. Despite the near-universal awareness of *Star Wars*, Disney believed the company could generate even greater consumer products sales and consumer awareness by reinvigorating the brand through new film releases, the last of which was released in 2005 (*Episode III – Revenge of the Sith*), as well as expanding the licensing opportunities both geographically and to new product categories. With Disney's first *Star Wars* film to be released on December 18th, there has been an incredible amount of consumer excitement, which we believe will easily translate into incremental revenues across all of Disney's divisions.

In 2012, the Lucasfilm Consumer Products business was expected to generate total licensing revenue of approximately $215m, similar to the amount Marvel generated in 2009. However, with new film releases and the support of Disney's sales/ distribution networks as well as TV channels, Disney believed it could grow these revenues substantially. At the time of the acquisition, Lucasfilm's licensing was heavily skewed to the toy category and to the North American market with <40% of revenue from international. Disney saw opportunities to expand merchandise into many new categories as well as bring the property to new markets worldwide by leveraging its own global organization. Lucasfilm's international merchandise was preciously sold through third-party representatives, which could be replaced by Disney representatives for much lower cost and more effective licensing. By combining the franchise with Disney's existing portfolio, all properties would benefit from more leverage with licensees and retailers, leading to better terms and increased shelf space.

Revival of Film in December 2015 Expected to Lift Consumer Products Revenues

Ahead of the release of *Star Wars: The Force Awakens* on December 18th this year, Disney has built up tremendous interest in the film and revival of the franchise through new merchandise, video games, the early release of trailers, and other strategic tactics. ***Disney plans to release new Star Wars merchandise associated with the new film this Friday, September 4th, which the company has named "Force Friday."*** At midnight, mass retail stores and online sites worldwide will make *Star Wars: The Force Awakens* merchandise available for purchase. The products will be spread across a wide variety of categories including action figures, play sets, books, comics, apps, apparel and other accessories. Notably, the release of the merchandise is a full 15 weeks ahead of the film release, which is a much earlier release than the typical six weeks for a consumer products rollout in conjunction with a film.

At the recent E3 video game conference in June, Disney gave out thousands of unreleased Yoda and Darth Maul toys for free. So many attendees lined up at the Disney booth at the start of each day to receive the toys that Disney was forced to close the line after sometimes just one minute in order to not run out of toys. Many of the attendees then sold the unreleased toys online – one collectible figure, part of Disney's Infinity 3.0 videogame platform, will retail for ~$14 when it goes on sale this fall but was selling for as much as $300 on eBay. Certain characters such as Darth Maul were also selling for $200-$300, and Chewbacca/Yoda characters were selling for ~$75. At Comic-Con in July, the *Star Wars* event showed some behind-the-scenes footage from filming. For that event, some fans lined up as early as 24 hours before the panel began.

Lucasfilm licensed the rights to Electronic Arts (EA) to create *Star Wars*-themed video games in May 2013 under a 10-year, exclusive deal. EA recently revealed the details on its first three new *Star Wars*-themed games that will be available on console, PC, and mobile, including the eagerly anticipated "Star Wars: Battlefront" game. EA expects the game, the first to be launched under the agreement, to be one of the biggest new games this year, and management said it expects to sell 9-10m copies. "Star Wars: Battlefront" will ship on November 17th, a month before the film release. Similar to its other licensing relationships, Disney described the partnership with EA as a deep partnership and offered access to Lucasfilm's archives and resources in order to ensure likeness to the actual films.

We believe that the rollout of the new *Star Wars* merchandise will lead to hugely beneficial revenues and profits for the Consumer Products segment beginning in FQ4 and for many quarters afterwards as we anticipate successful flow-through following the film's release as well. We expect the merchandise to be unique and collaborative – for example, Disney has already begun leveraging the IP to create new, interesting merchandise such as Mattel's Hot Wheels for Darth Vadermobiles and Hasbro's Ferby for "Furbacca," which has an embedded app that plays *Star Wars* songs. We also expect increases in sales for the classic *Star Wars* merchandise, such as the most popular product, the lightsaber with ~10m sold each year.

Hasbro Holds Majority of Disney's Master Licenses as Relationship with Mattel Becomes Less Significant

Hasbro is the master toy licensee for Marvel and Star Wars and will acquire the rights to Frozen and Princess from Mattel beginning in 2016.

Mattel Became First Toy Licensee of Disney Properties

For toy companies, holding the master toy license of popular properties is essential. While Hasbro currently holds the majority of Disney's important master toy licensees through their long partnership, Mattel was Disney's first key partner.

Disney's relationship with Mattel began in 1988 with a license to produce a line of infant and preschool toys incorporating classic Disney characters such as Mickey Mouse, Donald Duck, and Pluto. In 1991, the companies expanded the toy license to include additional entertainment characters and toy categories, specifically in the infant and preschool toys categories. The deal also gave Mattel participation in attractions at Disneyland, Walt Disney World and Disneyland Paris. In 1996, Disney further expanded its partnership with Mattel, giving the toymaker worldwide toy rights for all Disney TV and film properties. The three-year agreement gave Mattel first-look rights for deals to manufacture toys based on Disney characters. The deal covered categories including all dolls, plush, male action figures, vehicles and battery- powered ride-on toys worldwide as well as games and puzzles within the United States.

Hasbro Signs First Agreement with Disney in 2000

In 2000, Disney awarded licensing agreements to both Mattel and Hasbro. Mattel received the rights to produce toys based on classic Disney characters, such as Mickey Mouse and Winnie the Pooh worldwide excluding Japan for preschool and plush toys, dolls, games and puzzles.

Meanwhile, Hasbro received the rights to produce the more lucrative toys, action figures, and games portion of Walt Disney products associated with all upcoming Disney-branded film, television, and direct-to-video properties, which began with the release of *Monsters Inc.* in fall 2001. Hasbro was also named the official toy and game company for Walt Disney World, Disneyland, and Disneyland Paris resorts, allowing the company to open toy stores inside the resorts and supply games/toys to Disney's hotels and cruise ships.

We believe it is possible that Disney moved its licensing agreement away from Mattel to Hasbro since Mattel had an agreement for Warner Brothers' Harry Potter franchise at the time, and it was possible the toy company would spend more time focusing on the merchandise launch of the new franchise.

Table 7: Disney Master Toy Licensees

Intellectual Property	Licensee	Notes
Princess / Frozen	Mattel	Through 2016
	Hasbro	Beginning in 2016
Marvel	Hasbro	Through 2020
Star Wars	Hasbro	Through 2020; Will roll out new product September 4th

Source: Company, press reports, J.P. Morgan estimates.

Hasbro's Longstanding Agreements with Marvel and Lucasfilm Strengthen its Ties to Disney

Hasbro's relationships with Marvel and Lucasfilm precede Disney's acquisitions of the two companies. After the acquisitions, Disney resigned agreements with Hasbro, demonstrating the strength in the partnerships and Hasbro's increasingly strong ties to Disney.

In 2006, Hasbro become Marvel's master toy and game partner in a five-year licensing agreement covering categories such as action figures, role play and pre-school toys, board games and puzzles for both classic and film-related Marvel characters. Marvel also agreed to provide certain services to Hasbro in connection with the licensed toys. The deal guaranteed Marvel $205 million in royalty and service fee payments, $70 million of which was payable on the theatrical release of *Spider-Man 3* and $35 million of which was payable upon the theatrical release of *Spider-Man 4*. The license could be extended past the five years depending on the number of other entertainment properties released during the agreement. In order to complete the agreement, Marvel canceled its licensing agreement with Toy Biz Worldwide a year earlier than scheduled and paid an early termination fee.

In 2009, Marvel and Hasbro extended their relationship through 2017. The deal guaranteed Marvel $100 million in royalties and the potential to earn another $140 million in royalties contingent upon film releases that met certain criteria. The deal gave Hasbro global rights ex-Japan for toys and games based on both classic and film-based Marvel characters.

Meanwhile, Hasbro has a much longer and interesting relationship with Lucasfilm. In 1977, George Lucas initially granted Kenner the exclusive rights to produce *Star Wars* toys in perpetuity for $100,000/year. In 1991, Hasbro bought Kenner but sold the *Star Wars* license as the business was not generating much income at that time. In 1992, Galoob, the next owner of the license, launched and heavily promoted a new *Star Wars* line. After seeing this success, Hasbro convinced Lucas that the company also wanted to work on *Star Wars* products and focused on larger toys in comparison to Galoob's small-scale toys.

In 1997, ahead of the new *Star Wars* trilogy, Lucasfilm once again awarded the toy licensees to Hasbro and Galoob Toys over rival Mattel in the most lucrative toy licensing deal ever at the time. The deal covered all three new *Star Wars* films. Lucasfilm was given stock warrants equal to slightly less than 20% of Galoob's shares outstanding, valued at ~$57.2 million at the time, and warrants equal to slightly less than 5% of Hasbro's shares outstanding, valued at ~$170 million at the time. Galoob also paid a ~$140 million advance against future royalties, payable as the three new films were released. A Hasbro advance was not reported. Royalty fees from both companies were in the 15-20% range – double the industry standard. The licensees were also given long-term preferential negotiation rights from Lucasfilm for the same categories of toys based on any new Lucasfilm features. Hasbro was responsible for core action figures, vehicles and games, electronic hand-held games, creative play products, and more. Meanwhile, Galoob was awarded rights to small-scale figures, vehicles, playsets, and accessories.

The immensely lucrative deal was based on *Star Wars*' influence as already the best-selling toy license in the world. Analysts at the time estimated *Star Wars* global retail sales could have reached $1 billion before the end of the century, and the toys could generate $4 billion in sales over the life of the contract. In 1998, Hasbro acquired Galoob for $220 million, allowing the company to consolidate the *Star Wars* license.

In July 2013, Disney and Hasbro extended their licensing agreement for both Marvel and *Star Wars* properties through 2020, representing the first deal after Disney's acquisition of Marvel and Lucasfilm. Under the terms of the deal, Hasbro paid an additional $80 million in royalty payments to Disney to extend the Marvel licensing pact for two years through 2020 and also agreed to pay up to $225 million for *Star Wars* merchandise rights through 2020. The Marvel payments are contingent on additional theatrical releases, and the *Star Wars* payments are contingent on Disney's next three film installments with $75 million payable upon signing. The Marvel agreement covers both Marvel Comics and film toys, and the *Star Wars* agreement covers toys for the new films.

Hasbro to Hold *Frozen* and Princess License Rights Beginning in 2016, Solidifying Position as Disney's Top Key Licensee

In September 2014, Disney announced it was granting the global rights ex-Japan to its Princess line and *Frozen* dolls and accessories to Hasbro from Mattel beginning in the spring of 2016. With the new agreement, Hasbro holds most of Disney's key licenses, including Marvel and *Star Wars* properties. The deal ended the nearly 20-year relationship between Mattel and Disney as Mattel had held the rights since 1996. Financial terms of the agreement were not disclosed. Approximately one-third of Hasbro's business is now contingent upon deals with Disney.

Consumer Products Outlook

Licensing Opportunity and Positioning

Disney's increasing scale and portfolio of "must-have" intellectual property allow the company to push licensees on royalty rates and minimum guarantees as well as retailers on shelf space and marketing commitments/promotions.

We believe that Disney's position as the #1 global licensor and its growing portfolio of high-quality franchise properties will lead to sustained licensing revenue and profit growth as the company both leverages its market power to get better terms from licensees/retailers and expands geographically and into new product categories.

According to *The Licensing Letter*'s *Annual Licensing Business Survey*, many survey respondents attributed the 2.9% rise in entertainment/character property royalty rates in 2014 from to 9.70% from 9.43% in 2013 to "platinum" properties, particularly those owned by Disney, suggesting Disney has already been increasing its push for higher royalty rates with licensees given the lucrative potential sales volume associated with Disney properties.

