

VTECH/LEAPFROG MERGER INQUIRY

Summary of hearing with Smyths on 14 October 2016

Market segmentation

1. Smyths told us that VTech and LeapFrog were both present in the pre-school sector. LeapFrog could be broken down into a further two categories, toys and early learning, which comprised its tablets and books. Smyths said that historically LeapFrog had been strong in books and had recently launched a new learning book.
2. Smyths said that LeapFrog had entered the tablet market, followed by VTech. After a couple of years, more companies entered. A number of companies had left the market because of overcrowding and heavy discounting, due to overcapacity (in particular two years ago). In the tablet market, LeapFrog is the leader, with Kurio and VTech bit players.
3. [✂].
4. [✂].
5. Smyths said that it had retained VTech and LeapFrog products as it enjoyed a good relationship with both companies. Other retailers only sold tablets online, and most bricks and mortar retailers did not include them in their stores.
6. Smyths said that in-store, it did not group all the tablets it sold together, with LeapFrog and VTech tablets located in a different aisle to those produced by Kurio. The reason for this was that the Kurio tablet was aimed at an older age group and were in the software counter with other Kurio products, while early learning products were usually grouped together and that is where you would expect to find LeapFrog and VTech products.
7. [✂].
8. Smyths said that pre-school products were flexible with regard to the space allocated to them and unsuccessful products could be replaced with others from the same category.
9. Smyths believed that the most fashionable items in the toy market this Christmas would be Hatchimals and PAW Patrol, rather than generic, learning toys.

10. [X].
11. [X].
12. Smyths said that marketing activity was a key driver of demand and brand loyalty. [X].

Contracts and negotiations with retailers

13. Smyths said that it adopted the same negotiating approach with all toy suppliers. Smyths usual practice was to agree a general terms of agreement based on the vendor's price list, [X].
14. [X].
15. [X].
16. Smyths said that it had long-term, mutually beneficial, relationships with many of its suppliers. [X].
17. [X].
18. Smyths said that it looked retrospectively at products and in 2014 had considered the delisting of, and reduction of floor space allocated to, LeapFrog tablets due to a decrease in turnover and margins.
19. Smyths said that tablets were a small percentage of the toy market and was unlikely to grow again. While it did still stock some tablets, Smyths believed children were more concerned with having the latest phone as the 'must have' tech.

Consumer behaviour

20. Smyths said that it stocked many brands such Fisher Price, VTech, LeapFrog and TOMY. Licensed products were also popular and Smyths stocked Thomas the Tank Engine, Paw Patrol, Fireman Sam and Peppa Pig.
21. Smyths said that it also had imported, wooden toys [X].
22. [X].
23. Smyths said that Fisher Price and VTech were the key players and Little Tikes and TOMY also had a small presence (and were making a comeback). [X].
24. Smyths said that licensed toys were spread between different suppliers of specific products. For example, for a character such as Peppa Pig, one

company could be responsible for the master toy, while other companies would produce items such as clothes and cushions and duvets. Any number of distributors could have the UK rights for a license, but Smyths would have to deal with the company that held the core UK licence.

Innovation

25. Smyths viewed both Vtech and LeapFrog as innovative companies, who continuously produced new products. Vtech's 'Toot-Toot' range was a good example of this, where basic play toys had benefitted from the addition of electronics. Fisher Price's code a caterpillar was another example of an innovative product that had proved popular.
26. Smyths said that following its entry into the tablet market, LeapFrog had returned to producing books, and were having a huge success with a paper book. LeapFrog appeared to be the only firm targeting the paper book and had established its own segment, [✂].
27. Smyths did not believe that an electronic component was critical to the success of a toy and noted that a number of traditional toys sold very well. As [✂].
28. Smyths noted that in contrast to this, Fisher Price had achieved a huge success in the pre-school sector with BeatBo, a dancing, musical toy.

Top toys

29. Smyths said that it produced a 'top-10' list of top toys, which tended to reflect new toys and which was intended to be a fair reflection of toys from a number of suppliers. The list was also designed to attract media [✂].
30. Smyths said that there were recurring products across top-10 lists, but if a product was perceived as poor it would not be listed.
31. Smyths said that parents would not focus on top-10 lists when selecting a product and were more informed by the needs of their children. Smyths cited television advertising and movie tie-ins as more influential than top-10 lists in a child's choice of toy.

Views on the merger

32. Smyths noted that a number of senior staff had left LeapFrog following the merger, but there was no change in Smyths' day-to-day dealings with the company.