

VTECH/LEAPFROG MERGER INQUIRY

Summary of hearing with KD Group on 7 October 2016

1. KD Group told us that, as a competitor to VTech and LeapFrog, they were not overly concerned about the merger. It said that, in the UK, VTech was a much stronger brand (than LeapFrog) and was able to maintain a more competitive position because it was a Hong Kong-based company with more direct access and a shorter supply chain from the factory gate to the retail shelf.
2. KD Group told us that it has two divisions: KD Interactive (in which tablets and smartwatches were located) and KD Toys (which included electronic learning toys made as generic items in its original designs and under licence working with companies such as Disney, Nickelodeon and Mattel)
3. KD Group told us that it (and the industry) considered electronic learning toys to be a distinct segment within the pre-school and infant market. KD Group said that, in terms of how it looked at data, the key markets were for infant toys (0 to 18 months) and pre-school toys, and electronic learning was the second largest category within the pre-school market worth around £85 million a year.
4. KD Group said that all pre-school toys and, to some extent, infant toys were designed to address one or a combination of three objectives: cognitive development, physical development and social development. KD Group told us that it drew a distinction between an interactive electronic product and an electronic learning toy (ie a toy that was designed to teach children about colours, letters, shapes, etc). KD Group's interactive products are made under the Kurio brand, featuring apps and gaming that have learning benefits but are developed as proper electronics.
5. KD told us that its products were different from those of VTech and LeapFrog. It highlighted that while VTech and LeapFrog's tablets were closed platform tablets that were filled with their own content, KD Group's tablet was an Android tablet with access to the internet and provided an open platform for a child to use a tablet in the same way as an adult. KD Group defined its tablet as an adult tablet in child form and stated that the distinction between its adult and child tablets was that the content pre-loaded on the child tablet had been carefully selected to fit the age of the child and that it contained proprietary parental control software setting parameters to prevent access to inappropriate material and control the amount of usage of the device. KD

Group did not see its interactive products as toys, but as consumer electronics developed with children in mind.

6. KD Group referred to Generation Z children who were born into a digital world sharing their lives on social media and interacting digitally, with the effect that younger and younger children were accessing devices.
7. KD Group told us that it was aware that around 45% of two to four year olds accessed digital devices on a regular basis and tablets were their preferred way of doing that. KD Group said that it was aware that there was an element of hand-me-down tablets, where this involved parents giving their old tablets to their children as they upgraded their personal tablets.
8. KD Group said that it expected children to keep wanting digital devices. It said that it had noticed that children wanted the same products based on innovative technologies that came out for adults. KD Group told us that it had noticed it had performed well when it was able to launch the child versions of adult products quickly and at an accessible price and while the adult version was still very expensive. It had observed that, as soon as the adult prices came down and there was less of a price differential to child versions of products (as happened with tablets), its products competed with adult products.
9. KD Group told us that it believed that there was competition between child and adult tablets; however, younger children between the ages of four and eight were not brand-specific about the tablets they wanted and the purchase decision laid with the parent. KD Group noted that if the parents' decision was based purely on price, then there were lots of options in the adult market (eg Alcatel, Alba, Bush, Lenovo, etc). If on the other hand, the parent was concerned about content, the specification of the device in terms of things like shock absorbing casing and/or parental control, the parent would look to a child specific tablet which was where the KD Group's Kurio tablet was competitive.
10. KD Group stated that it saw its biggest competitor in this space as Amazon with its Kids' Fire products.
11. KD Group said that it believed that child tablets were moving towards content and hardware was becoming less important. It highlighted that a subscription-based model had already been launched by Disney.
12. KD Group noted that were positioned differently from LeapFrog and VTech; while LeapFrog and VTech were child-orientated, KD Group's background was in consumer electronics (rather than toys), using adult operating systems and having more functionality. KD Group said that the age profile of children

using tablets was coming down and the electronic learning market was declining because traditional toys were being replaced by consumer electronics; as such, its products might compete more closely with the offerings of VTech and LeapFrog in future.

13. KD group noted that in the KD Toys side of its business, it made toy versions of adult devices (such as toy plastic laptops and tablets) but it was no longer easy to sell these products as children of the age that used to buy them now wanted the real deal.
14. KD Group told us that it was developing other pre-school play toys and that there were various other brands supply these products such as LeapFrog, VTech, Mattel (Fisher Price), TOMY, Little Tikes, etc as well as many own brands.
15. KD Group said that there were certain characteristics that bigger brands (such as LeapFrog and VTech) had which it did not. For instance, bigger brands were able to leverage more from retailers in terms of store space and could afford to invest a lot more money in their retail accounts (to buy shelf space, participate in promotions, be it in a catalogue or website, or have a dedicated promotional space in-store). There is also an advantage in owning, or having a joint venture, in factories and selling direct to the retailer. If there is a longer supply chain, product lines will be more expensive than competitors, limiting sales opportunity. The reality of that is unrelated to whether organisations such as VTech or LeapFrog merge or not.
16. KD Group told us that VTech had moved forward very rapidly and aggressively over the last few years and LeapFrog found it hard to compete with VTech and margins suffered as a result.
17. KD Group told us that, for pre-school as a broad category, parents only spent a given amount each year on their children (around £47/child per year according to NPD data) and, as such, all toys compete with each other. Similarly, if a child wanted a licenced product (eg Paw Patrol), parents looked to spend a certain amount of money at a Paw Patrol display in the store that had all sorts of products across all sorts of categories.
18. KD Group told us that its retail customers controlled the route to market – what was important was getting shelf presence and making the products ‘shout’ from the shelf, or doing things in marketing terms that drive customers to the product.