In 2014, minimum guarantees generally remained flat across most categories. However, once again, survey respondents cited the entertainment/character category as the property type that increased the most and called out Disney as pushing for higher minimum guarantees for their brands given the company's significant market power and extremely lucrative properties. Despite increasing guarantees for well-performing, established properties, the survey respondents were less keen on paying guarantees for lesser known character properties.

Disney also has strong relationships with many of the world's largest retailers and we believe will continue to build these relationships as well as expand internationally. Disney's unique active licensing strategy in the media world, in which the company has field sales offices close to its key accounts worldwide, likely allows Disney to develop closer relationships with retailers than most other media companies. By having offices adjacent to Walmart in its headquarters in Bentonville, AR; Target in Minneapolis, MN; Toys-R-Us in Wayne, NJ; Tesco in Welwyn Garden City, UK;

and Asda in Leeds, UK, Disney employees are able to drive to a licensee's office often in fewer than five minutes.

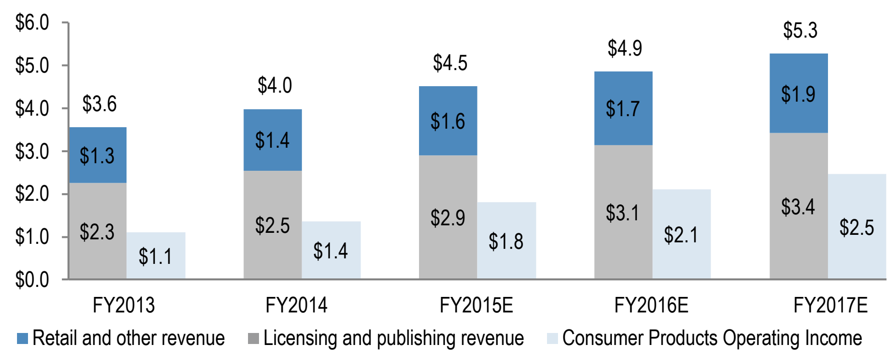
We believe Disney will be able to continue to use its leverage in the market to secure beneficial terms with retailers such as for shelf space or marketing commitments. Disney has secured permanent shelf space with most key accounts/mass retailers, ensuring more stability in the business. Similar to negotiations with licensees, as Disney continues to build out its franchise properties, the company will synergistically benefit from a more powerful position as it negotiates in the future with retailers. In *The Annual Licensing Business Survey*, respondents also cited Disney as being aggressive in securing retail shelf space for its properties and expect the company to continue to be aggressive for *Star Wars* merchandise later this year in particular.

Finally, we believe Disney will continue to expand its licensing agreements in international markets as many lucrative markets such as China are likely underpenetrated/undermonetized. We believe Disney will also increasingly expand beyond toys and games into much more diverse product offerings as the company no longer looks simply to toy companies as potential licensees but develops more innovative and expansive partnerships.

In our opinion, Disney's position as the #1 global licensor with a broad portfolio of attractive properties that we expect to further increase will allow the company to further leverage its powerful position for higher royalty rates and minimum guarantees in the future as well as continue to secure generous amounts of shelf space at key retailers. In particular, we believe the immense popularity of *Frozen* and rollout of the *Star Wars* merchandise ahead of the film release later this year have likely given a significant boost to Disney's already strong position in the marketplace and will likely lead to incremental benefits such as the ones cited above.

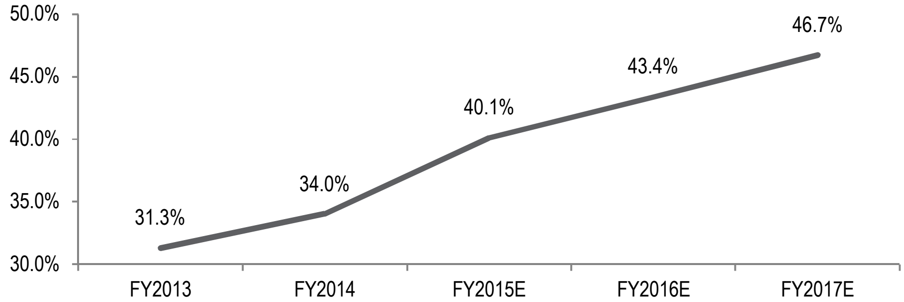
Figure 7: Consumer Products Financial Profile

$ in billions



Source: Company reports and J.P. Morgan estimates.

Figure 8: Consumer Products Operating Margin



Source: Company reports and J.P. Morgan estimates.

Retail Stores Opportunity: China Expansion Demonstrates Strong Demand

In May 2015, Disney opened its first retail store in China to a line of customers more than a mile long, forcing the store to close for the day only one hour after its opening.

Disney opened its first Disney retail store in China and largest store worldwide in Shanghai in May 2015. The 9,257-square-foot store with an outdoor plaza was forced to close for the day only one hour after its opening as there was a line longer than a mile of customers waiting outside, demonstrating the immense demand in the Chinese market for Disney properties. Hundreds of customers waited more than three hours to get into the store, and additional shoppers were prevented from joining the line due to overcrowding fears. The security staff had to set up a queuing system to control the crowd with signs set out at the 60-minute, 90-minute, and 180-minute marks to let customers know the estimated waiting time. The Shanghai store has 2,000+ Disney products and has a 19-foot-high Magic Kingdom castle at the center where there is a performance every hour. Disney designed special toys for the grand opening, which were the best-selling products on the opening day. With approximately 40 million tourists visiting the Lujiazui area of Shanghai each year where the store is located, the store represents a tremendous opportunity for growth in Disney's retail store operations. The store will also get further traction when the complementary Shanghai Disneyland theme park opens in spring 2016.

We expect that further store openings in lucrative, densely populated international markets such as China will primarily fuel growth at the retail stores. Although Disney has not yet announced its final plans yet, we believe the company will open more stores in China following the astounding early success with the first store. In particular, we believe there will be increased local interest following the opening of the Shanghai theme park

Frozen Case Study Demonstrates Effect of Powerful New Franchise on Consumer Products Segment

***Frozen* products generated ~$531 million in licensed toy sales in the U.S. in 2014, represented recently the top-selling licensed property in both the U.S. and globally, and won Property of the Year at the 2015 Toy Fair.**

The immense success of *Frozen* is best shown in the Consumer Products segment. Despite being somewhat caught off guard by the immediate popularity of the franchise and initially understocking at retailers, Disney quickly pushed out more merchandise and sales of *Frozen* licensed merchandise is up ~10x this year vs. the comparable period last year with earned licensing revenues up 20%+ compared to last year.

In 2014, *Frozen* won Property of the Year at the 2015 Toy Fair after generating ~$531 million in licensed toy sales in the U.S. across 39 different categories with 300+ different items according to the NPD Group estimates. *Frozen* was in fact a large contributor to the 7% increase in the Toys/Games category in 2014 as both the top toy property as well as the top gainer among all toy properties based on absolute dollar growth.

Many retailers as well as Disney were caught off guard by the immense popularity of *Frozen* properties. For example, Toys R Us expanded its selection of *Frozen*-related products from a few dozen in the beginning of 2014 to more than 300 by the end of the year for the holiday season. Disney rolled out properties across many different age groups with dolls, phone cases, and adult apparel, for example. Through Halloween last year, there were 3 million+ *Frozen* role-play dresses sold. Disney creative employees also actively worked with retailers throughout the design process in creating merchandise in order to protect the brand.

After observing the incredible success of the film, Disney executives worked quickly to keep the popularity of the film going by rolling out the IP across all the company's segments. Disney launched a short film named *Frozen Fever* to air before the *Cinderella* film earlier this year, which was also associated with new merchandise at retail stores. Disney is also working to add *Frozen* attractions at the theme parks, launch a themed cruise, and announced a sequel. The company will also launch a musical on Broadway, story books, videos, and interactive games.

We believe that the success of *Frozen* in theater demonstrates the potential for a franchise to launch a wave of consumer products revenues. *Frozen* recently became the eleventh franchise for Disney to reach more than one billion dollars in global retail sales, and we believe the momentum can continue for some time. We believe Disney is actively working to manage the brand and balance a continued rollout of product to generate enthusiasm while being careful to avoid oversaturation of the properties.

We Estimate *Star Wars* Film Could Contribute ~$500M to Annual Revenues and ~$200M to Operating Profit

We believe the rollout of *Star Wars* merchandise this Friday, branded "Force Friday," ahead of the new film release on December 18th could lead to an annual increase in revenues of ~$500m and operating profit of ~$200m.

In our analysis below, we attempt to estimate the impact of the new *Star Wars* film release in December on the Consumer Products division in F2016. In 1999, when the new *Star Wars* trilogy was released, sales of *Star Wars* licensed merchandise increased by 400%+ over a few months. We believe a similar increase is possible with the significant new merchandise rollout and promotion ahead of the new film release. ***Our analysis shows that a 200% increase in Star Wars products sales could contribute an incremental ~$500m in annual revenues and ~$200m in operating income to the Consumer Products division in F2016***. Our analysis is based on several assumptions, and we note that the potential upside could be even greater as royalty rates for *Star Wars* properties may be higher than our 7.5% assumption (Lucasfilm's 1997 licensing deals commanded royalty rates of 15-20%), licensing margins could be higher than our 60% assumption, and sales could exceed our estimates.

On the licensing side, we begin by estimating current annual *Star Wars* global annual licensed retail sales at ~$2.2b, an estimate from *The Licensing Letter*'s "$100 Million Properties" issue in November 2014. We then apply a range of royalty rates of 5.5%-9.5% and assume a range of 100%-300% increases in global licensed retail sales of *Star Wars* merchandise to arrive at a midpoint of ~$330m annual increase in revenues. We assume ~60% operating income margin for licensing revenues, leading to a midpoint of ~$200m in potential added operating income from *Star Wars*.

On the retail store side, we begin by estimating current annual *Star Wars* global retail sales at ~$72m, which assumes *Star Wars* accounts for ~5% of Disney retail store sales, the same proportion of the company's licensing revenues (assuming $2.2b out of $45.2b of annual global retail sales, an estimate according to *License! Global*'s *Top 150 Global Licensors Report*). Assuming the same 100%-300% potential increase in Disney store retail sales and 5% operating margin for the retail store business, we arrive at a midpoint of ~$150m annual increase in revenues and ~$7m increase in operating income from *Star Wars*.

Overall, our analysis demonstrates that a ~200% increase in global retail sales of Star Wars merchandise would lead to ~$500m of incremental annual revenues and ~$200m of incremental annual operating income. Based on our estimates, this would lead to 10.5% y/y growth in revenues in F2016 and 11.3% y/y growth in operating income attributed entirely to Star Wars. We believe growth from other properties, such as *Frozen* and other Marvel/Pixar properties, will also help boost the division and could provide further upside to our estimates.

Table 8: *Star Wars* Illustrative Impact to Consumer Products Licensing

$ in millions

		% Growth of Global Retail Sales Post-Film Release				
	Current	100%	150%	200%	250%	300%
Licensing Analysis						
Annual Est. Global Licensed Retail Sales	$2,200	$4,400	$5,500	$6,600	$7,700	$8,800
Annual Est. Global Licensing Revenues						
5.5% Royalty Rate	$121	$242	$303	$363	$424	$484
6.5% Royalty Rate	$143	$286	$358	$429	$501	$572
7.5% Royalty Rate	$165	$330	$413	$495	$578	$660
8.5% Royalty Rate	$187	$374	$468	$561	$655	$748
9.5% Royalty Rate	$209	$418	$523	$627	$732	$836
Annual Est. Global Licensing Op. Income @ 60% Margin						
5.5% Royalty Rate	$73	$145	$182	$218	$254	$290
6.5% Royalty Rate	$86	$172	$215	$257	$300	$343
7.5% Royalty Rate	$99	$198	$248	$297	$347	$396
8.5% Royalty Rate	$112	$224	$281	$337	$393	$449
9.5% Royalty Rate	$125	$251	$314	$376	$439	$502
Potential Annual Revenue Increase from *Star Wars*						
5.5% Royalty Rate		$121	$182	$242	$303	$363
6.5% Royalty Rate		$143	$215	$286	$358	$429
7.5% Royalty Rate		$165	$248	$330	$413	$495
8.5% Royalty Rate		$187	$281	$374	$468	$561
9.5% Royalty Rate		$209	$314	$418	$523	$627
Potential Annual Op. Inc. Increase from *Star Wars*						
5.5% Royalty Rate		$73	$109	$145	$182	$218
6.5% Royalty Rate		$86	$129	$172	$215	$257
7.5% Royalty Rate		$99	$149	$198	$248	$297
8.5% Royalty Rate		$112	$168	$224	$281	$337
9.5% Royalty Rate		$125	$188	$251	$314	$376

Source: J.P. Morgan estimates.

Table 9: *Star Wars* Illustrative Impact to Consumer Products Retail Stores

$ in millions

		% Growth of Global Retail Sales Post-Film Release				
	Current	*100%*	*150%*	*200%*	*250%*	*300%*
Disney Retail Store Analysis						
Annual Est. Global Disney Store Retail Sales	$72	$144	$180	$215	$251	$287
Annual Est. Global Disney Store Retail Op. Inc @ 15% Margin	$11	$22	$27	$32	$38	$43
Potential Annual Revenue Increase from *Star Wars*		$72	$108	$144	$180	$215
Potential Annual Op. Inc. Increase from *Star Wars*		$11	$16	$22	$27	$32

Source: J.P. Morgan estimates.

Table 10: *Star Wars* Illustrative Impact to Consumer Products Division

$ in millions

	% Growth of Global Retail Sales Post-Film Release				
	100%	*150%*	*200%*	*250%*	*300%*
Total Consumer Products Impact					
Potential Annual Revenue Increase from Star Wars					
5.5% Royalty Rate	$193	$289	$386	$482	$578
6.5% Royalty Rate	$215	$322	$430	$537	$644
7.5% Royalty Rate	$237	$355	$474	$592	$710
8.5% Royalty Rate	$259	$388	$518	$647	$776
9.5% Royalty Rate	$281	$421	$562	$702	$842
Potential Annual Operating Income Increase from *Star Wars*					
5.5% Royalty Rate	$83	$125	$167	$208	$250
6.5% Royalty Rate	$97	$145	$193	$241	$290
7.5% Royalty Rate	$110	$165	$220	$274	$329
8.5% Royalty Rate	$123	$184	$246	$307	$369
9.5% Royalty Rate	$136	$204	$272	$340	$409
Potential F2016E Revenue Increase from Star Wars					
5.5% Royalty Rate	*4.3%*	*6.4%*	*8.5%*	*10.7%*	*12.8%*
6.5% Royalty Rate	*4.8%*	*7.1%*	*9.5%*	*11.9%*	*14.3%*
7.5% Royalty Rate	*5.2%*	*7.9%*	*10.5%*	*13.1%*	*15.7%*
8.5% Royalty Rate	*5.7%*	*8.6%*	*11.4%*	*14.3%*	*17.2%*
9.5% Royalty Rate	*6.2%*	*9.3%*	*12.4%*	*15.5%*	*18.6%*
Potential F2016E Operating Income Increase from Star Wars					
5.5% Royalty Rate	*4.6%*	*6.9%*	*9.2%*	*11.5%*	*13.8%*
6.5% Royalty Rate	*5.3%*	*8.0%*	*10.7%*	*13.3%*	*16.0%*
7.5% Royalty Rate	*6.1%*	*9.1%*	*12.1%*	*15.1%*	*18.2%*
8.5% Royalty Rate	*6.8%*	*10.2%*	*13.6%*	*17.0%*	*20.3%*
9.5% Royalty Rate	*7.5%*	*11.3%*	*15.0%*	*18.8%*	*22.5%*

Source: J.P. Morgan estimates.

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Competitive Landscape

Industry Risks

We believe the biggest risks to licensing and consumer products sales are declines in consumer spending and, longer-term, 3-D printing.

Primary Risk Is Decline in Consumer Spending

We believe the biggest risks for the licensing and retail industry are any factors that could lead to decreases in consumer spending, including a slowdown in GDP growth and an increase in interest rates, among other factors. While we do not see this being a large issue near-term, we believe if an industry slowdown were to occur, it would lead to a divergence between the higher- and lower-quality brands/franchises as consumers allocate their dollars more thoughtfully on merchandise.

In general, we believe there is also a potential, much like the film industry, for saturation of specific categories of merchandise, such as superheroes or animated characters. While this is less likely to be a major factor as box-office receipts are an indicator for the extent of a product rollout plan, consumer fatigue of certain categories of characters may lead to less spending on these properties.

3-D Printing Could Become Longer-Term Risk

A longer-term risk may be the impact of 3-D printing on consumer products, which gives consumers the ability to create toys based on their favorite characters or properties in their own homes. While the industry is still in very early stages with just ~217K 3-D printers expected to be sold worldwide in 2015 according to Gartner Inc., a recent report from *Research and Markets* estimates that the global 3-D printing market will grow from $2.3 billion in 2013 and to $8.6 billion in 2020 at a 21% CAGR. Siemens also estimates that 3-D printing will become 50% cheaper and 400% faster in the next five years. A consumer being able to create merchandise that nearly replicates that sold in retail stores could be a threat to the overall consumer products and licensing businesses in the longer term but will likely not affect the industry near-term, in our opinion.

Media Company Competitors

In the below section, we outline many of the media companies that could compete with Disney in the global licensing landscape. Its largest competitors, Time Warner's Warner Brothers and Viacom, are expanding their consumer products operations as most media companies in recent years have talked about increasingly leveraging their intellectual property to generate greater licensing revenues. However, we view Disney as having a best-in-class portfolio of franchises and brands with a uniquely active licensing strategy allowing for strong licensee and retailer relationships both domestically and worldwide. ***With many evergreen properties that consistently generate $1b+ in annual global retail sales, a strong upcoming slate of films that can feed into merchandise/products, and a history of success, Disney's Consumer Products segment is poised for strong growth in the upcoming years, in our view.***

Competitive Overview of Franchises

DIS: Disney Consumer Products: #1 Global Licensor in 2014 • $45b in total retail sales • Classic Disney characters (Mickey, Pooh), Disney Princess, Pixar properties (Cars, Toy Story), Marvel properties (The Avengers, Spider-Man), Star Wars, Disney Channel properties, Disney Junior

TWX: Warner Brothers Consumer Products and **Cartoon Network/Turner Consumer Products:** #7 and #28 Global Licensors in 2014, respectively • $8b in total retail sales • DC Comics properties (Superman, Batman), Harry Potter, Lego, The Hobbit, Looney Tunes, Scooby-Doo, TV properties (The Big Bang Theory, Supernatural)

VIAB: Nickelodeon Consumer Products: #9 Global Licensor in 2014 • $5.5b in total retail sales • SpongeBob, Teenage Mutant Ninja Turtles, Mission Impossible

DreamWorks Animation Consumer Products: #17 Global Licensor in 2014 • $3.3b in total retail sales • How to Train Your Dragon, Penguins of Madagascar, Kung Fu Panda

FOXA: Twentieth Century Fox Consumer Products: #27 Global Licensor in 2014 • $2.1b in total retail sales • The Simpsons, X-Men, Ice Age, Avatar

Comcast: Universal Partnerships & Licensing: #33 Global Licensor in 2014 • $2b in total retail sales • Despicable Me, Jurassic World, The Biggest Loser

DISCA: Discovery Consumer Products: #53 Global Licensor in 2014 • $1b in total retail sales • Discovery Expedition, Discovery Kids, Shark Week

SNI: HGTV Home & Food Network: #108 and #112 Global Licensors in 2014, respectively • $417m in total retail sales • HGTV, Food Network

CBS: CBS Consumer Products: #91 Global Licensor in 2014 • $300m in total retail sales • Star Trek, CSI

Sony Pictures Consumer Products: #105 Global Licensor in 2014 • $225m in total retail sales • Ghostbusters, Breaking Bad, The Smurfs

TWX: Warner Brothers Consumer Products and Cartoon Network/Turner Consumer Products

Time Warner's Warner Brothers was the #7 global licensor in 2014 with major properties DC Comics characters, The Hobbit, and Harry Potter. Time Warner's Cartoon Network/Turner was the #28 global licensor in 2014 with major properties Adventure Time and The Powerpuff Girls.

Time Warner's Warner Brother Consumer Products (WBCP) was the #7 global licensor in 2014, generating ~$6 in total retail sales with 3,700+ active licensees for its properties. Time Warner's Cartoon Network/Turner Consumer Products (WBCP) was the #28 global licensor in 2014, generating ~$2 billion in total retail sales with Warner Bros. Consumer Products licenses its IP globally for both its classic properties and new content across the studio. Time Warner's television and film businesses benefit from a shared infrastructure, which allow them to share certain production, distribution, marketing and administrative resources. We believe WBCP has a lot of potential over the next few years and will be Disney's largest competitor as it begins releasing the new DC films with the associated consumer products push.

DC Entertainment Will Be Likely Driver of WBCP Growth

We believe that the WBCP growth will be led by the DC Comics universe, whose key characters include Batman, the Flash, Green Arrow, Superman, and Wonder Woman. In the 2014-2015 broadcast season, there were five series on air based on DC Entertainment characters that had licensing programs (including *Arrow*, *The Flash*, *Gotham*, *Supergirl*, and *DC's Legends of Tomorrow*).

At its Investor Day in October 2014, Time Warner announced it will release at least 10 films based on the DC Entertainment universe from 2016 through 2020, kicking off with *Batman vs. Superman: Dawn of Justice* in March 2016, which will also bring a substantial rollout of consumer products offerings.

Licensees for *Batman vs. Superman* include Mattel, The LEGO Group, Rubie's Costume Co, Thinkway Toys, Junkfood, Bioworld, and Converse. In 2014, WBCP extended its 15-year partnership with Mattel as its master toy licensee for the entire universe of DC Comics characters, and Fisher-Price is the master licensee for the 'DC Super Friends' preschool line. Fisher-Price is expanding its Imaginext DC Super Friends toy line with new animated content, and JAKKS Pacific recently renewed an agreement for both domestic and international rights for the entire DC Comics franchise. JAKKS plans to distribute large-scale action figures and vehicles, accessories, games, wagons, and other products in spring 2016 to coincide with the *Batman vs. Superman* film release.

WBCP will also debut a new Superhero universe in the fall targeting girls 5-12, "DC Super Hero Girls" with new television, gaming, social media initiatives, digital content, publishing, TV specials, videos, toys, apparel, books, and other products that will roll out in 2016. The franchise is in partnership with Mattel and will star female superheroes and super villains from the DC Comics universe.

We believe the 10 DC Comics films through 2020 will likely drive substantial licensing revenues for Warner Brothers over the next several years and gives WBCP better leverage with licensing and retail partners worldwide given the slate of films is already announced. TWX plans to roll out the film-related merchandise approximately eight weeks prior to the film's release date with a launch across mass retailers, mid-tier retailers, specialty stores, and online commerce.

While the DC Entertainment initiatives are substantial and impressive, Marvel and DC Comics have a large difference in licensing revenues. At the Investor Day, Warner Brothers CEO Kevin Tsujihara stated that if TWX could close the gap between Marvel and DC Comics by half, the studio would earn an additional $150 million/year in profits, demonstrating the immense difference in size between the two licensing programs. While Disney is clearly in a position of power with greater market share, we believe TWX also has meaningful potential for growth.

Other Contributors: *Harry Potter, LEGO, The Big Bang Theory*

WBCP also benefits from licensing programs with other franchises that come out of its film studio as well as its television business.

Previously, the film studio saw huge success with the *Harry Potter* film franchise, which led to many licensing opportunities. Although the last film was released in 2011, TWX has a partnership with J.K. Rowling for a new film trilogy, which will likely reinvigorate the brand and merchandise sales once again. We expect *Fantastic Beasts and Where to Find Them*, which is currently in production, will become another successful franchise with the potential to generate global revenues from licensing and merchandising. The first film will debut in 2016 with the next two films in 2018 and 2020. The film will feature the wizarding world from *Harry Potter* and include characters from the franchise, which should also boost licensing.

In 2014, the release of *The LEGO Movie* increased sales of the associated toys, and the studio plans to release several additional *LEGO* films in future years. The third LEGO Batman videogame was also released last year, LEGO Batman 3: Beyond Gotham.

Other franchise properties that generate substantial licensing revenues include *The Hobbit* as well as some of its owned television series such as *The Big Bang Theory, Friends,* and *Supernatural.* TWX also licenses its classic animation brands such as Scooby-Doo and Looney Tunes and continues to generate interest in these longstanding brands. Scooby-Doo recently received new licensing support from The LEGO Group in five new sets and animated content in LEGO form. Meanwhile, Looney Tunes signed new partnerships with Nike for Hare Jordan and Moschino for haute couture apparel/accessories. Three WB Animation shows will also partner with licensees including *Wabbit – A Looney Tunes Production*, *Be Cool Scooby-Doo!* and *The Tom and Jerry Show.*

Cartoon Network/Turner Consumer Products

Cartoon Network/Turner key brands include *Adventure Time* and *Regular Show* and newer series *Clarence*, *Steven Universe,* and *The Amazing World of Gumball*. Cartoon Network's key franchises include *The Powerpuff Girls, Dexter's Laboratory,* and *Johnny Bravo.* The properties are represented at key retailers and distributed throughout the world.

The Powerpuff Girls will benefit from a global launch of a new series and a merchandise rollout in 2016 with its global toy partner Spin Master. At Adult Swim, *Rick and Morty* will expand its consumer products offerings into toys, apparel, publishing, and more in 2015.

We believe TWX will continue to build out the consumer products business at Cartoon Network and leverage both existing and new IP by signing new licensing partners, branching into new product categories, and developing better relationships with key retailers. We believe the group's positioning as under the same corporate umbrella as DC Entertainment properties brings additional leverage in these negotiations.

VIAB: Nickelodeon Consumer Products

Viacom's Nickelodeon was the #9 global licensor in 2014 with major properties SpongeBob and Teenage Mutant Ninja Turtles.

Viacom's Nickelodeon was the #9 global licensor in 2014 with $5.5 billion in total retail sales, although licensing revenues are a small portion of the company's overall revenues. In F2014, "ancillary revenues," which includes licensing as well as sale of content on DVDs and Blu-ray discs, licensing content for download-to-own and download-to-rent services, and television syndication, generated ~5% of Viacom's total Media Networks revenues, suggesting consumer products/brand licensing is an even smaller portion of the total. In F2014, ancillary revenues represented ~15% of total Filmed Entertainment revenues. As another media company with both cable networks and a film studio, Viacom is able to build franchises through both segments and capitalize on successful IP through licensing.

Nickelodeon's most well-known and heavily licensed properties include *SpongeBob SquarePants, Teenage Mutant Ninja Turtles*, and *Dora the Explorer*. In 2014, *SpongeBob* benefited from its animated film debut and continued position as the #1 animated kids show. Licensees for the film included Just Play, MEGA Bloks, Rubie's Costumes and Fisher-Price Imaginext.

Meanwhile, *Teenage Mutant Ninja Turtles* also benefited from a film release. The related action figures were last year's top overall best-selling toy, and licensing partners for the franchise include Playmates, MEGA Bloks, Rubie's Costumes and Pacific Cycle. Playmates also launched three new related toy segments including Mutations, T-Machine, and Half Shell Heroes.

Nickelodeon's preschool portfolio of characters is also heavily licensed with key shows such as *PAW Patrol* that has licensing partners Spin Master, Cardinal Industries, Pacific Cycle, Bravo Sports, Playhut, and Alex Toys. *Dora and Friends* benefits from Fisher-Price products, and the more recent show *Blaze and the Monster Machines* will benefit from a more extensive consumer products rollout this year.

DreamWorks Animation Consumer Products

DreamWorks was the #17 global licensor in 2014 with major properties How to Train Your Dragon, Penguins of Madagascar, and Kung Fu Panda.

DreamWorks was the #17 global licensor in 2014 with $3.3 billion in total retail sales. DreamWorks' properties are created from its films, and the consumer products segment helps to smooth out revenues between films and generate greater profitability for successful films. In recent years, the company has been looking to actively increase the size and scale of its consumer products business in order to capitalize on the popularity of its intellectual property.

DreamWorks saw licensing success in 2014 from its films *How to Train Your Dragon 2* and *Penguins of Madagascar*. *HTTYD2* merchandise was available at all major retailers in conjunction with the film's release. In 2015, DreamWorks likely saw a healthy boost from consumer products sales of merchandise related to the film *Home.*

DreamWorks also benefits from its classic brands, which include *Lassie*, *Noddy*, *Felix*, *Where's Waldo*, *Casper*, *Lassie*, *Frosty* and *Rudolph the Red-Nosed Reindeer*. These properties drive healthy licensing revenue through agreements with many licensees and retailers.

The consumer products segment will likely benefit from the studio's upcoming films, such as *Trolls*, *DinoTrux, DreamWorks Dragons,* and *Voltron,* and *Kung Fu Panda 3* should also boost profitability for the already popular franchise. The company is also looking to expand its licensing business into new categories, including location-based entertainment such as cruise ships, amusement parks and shopping malls.

FOXA: Twentieth Century Fox Consumer Products

Twentieth Century Fox was the #27 global licensor in 2014 with major properties The Simpsons, Ice Age, and Alien.

21st Century Fox's Twenty Century Fox Consumer Products was the #27 global licensor in 2014 with $2.1 billion in total retail sales.

The 25th anniversary of the very popular show *The Simpsons* in 2014 helped drive increased licensing revenues through partnerships with LEGO and MAC; fashion collaborations with Drop Dead, Uniqlo, Converse, and Eleven Paris; and global expansion with licensors Etam, A Bathing Ape, Joyrich, MC2 Saint Barth, and Just Hype. The merchandise also received support from retailers Toys R Us and Hastings.

As part of the 35th anniversary celebration of *Alien*, Fox released the Alien Isolation video game, which sold 1.2 million units in its first three months of release. The brand had licensees such as SEGA, NECA, Funko, and Diamond Select and partnered for the Alien vs. Predator Maze at Halloween Horror Nights at Universal Studios.

Ice Age is also a strong brand for the segment, with a global live show tour called *Ice Age Live!*, mobile game apps, and even a clothing partnership with Monnalisa. Other ongoing licensing revenues come from franchises such as *Avatar, Titanic, Planet of the Apes, Predator, Home Alone, Rocky Horror Picture Show, Firefly, The X-Files,* and *Buffy the Vampire Slayer*, which sell in various categories such as collectibles, publishing, apparel, accessories and seasonal products.

Similar to Warner Brothers, the segment also benefits from its television studio, especially with popular series such as *Modern Family, Family Guy,* and *Sons of Anarchy*, with *Sons* finishing its final season with 60+ licensees.

We expect FOXA to continue to generate solid consumer products revenues with continued strength at existing franchises and the launch of new ones. Most recently, the hit television show *Empire*, which impressively grew ratings every episode of its first season, should become even more popular with more episodes slated for its second season. FOXA will also release a new *Ice Age* film in July 2016 that should reinvigorate the brand and its associated merchandise sales. Fox continues to sign new partnerships for its brands as well.

Comcast: Universal Partnerships & Licensing

Twentieth Century Fox was the #33 global licensor in 2014 with major properties Despicable Me, Jurassic World, and The Biggest Loser.

Comcast's NBCUniversal was the #33 global licensor in 2014 with $2 billion in total retail sales. NBCUniversal consumer product and digital licensing is overseen by Universal Partnerships & Licensing. NBCUniversal includes Universal Pictures, NBC Television, Focus Features and Sprout Channel.

On the film side, Universal has had great success with the *Despicable Me* franchise, which has generated $1b+ in retail sales. We expect a large increase in consumer products revenues this year, especially in international markets, after the very successful launch of the *Minions* prequel, which had a strong opening weekend, the second-highest domestic animated film release ever. The film has 850+ licensees worldwide, up from ~250 for *Despicable Me 2*. *Minions* also has Thinkway Toys as its global master toy partner, Hasbro for games, and Mega Bloks for construction. The franchise also has major retailer support from Walmart, Target, Toys 'R' Us, Asda, Liverpool, and Big W. Gameloft's *Despicable Me: Minion Rush* game has also been downloaded 500 million+ times.

Furious 7, which is now the fifth highest grossing film worldwide, capitalized on its strong box-office success by partnering with Xbox, Forza Horizon 2, and Kabam.

Jurassic World, which is now the third highest grossing film worldwide, also has strong consumer products offerings with 165+ licensees signed on worldwide including global master toy partner Hasbro and LEGO. Although the franchise targets mostly boys 4-11, three digital games are aimed at drawing interest from older kids and adults.

NBCUniversal also has several television franchises. After 10 years, *The Biggest Loser* franchise continues to see strength with many licensing partners and expansion with retail launches of food and household products. *Sprout*, a kids' network, also has many licensing partners and merchandise programs in place. *American Ninja Warrior* on Esquire Network will also launch a merchandising program with its seventh season this year. Other television series include *The Tonight Show Starring Jimmy Fallon, Brooklyn Nine-Nine, Battlestar Galactica,* and *The Office*.

Looking forward, NBCUniversal will aim to expand its licensing revenues with the February 2016 release of *The Secret Life of Pets* and build on its success with the release of *Despicable Me 3* in 2017.

DISCA: Discovery Consumer Products

Discovery Consumer Products was the #53 global licensor in 2014 with major properties Discovery Expedition, Discovery Kids, and Shark Week.

Discovery Consumer Products (DCP) was the #53 global licensor in 2014 with $1 billion in total retail sales. The segment's top licensed brands come from its portfolio of cable networks that are shown worldwide with key brands including Discovery Channel, Discovery Expedition, Animal Planet, Discovery Kids, and others.

Several popular Discovery Channel shows have licensing opportunities, including *Gold Rush*, *Moonshiners*, and *MythBusters*.

Discovery Expedition (DX), a lifestyle brand, had healthy growth in 2014 led by Asia and offers apparel and equipment for the outdoor adventurer. There are 180+ Discovery Expedition retail stores in Asia and more in Europe. Last year, Discovery Consumer Products partnered with Fei Fan, a Chinese outdoor product provider, to expand the DX line and also named Bear Grylls as an ambassador in China. Discovery plans to further expand DX worldwide to increase the retail presence.

Animal Planet has an expansive toy program worldwide with many licensees including Smart Play for children's toys and MasterPieces Puzzle Company for puzzles and craft sets in the U.S. as well as EDU-Science as the master toy partner for Europe, Africa, and the Middle East. Animal Planet also renewed its 15-year partnership with Toys R Us in North America last year with a more expansive toy line and increased store space. The partnership also expanded to Australia through 2017 for a toy line, and the company expects it to continue expanding this year.

The annual programming event each summer, *Shark Week* on the Discovery Channel, also has its own merchandise offering across categories including apparel and toys. The event partners with retailers such as Toys R Us, Walmart, and Target.

Discovery Kids has toys, games, apparel, publishing, and apps that target children ages 6-12. In 2014, Discovery Kids expanded through a partnership with Walgreens. Licensees include NKOK, Good Stuff, Merchsource, Parragon, Kids Station, and Tek Nek Toys.

Last year, DCP also partnered with Princess Cruises to create a themed cruise: Discovery at Sea. The cruises will debut this year, offering Discovery Channel and Animal Planet themed tours, science activities, hands-on programs, and games based on Discovery's brands and programming.

Discovery is also looking to expand its brand into China. In 2014, Discovery opened a Discovery Channel Store in Ocean Park in China, which offers souvenirs and products related to Discovery programs. In July 2015, DCP announced a new partnership with Apax Group to develop the first-ever Discovery Adventures Park and Discovery Destinations Hotel at China's Andaman Moganshan Resort. The park will open in Q4 2015 for private and corporate team building events with a grand opening for general admission in spring 2016. The park will look to integrate extreme sports, tourism, and vacation.

SNI: HGTV Home and Food Network

HGTV Home was the #108 global licensor in 2014, and Food Network was the #112 global licensor in 2014.

HGTV Home was the #108 global licensor in 2014 with $217 million in total retail sales. Food Network was the #112 global licensor in 2014 with $200 million in licensing revenues.

HGTV Home is the cable network HGTB's consumer products brand that sells branded products related to the network's shows and is a leader in home licensing. The group has nine partners and 11 product lines available in 8,000+ stores across North America. Product categories include paint, furniture, flooring, plants, indoor lighting, outdoor living, solar lighting and decorative fabric and trim. Key partners include Sherwin-Williams, Bassett, Shaw, and Agricola.

In 2012, SNI launched HGTV Magazine. In 2013, HGTV Home partnered with HSN to launch an outdoor living program for outdoor equipment, plants, lighting, water accessories, outdoor entertaining, garden tools, and more.

In 2015, HGTV Home plans to continue to expand through new products and increased distribution. The group plans to be available in 9,100+ stores by the end of the year.

The Food Network licensing program launched in 2007 and has an eight-year partnership with Kohl's, which offers 1,200+ branded houseware products sold exclusively at the retailer's ~1,200 stores. In 2011, Food Network partnered with Wente Vineyards to launch a line of food-friendly wines. Food Network also opened two restaurants in partnership with the Delaware North Companies in Atlanta and Fort Lauderdale airports. The Food Network magazine also launched in 2008 in partnership with Hearst. The Food Network is also involved in book publishing as well as the South Beach and New York City Food & Wine Festivals.

CBS: CBS Consumer Products

CBS Consumer Products was the #91 global licensor in 2014 with major properties Star Trek and CSI.

CBS Consumer Products was the #91 global licensor in 2014 with $300 million in total retail sales. CBS licenses its television and film brands from CBS, CBS Television Studios, CBS Television Distribution, Showtime, and CBS Films worldwide.

Recently, the company has also expanded into e-commerce initiatives with the launch of an *I Love Lucy* shop as well as one for the film *The Duff*.

In 2015, the segment is rolling out new product lines for series such as *Penny Dreadful, Scorpion,* and *CSI* as well as classic properties such as *MacGyver* and *The Honeymooners.* In addition, the company is moving more into publishing for shows such as *Elementary* and *Penny Dreadful.*

However, the major catalyst for CBS Consumer Products is the 50th anniversary of the *Star Trek* franchise in 2016, which will likely to lead to a significant rollout of consumer products offerings and be further fueled by the theatrical release of a new

Star Trek film in July 2016. Licensee ThinkGeek recently expanded merchandise offerings. There are official *Star Trek* online shops in the U.S., U.K., Germany, Japan, and Brazil.

Sony Pictures Consumer Products

Sony Pictures Consumer Products was the #105 global licensor in 2014 with major properties Ghostbusters, Breaking Bad, and The Smurfs.

Sony Pictures Consumer Products was the #105 global licensor in 2014 with $225 million in total retail sales from both its film and television properties.

On the television side, Sony recently had success with *Ghostbusters,* which just celebrated its 30th anniversary. For the occasion, Sony rolled out a Ghostbusters program including a traveling art show, a re-release of the original film, the release of Blu-Ray anniversary editions of the film, and a merchandise program. The franchise is also likely to benefit from a new film release in July 2016 with a female cast of characters. Mattel is the master toy licensee for *Ghostbusters* with additional licensees including LEGO, Atari, Rubie's, Ubisoft, Funko, Underground Toys, Freeze, and Bioworld.

Other popular television shows include *Breaking Bad* as well as the classic shows *Wheel of Fortune* and *Jeopardy.* Despite the series finale airing in 2013, *Breaking Bad* continues to generate solid licensing revenues for Sony as consumer interest remains strong in the brand with over $100 million in retail sales worldwide in 2014 with 50+ licensees across categories such as publishing, apparel, toys, and accessories. Merchandise is available at Target, Walmart, Amazon, Best Buy, Hot Topic, and more.

In 2015 on the film side, Sony will license properties for its upcoming film *Pixels*, released on July 24th, with characters from 1980s video games such as Pac-Man, Donkey Kong, Centipide, Q*ben, and others and licensees including Freeze, Bioworld, and Rasta Imposta. Sony will also coordinate with licensees for the release of *Hotel Transylvania 2* (September 25th) with partners including Kellytoy and Rubie's Costume Co. for Halloween decor, giftware, and party goods merchandise. The franchise will also work with Simon & Schuster to publish series of storybook formats. Finally, *Goosebumps* in October 2015 will partner with Scholastic for a licensing program targeted towards young adults, spanning categories such as apparel and accessories, home furnishings, publishing, toys and gifts, stationery and paper goods, costumes and interactive.

Meanwhile, on the television side, Sony is working on licensing programs for shows including *Better Call Saul*, *The Blacklist*, and *The Goldbergs* as well as more classic properties such as *Wheel of Fortune* and *Jeopardy*. For *Better Call Saul,* Sony signed a partnership with Hot Topic as well as Jack Threads and others. Sony plans to expand its product offerings as the show builds momentum. 2015 is also the 50th anniversary of *I Dream of Jeannie*, which is accompanied by products from licensees Tonner Dolls, Greenlight Collectibles, Rubie's, and Trecvo.

The new *Smurfs* film in 2017 will also create further licensing opportunities. In 2013, *The Smurfs 2* launched a merchandising program with good retail placement and 70+ North American licensees across every major category. The *Smurfs* licensees include Rasta Imposta, Bioworld, and Freeze.

Retail/Toy Industry Overview

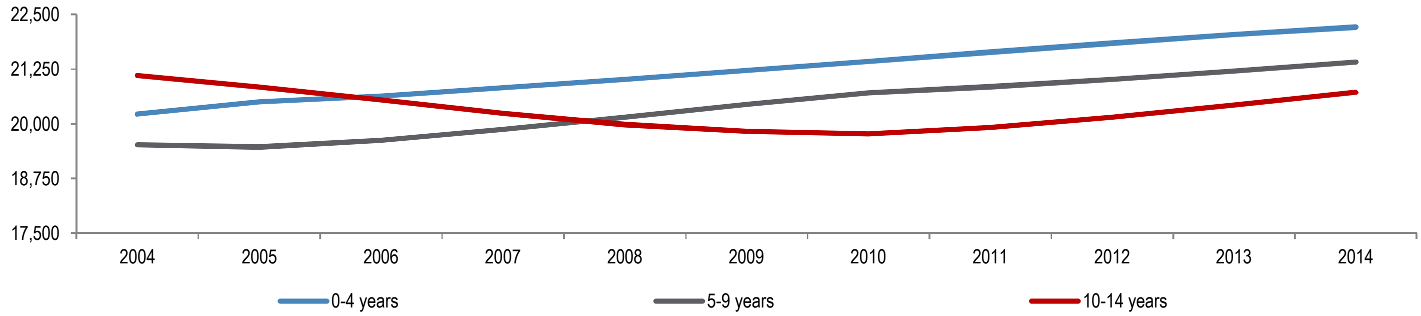
United States Population Trends

The CDC estimates the population of children aged 0-14 years old in the U.S. will grow at a 0.67% CAGR through 2030.

According to the Centers for Disease Control and Prevention (CDC), in 2014 there were approximately 64 million children in the U.S. who were 0-14 years old including 22.2 million 0-4 years old, 21.6 million 5-9 years old, and 20.7 million 10-14 years old. According to the CDC's projections, the population of each of these age groups is expected to grow through 2030 although at very slow growth rates. The 0-4 age group is expected to grow at a 0.56% CAGR to 24.3 million in 2030, the 5-9 age group is expected to grow at a 0.66% CAGR to 23.8 million, and the 10-14 age group is expected to grow at a 0.80% CAGR to 23.5 million. Given these slow growth rates and a relatively mature domestic retail industry, many companies are looking to expand overseas in countries where there are growing middle classes of consumers.

Figure 9: U.S. Population by Age Group, 2004-2014

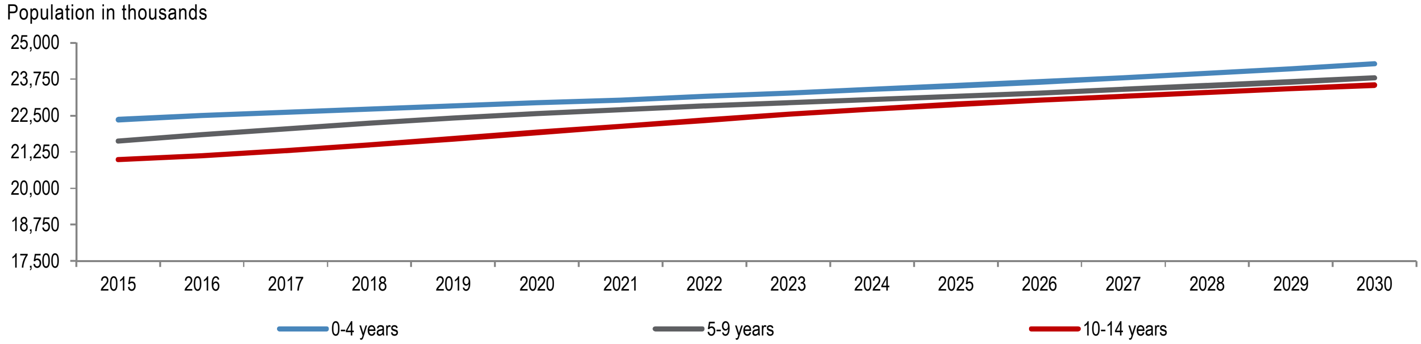
Population in thousands



Source: Centers for Disease Control and Prevention, J.P. Morgan estimates.

Figure 10: U.S. Population Projections by Age Group, 2015-2030

Population in thousands



Source: CDC, J.P. Morgan estimates.

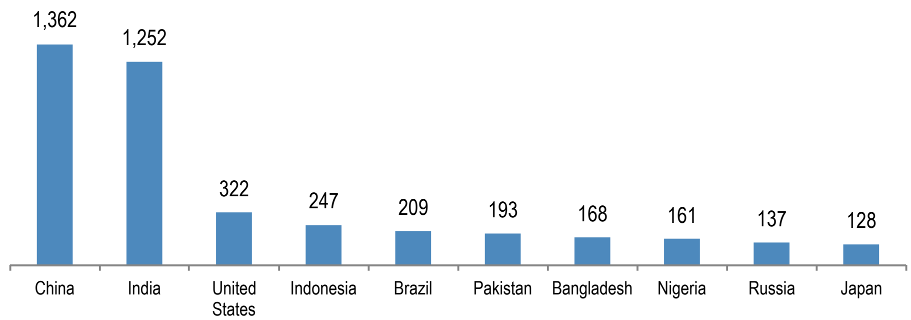
Emerging Markets Will Likely Fuel Future Growth

Emerging markets, with growing middle classes with increasing disposable incomes, will likely drive future growth for toy companies and licensees.

Emerging markets will likely drive future global toy growth as they have growing middle classes with increasing disposable incomes to spend. Unsurprisingly, many retail and toy companies are expanding their operations internationally and into new markets in order to capitalize on these new opportunities and more favorable population trends. China and India represent especially lucrative opportunities with the largest populations in the world – China has a population of approximately 1.36 billion and India has a population of approximately 1.25 billion, while the U.S. has a total population of just 322 million.

Figure 11: Population by Country, 2015

Population in millions

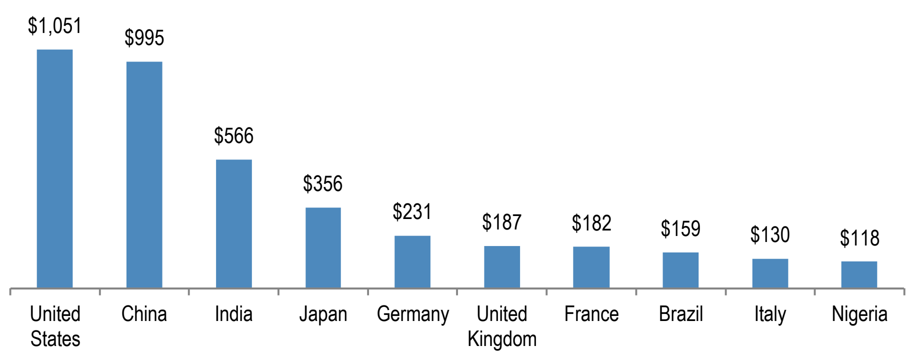


Source: NationMaster, geoba.se, J.P. Morgan estimates.

However, in order to get a better sense of the actual market opportunities, we examined both the countries with the highest populations and the highest average 2014 monthly disposable salaries after-tax. Multiplying these two metrics for each country as a proxy for relative market size, we determined that the U.S., China, and India are the markets with the largest overall disposable income. Notably, although the U.S. has just one-fourth of the population of India, its relative disposable income is much greater. Once again, China and India present the best growth opportunities given the already mature U.S. market.

Figure 12: Population Times Average Monthly Disposable Salary (After-Tax)

$ in billions



Source: NationMaster, J.P. Morgan estimates.

Toy Industry Trends

Toys and games experienced the highest global growth in six years in 2014, with global sales growing 6% to $151b+, largely driven by emerging regions.

The toy industry had experienced low-single-digit global growth annually since 2008 before accelerating in 2014 to 6% global growth, reaching $151b+ in sales. Revenues in the toy industry are seasonal and tend to be skewed towards the six-week holiday period. In the U.S., the three largest toy companies are Mattel, Hasbro, and Lego, and toy sales are highly concentrated at Walmart (covered by JPM Analyst Chris Horvers), Target (covered by Chris Horvers), Toys R Us, Amazon (covered by JPM Analyst Doug Anmuth), and Sears Kmart.

The global toy industry is relatively mature – Euromonitor estimates that 2014 was the highest global growth year in toys and games in six years, with global sales growing 6% to $151b+ compared to 3% in 2013, largely driven by emerging regions. The fastest-growing regions, Eastern Europe, Asia Pacific, and Latin America, grew 9%, 7%, and 6%, respectively. Traditional toys and games, which account for ~56% of the global toys and games market, grew 5% for the highest rate in over a decade to reach sales of $85b+. The top-performing markets, each with double-digit growth rates, included Argentina, Turkey, Indonesia, Thailand, and Russia.

Euromonitor expects growth in the global toy industry to come from both emerging markets regions as well as licensed toys. The group forecasts the Asia Pacific region will surpass both Western Europe and North America in 2017 to claim the spot as the top traditional toys market with 25% market share of global sales. The group expects the Asia Pacific region to grow at a 5% CAGR through 2019, adding $5.5b to global retail sales, helped by rising disposable incomes, increased penetration of organized retailing, and urbanization. Meanwhile, Euromonitor expects North America to grow at a modest 1.4% CAGR for $1.5b in additional sales by 2019. China is expected to be one of the largest individual growth drivers, adding $4.4b+ to sales by 2019.

Figure 13: U.S. Retail Sales of Traditional Toys, 2014

$ in billions

Source: NPD Group, Toy Industry Association, J.P. Morgan estimates.

In addition to growth in emerging regions, Euromonitor expects licensed toys to be a key growth factor of global toys and games sales over the next few years, citing the several upcoming and announced Marvel and *Star Wars* films as well as the 2015 films *Jurassic World* and *Minions*, another potential *Transformers* film, a *Frozen* sequel, and DC Comics films.

In 2014, U.S. retail sales of toys increased 4% to $18.1b with *Frozen* the top license overall.

In the U.S., The NPD Group estimates that U.S. retail sales of toys increased 4% in 2014 to $18.08b compared to $17.46b in 2013. Penetration of licensed toys increased 7% to 31% of total industry sales. ***Disney's Frozen was the top toy overall and the top gainer among all toy properties in 2014 based on absolute dollar growth with $531 million in sales in 2014 and 300+ different items on sale.***

Overall, the toys industry is expected to benefit from the blockbuster movie slate this year and in future years with Disney and Time Warner rolling out their notable Marvel and DC Comics slates, respectively, for several years. Many media companies are increasingly trying to capitalize on their franchise successes by rolling out more related consumer products offerings and growing their licensing revenues, which may lead to both overall growth in toy sales as well as licensed toys becoming an increasingly large portion of the overall toy market.

Table 11: 2014 Top Selling Traditional Toy Items, Ranked by Dollars

Item	Manufacturer
Teenage Mutant Ninja Turtles Fig Asst	Playmates Toys
My First Disney Princess Frozen Snow Glow Elsa	JAKKS Pacific
Hot Wheels Car Basic Asst	Mattel
LeapFrog Explorer Licensed Software Asst	LeapFrog
Galaxy Tab 3 Kids 8GB	Samsung
Minecraft Core Steve W/ Accessory	Jazwares
Zoomer Dino Asst	Spin Master
Barbie 3-Story Dream Townhouse	Mattel
Nabi 2 8GB Bundle 7" Tablet	Fuhu
Disney Frozen Sparkle Doll Asst	Mattel

Source: The NPD Group/Retail Tracking Service, J.P. Morgan estimates.

Licensing Industry Overview

Licensing to Drive Growth in Global Toy Sales

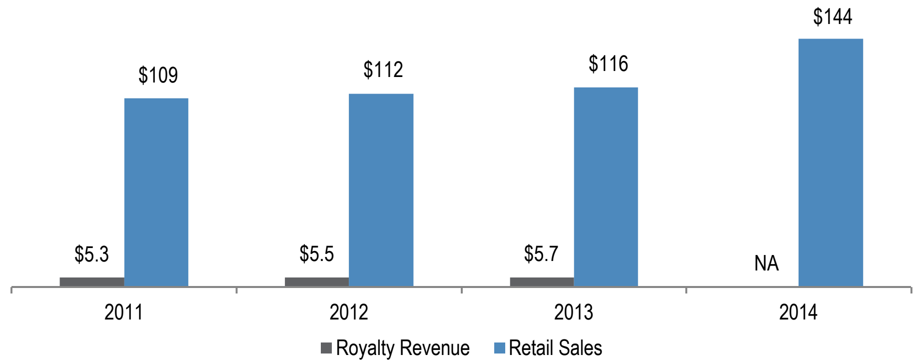
In 2014, licensed merchandise accounted for ~$242b in worldwide retail sales and accounted for 31% of U.S. toy sales.

Licensed products have the trademarked names and likenesses of cartoon characters, corporate logos/brands, major sports teams, and more. Licensees will pay licensors, the holders of the intellectual property, for the right to use these trademarks and likeness on properties that they sell. ***Disney is the largest licensor in the world, generating ~$45.2b in global retail sales in 2014.***

According to the International Licensing Industry Merchandisers' Association's (LIMA) *Annual Global Licensing Survey*, in 2014, licensed products generated $242b in global retail sales and $13.4b in royalty revenues, implying an average royalty rate of ~5.5%. Entertainment/character was the dominant licensed merchandise property type, generating $107b in global retail sales and capturing 44% market share. The U.S./Canada was the most dominant region with $144b+ in licensed retail sales, nearly 60% market share, followed by Europe at $57b for a little less than one-fourth market share and Asia at nearly 10% share.

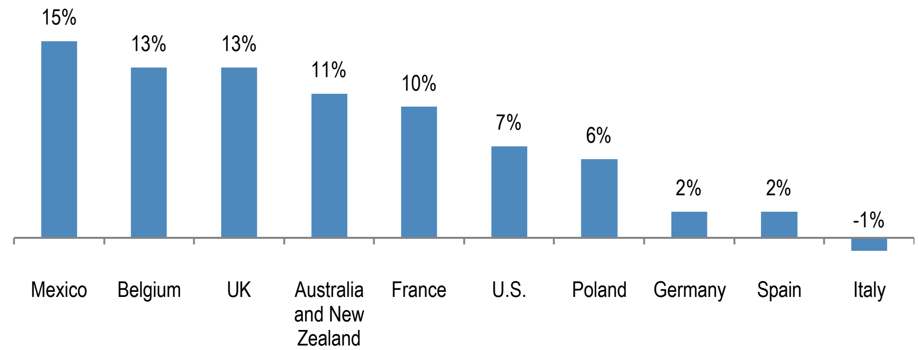
Figure 14: U.S./Canada Licensed Products Royalties and Retail Sales

$ in billions



Source: LIMA Annual Global Licensing Study, J.P. Morgan estimates.

Figure 15: Global Licensed Toys Growth, LTM Ending April 2015



Source: The NPD Group / Retail Tracking Service, OzToys, J.P. Morgan estimates.

According to *The Licensing Letter*, 2014 worldwide sales of licensed toys totaled $17.1b, an increase of 3.1% (although international counts both traditional and interactive toys and interactive was down in both markets in 2014). Toys based on licensed entertainment properties once again accounted for the majority of sales, although this was mainly driven by a few properties, mostly owned by Disney with the *Frozen* and *Marvel* properties, as well as some non-Disney properties such as *Teenage Mutant Ninja Turtles*. Many respondents to The Licensing Letter's *Annual Licensing Business Survey* attributed growth to "the *Frozen* factor."

In the U.S., The NPD Group estimates that in 2014, U.S. retail sales of toys increased 4% to $18.08b with sales of youth electronics, action figures, and licensed toys as leading categories. Penetration of licensed toys also increased 7%, reaching 31% of total industry sales, or $5.7b. The most notable category of growth came from retail sales of entertainment-licensed toys, which grew 8.9% in the US/Canada last year. ***Disney's Frozen was the top toy overall and the top gainer among all toy properties in 2014 based on absolute dollar growth with $531 million in sales in 2014 and 300+ different items on sale.*** Notably, Disney owns three of the top five toy licenses by sales in the U.S. and four of the top five globally for the twelve months ending April 2015 according to data released by The NPD Group, demonstrating the immense breadth of Disney's successful licensing properties both domestically and globally.

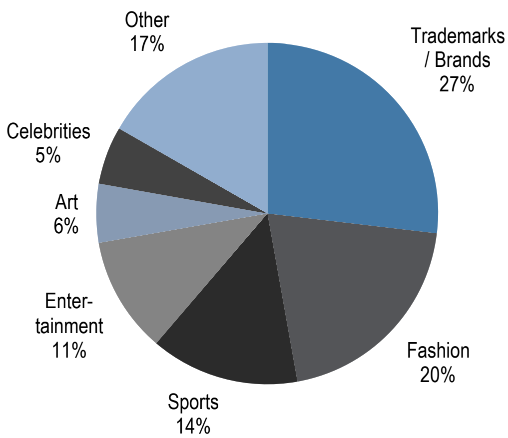
Euromonitor expects licensed toys to remain a key growth factor of global toys and games growth, citing the several upcoming and announced Marvel and *Star Wars* films as well as the 2015 films *Jurassic World* and *Minions*, another potential *Transformers* film, a *Frozen* sequel, and DC Comics films. It is possible that these franchises will drive toy and other merchandise sales to record levels.

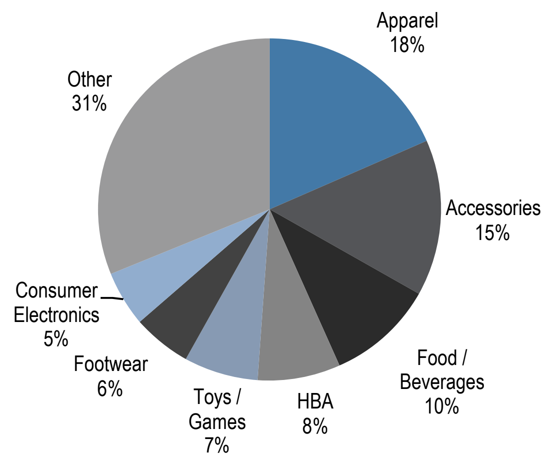
Table 12: Top Five Toy Licenses, LTM Ending April 2015

	U.S.		Global
1	Disney Frozen	1	Disney Frozen
2	Ninja Turtles	2	Star Wars
3	Disney Princess	3	Ninja Turtles
4	Star Wars	4	Disney Princess
5	Minecraft	5	Mickey & Friends

Source: The NPD Group / Retail Tracking Service, J.P. Morgan estimates.
Note: Global ranking includes U.S., Belgium, France, Germany, Italy, Mexico, Poland, Spain, and U.K. Highlighted represents Disney-owned property.

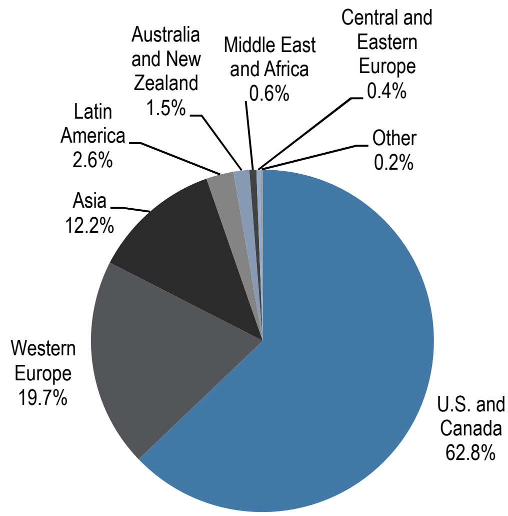
Figure 16: 2014 U.S./Canada Licensed Merchandise Retail Sales by Property Type, Product Category





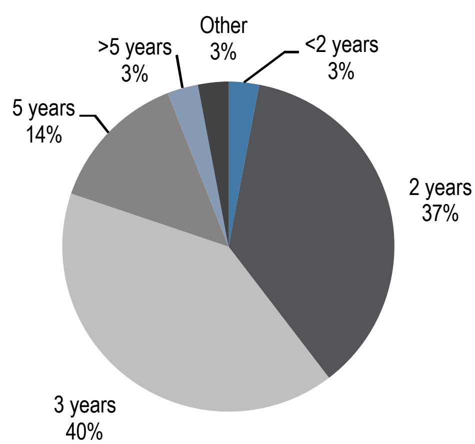
Source: The Licensing Letter, J.P. Morgan estimates.

Figure 17: 2014 Retail Sales of Licensed Merchandise by Territory



Source: The Licensing Letter, J.P. Morgan estimates.

Figure 18: Average Length of New Licensing Agreements, 2014



Source: The Licensing Letter, J.P. Morgan estimates.

Entertainment/Character Is the Dominant Licensed Property Type

Entertainment/character accounted for $107b of worldwide retail sales of licensed merchandise in 2014, capturing ~44.4% market share.

In 2014, the entertainment/character property type grew 6% y/y to $107b of worldwide retail sales of licensed merchandise, capturing 44.4% market share. The category has likely benefited from an increase in franchise films with more comprehensive consumer products merchandising strategies as well as retailers become more risk averse on the properties they are willing to distribute with already established franchises often guaranteeing much higher revenues than less high-profile, somewhat unknown properties.

Disney's *Frozen* was a significant contributing factor to overall growth last year as it was the dominant licensing property after its extremely successful film release in November 2013. According to The NPD Group, *Frozen* was the top toy property in 2014 with $531m in global retail sales. Although *Frozen* did not capture the top spot

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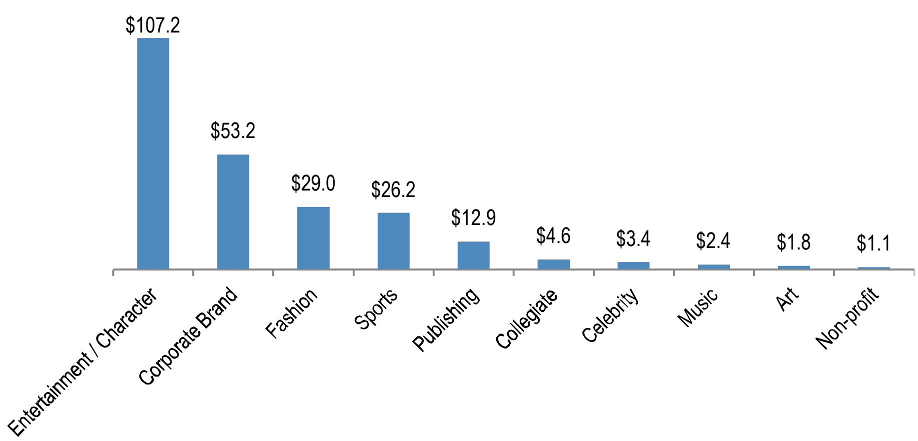
in any of the 11 super-categories the group tracks and was only the top property in 4 of 100 subclasses, the property benefited from the wide array of offerings across property types. Even with its impressive success last year, we believe there is further potential for the franchise this year as *Frozen* consumer products sales experienced a somewhat softer beginning of the year in 2014 as retailers and even Disney executives were initially surprised by the film's popularity. After understocking at several retailers, Disney and the retailers rushed to serve more merchandise and by the holiday season were much more prepared. For example, while Toys R Us was selling only a few dozen *Frozen* products in the beginning of the year, the retailer expanded its offering to hundreds of items by the holiday season in order to keep up with demand.

More recently, licensors of entertainment/character properties have also become more aggressive in the rollout of merchandise ahead of film releases. While traditionally merchandise linked to films appeared in stores approximately six weeks before the film release, some industry executives cited in the *TLL* survey predict that merchandise may begin to appear earlier as companies attempt to generate greater buzz for the films and attract higher licensing/retail revenues. For example, Disney announced it intends to begin releasing new *Star Wars* merchandise with a global event named "Force Friday" on September 4th, 15 weeks before the film's December 18th release.

Figure 19: Worldwide Retail Sales of Licensed Merchandise by Property Type, 2014

$ in billions



Source: LIMA Annual Global Licensing Study, J.P. Morgan estimates.

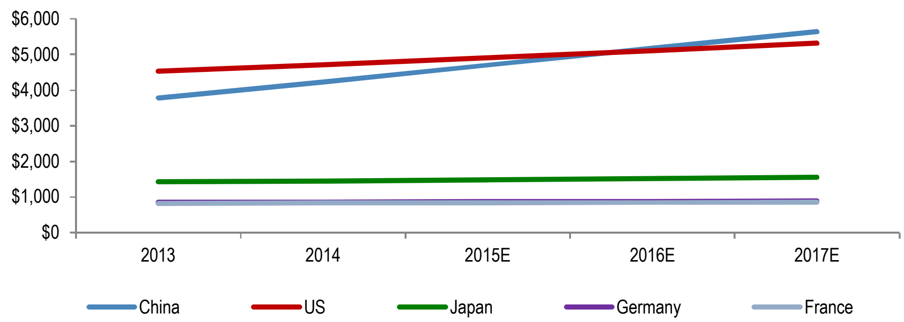
Retail Sales Growth Led by e-Commerce

E-commerce grew its market share from 8.5% to 10.0% of all retail sales of licensed products in 2014.

As consumers spend an increasing amount of time online and with mobile devices, purchase behavior is also shifting towards e-Commerce. In 2014, the U.S. generated $4.7b of total e-Commerce retail sales with China trailing only slightly at $4.2b. However, eMarketer expects China's overall total retail sales to surpass that of the U.S. next year, estimating China will generate $5.17b compared to the U.S. at $5.10b. This is likely largely fueled by China's rapidly growing middle class population that is becoming more digitally acclimated. While China's number of digital buyers is expected to grow from 269 million in 2013 to 499 million by 2018, the U.S. is expected to grow more modestly from 157 million to 190 million during the same period. The Chinese market presents enormous opportunity for digital/ e-Commerce sales given that in 2014 the country had digital buyer penetration of only 28% compared to the United States at 63%. India is also once again a notable standout growth candidate with the fifth greatest worldwide number of digital buyers at 42 million in 2014 and just 4% digital buyer penetration.

Figure 20: Total Retail Sales Worldwide, by Top Five Countries, 2013-2018E

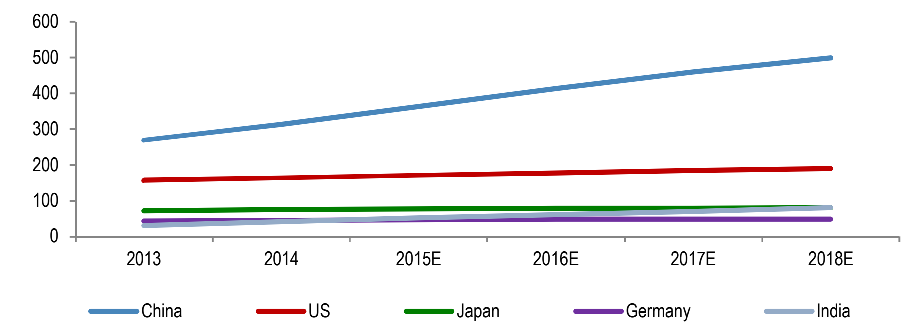
$ in billions



Source: eMarketer, J.P. Morgan estimates.
Note: Excludes travel and event tickets; China excludes Hong Kong.

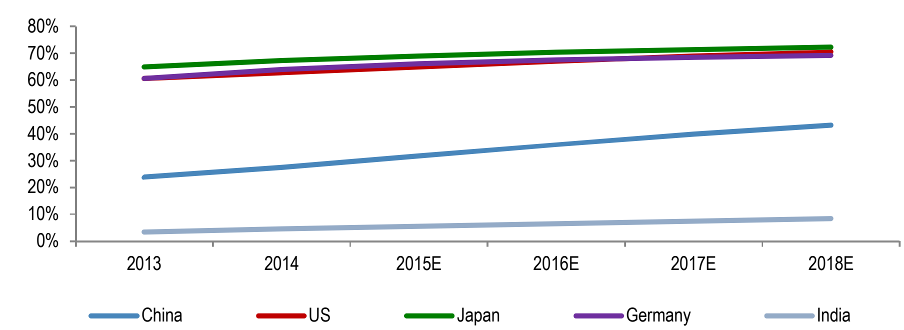
Figure 21: Digital Buyers Worldwide, by Top Five Countries, 2013-2018E

In millions



Source: eMarketer, J.P. Morgane estimates.
Note: Ages 14+; internet users who have made at least one purchase via any digital channel during the calendar year, including online, mobile, and tablet purchases; China excludes Hong Kong.

Figure 22: Digital Buyer Penetration Worldwide, by Country, 2013-2018E



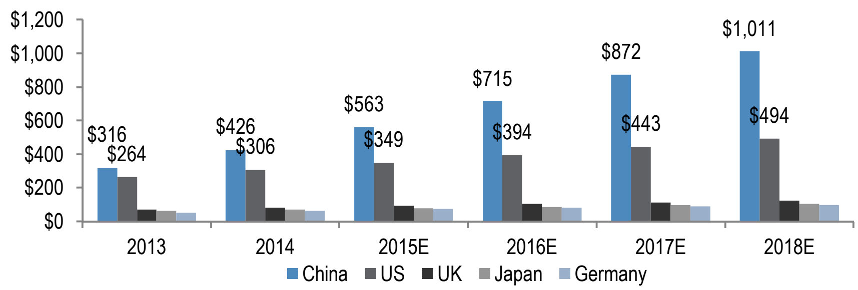
Source: eMarketer, J.P. Morgan estimates.

While the U.S. leads China in total retail sales, China is already ahead in retail e-Commerce sales, generating 2014 e-Commerce sales of $426b compared to $306b in the United States. e-Commerce represented 10.1% of total retail sales in China in 2014 compared to 6.5% in the United States. The trend is expected to continue with China reaching 15.5% e-Commerce sales penetration by 2017 compared to 8.3% in the U.S. In the U.S., computer and consumer electronics captures the highest share of e-Commerce sales with 22%, followed by apparel and accessories at 17%. Toys and hobby represents only 4% of e-Commerce sales, suggesting both the potential growth opportunity as well as the continued importance of strong retailer relationships.

Sales of licensed retail products in the e-Commerce channel also accelerated in 2014 in the U.S./Canada according to *TLL's Annual Licensing Business Survey*. E-Commerce/online channel sales increased market share from 8.5% to 10.0% of all retail sales of licensed products in 2014. Meanwhile, department stores/mid-tier stores decreased market share from 13.0% to 12.6% in 2014, and the lowest-priced retail tier (dollar/value/outlet stores) modestly increased its market share from 8.5% to 8.8%.

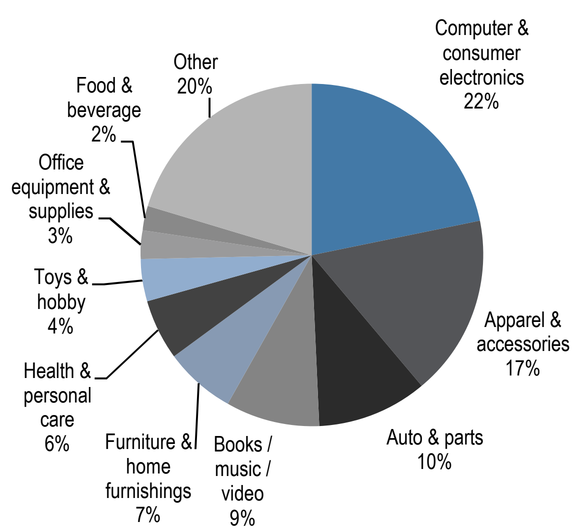
Figure 23: Retail Ecommerce Sales Worldwide, by Top 5 Countries, 2013-2018E

$ in billions



Source: eMarketer, J.P. Morgan estimates. Note: Includes products or services ordered using the internet via any device, regardless of the method of payment or fulfillment; excludes travel and event tickets; China excludes Hong Kong.

Figure 24: US Retail Ecommerce Sales Share, by Product, 2014



Source: eMarketer, J.P. Morgan estimates. Note: Includes products/services ordered using the internet, regardless of the method of payment or fulfillment; excludes travel and event tickets.

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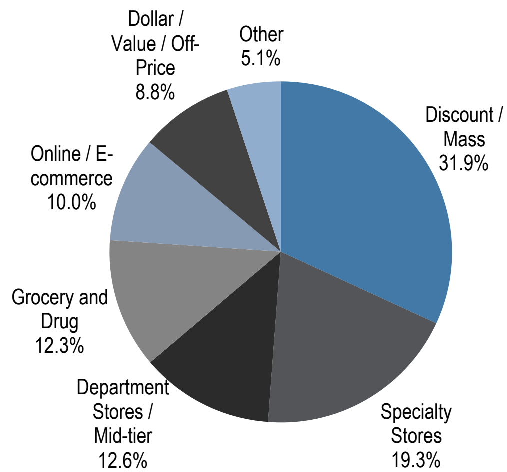
Figure 25: 12: U.S./Canada 2014 Retail Sales Market Share of Licensed Merchandise by Distribution Channel



Source: The Licensing Letter, J.P. Morgan estimates.

Royalties and Guarantees

Royalty rates in the Entertainment/character segment are on the higher end at ~9.7% in 2014 and have had the highest increase in average royalties, increasing by 2.9% in 2014.

Licensors agree to license their properties in exchange for royalties and guarantees. Typically, licensors will require a portion of the first year's guarantee as an advance that is paid when the contract is signed, although the licensor may waive the advance in return for a higher guarantee or royalty rate or in an effort to allow the licensee to spend more on product development and marketing. Licensors also receive lower royalties from manufactures that sell to mass merchants as prices and margins are lower but are offset by higher volumes and overall sales. If a property is unproven or lesser-known, licensors are likely to offer lower royalty rates and lower guarantees.

According to *The Licensing Letter*'s *Annual Licensing Business Survey*, royalty rates in the U.S. and Canada were ~8.68% in 2014 across all property types and have been broadly stable in the range of 8.6%-8.8% since 2005. Entertainment/character was the property type with the highest rise in average royalties, increasing by 2.9% to 9.70% from 9.43% in 2013. ***Notably, many of the survey's respondents attributed the increase in royalty rate to "platinum" properties, particularly those owned by Disney, which is the largest global licensor and has highly sought-after properties after its acquisitions of Marvel and Star Wars***. In our opinion, companies with broad portfolios of attractive properties that are able to demonstrate success and consumer desire such as Disney will be better able to leverage them for higher royalty rate resets.

In 2014, minimum guarantees remained flat in general across most categories. However, once again, ***survey respondents cited the entertainment/character category as the property type that increased the most with Disney pushing for higher minimum guarantees for its brands as the company has significant market power and extremely lucrative properties***, in our opinion. With higher guarantees for well-performing, established properties, the survey respondents were less keen on paying guarantees for lesser-known character properties.

Table 13: Average Royalty Rate and Range of Royalties, by Property Type

	Average Royalty			2014
Product Type	2014	2013	% change	Royalty Range
Celebrities	10.31%	10.31%	0.0%	4% - 15%
Collegiate	10.00%	9.97%	0.3%	5% - 18%
Sports	10.00%	9.98%	0.2%	5% - 18%
Entertainment / Character	9.70%	9.43%	2.9%	4% - 18%
Estates	9.65%	9.70%	-0.5%	4% - 18%
Videogames / Interactive / Online	8.91%	8.91%	0.0%	6% - 15%
Publishing	8.55%	8.68%	-1.5%	2% - 18%
Fashion	8.50%	8.46%	0.5%	2% - 16%
Non-profit	8.30%	8.34%	-0.5%	4% - 14%
Music	8.28%	8.26%	0.2%	4% - 20%
Traditional Toys / Games	8.16%	8.16%	0.0%	5% - 12%
Trademarks / Brands	7.78%	7.78%	0.0%	1% - 16%
Art	6.25%	6.30%	-0.8%	4% - 12%
Overall Average	**8.68%**	**8.67%**	**0.1%**	**1% - 20%**

Source: The Licensing Letter, J.P. Morgan estimates.

Table 14: Average Royalty Rate and Range of Royalties, by Product Category

	Average Royalty			2014
Product Type	2014	2013	% change	Royalty Range
Videogames / Software	10.45%	10.41%	0.4%	1% - 20%
Toys / Games	10.40%	10.37%	0.3%	5% - 20%
Sporting Goods	9.81%	9.81%	0.0%	4% - 15%
Publishing	9.73%	9.73%	0.0%	5% - 15%
Apparel	9.50%	9.44%	0.6%	5% - 18%
Accessories	9.15%	9.12%	0.3%	3% - 18%
Stationery / Paper	9.00%	9.09%	-1.0%	4% - 12%
Fragrance / Cosmetics	8.99%	8.99%	0.0%	5% - 14%
Domestics	8.85%	8.85%	0.0%	4% - 14%
Gifts / Novelties	8.70%	8.76%	8.8%	4% - 15%
Infant Products	8.70%	8.70%	0.0%	5% - 14%
Footwear	8.19%	8.19%	0.0%	3% - 16%
Furniture / Home Furnishings	7.51%	7.51%	0.0%	3% - 14%
Housewares	6.28%	6.28%	0.0%	3% - 14%
Food / Beverages	5.95%	5.93%	0.3%	1% - 12%
Consumer Electronics	5.25%	5.25%	0.0%	3% - 10%
Overall Average	**8.68%**	**8.67%**	**0.8%**	**1% - 20%**

Source: The Licensing Letter, J.P. Morgan estimates.

Marketing Commitments

Corporate trademarks, fashion, sports, and entertainment/ character are cited most commonly as having annual marketing commitment requirements.

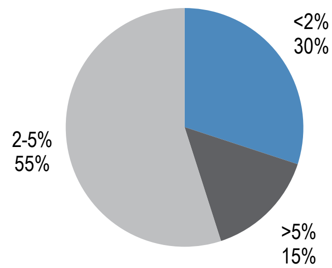
Marketing commitments are the amount a licensee agrees to spend on marketing the licensed products during the term of the agreement and can be for specific periods during the contract or for specific properties, categories, territories, or distribution channels.

According to *The Licensing Letter*'s *Annual Licensing Business Survey*, 45% of respondents were required to pay or contribute to a central marketing fund (CMF) in 2014, down from 52% in 2013. Meanwhile, 42% of survey respondents were required to commit a percentage of annual wholesale or net sales to their own advertising/marketing of the license.

Annual marketing commitments were reported most commonly as 2-5% of net sales or wholesale, and some other requirements included participating in trade shows/consumer exhibitions, buying TV advertising, or marketing products in licensor-controlled venues such as websites and comic books.

Corporate trademarks, fashion, sports, and entertainment/character were cited most commonly as having these types of requirements.

Figure 26: Average Required Annual Marketing Commitment, as Percentage of Net or Wholesale Sales



Source: The Licensing Letter, J.P. Morgan estimates.
Note: Excludes those not reporting a commitment.

Companies Discussed in This Report (all prices in this report as of market close on 28 August 2015)
Disney (DIS/$102.48/Overweight)

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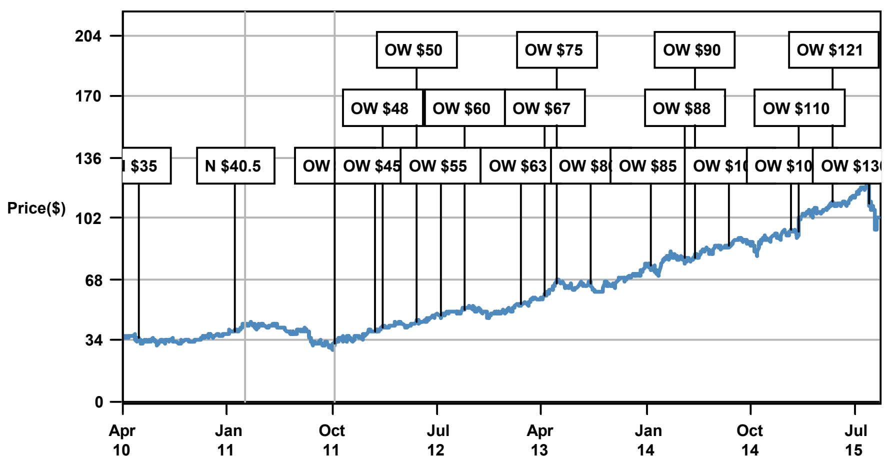
Disney (DIS, DIS US) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage May 12, 2010.

Date	Rating	Share Price ($)	Price Target ($)
12-May-10	N	35.76	35.00
18-Jan-11	N	39.39	40.50
07-Oct-11	OW	32.03	42.00
19-Jan-12	OW	39.44	45.00
08-Feb-12	OW	41.27	48.00
09-May-12	OW	45.02	50.00
13-Jul-12	OW	48.19	55.00
11-Sep-12	OW	51.56	60.00
06-Feb-13	OW	54.52	63.00
08-Apr-13	OW	58.82	67.00
08-May-13	OW	66.07	75.00
06-Aug-13	OW	65.91	80.00
09-Jan-14	OW	75.39	85.00
09-Apr-14	OW	79.57	88.00
07-May-14	OW	80.29	90.00
05-Aug-14	OW	86.75	100.00
12-Jan-15	OW	95.19	105.00
03-Feb-15	OW	94.10	110.00
05-May-15	OW	110.81	121.00
04-Aug-15	OW	110.53	130.00

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