Evaluation of the 'Dramatic Choices' Report:

Economic Considerations of Certain Audience-based Incentives

Prepared for the CRTC by

Nordicity Group Ltd., September 2003

Nordicity Group Ltd.
Le Groupe Nordicité ltée

Table of Contents

NOTE:

This English-language version of the Nordicity Report replaces that placed in the CRTC's exam room in Gatineau and in its Regional Offices on 1 October 2003. Although this version contains certain corrections, all are of a minor editorial nature.

Nordicity Mandate and Approach

Mandate: The CRTC commissioned Nordicity Group Ltd. (Nordicity) to assess the economic incentives of the main recommendations proposed by the McQueen report *Dramatic Choices* ("McQueen Report"). Our focus was to evaluate the potential net gains or net losses for national conventional broadcasters who availed themselves of specific regulatory incentives.

Nordicity Approach: Nordicity is a leading Canadian media consultancy whose principals have undertaken numerous studies and reports for industry stakeholders. Noridicity developed this analysis of the McQueen Report's proposed incentives by building a financial model whose assumptions were based on selected interviews with TV executives and media buyers as well as on Nordicity's own industry and regulatory experience. Confidentiality considerations precluded consultation with broadcasters or a wider range of industry experts. Fiscal 2002 broadcaster financial data were provided by the CRTC.

Caveats: Given that this analysis was conducted over a short timeframe, further verification as to assumptions from broadcasters, producers, and advertisers/media buyers is recommended. It should also be understood that there are many unique circumstances that would generate different assumptions, since broadcasting groups have a number of options in terms of how they would take advantage of the proposed incentives.

Alternative Model Simulations

In order to assess the economic impact of the broadcaster incentives proposed in the McQueen Report, we prepared a financial model. This model examined the impact the incentives may have on the airtime revenues and programming costs of a national Canadian broadcaster.

Scenarios are constructed for each of the major recommendations of the McQueen Report. We produced two different simulations for each scenario:

- One whereby we relied relatively more on incremental costs and revenues, as we understand them and as confirmed by the practitioners we were able to canvas in confidence – we call it the "market-based simulation"

- The other relies relatively more on average programming costs and revenues by genre and day part, derived from actual CRTC data from national broadcasters – we call it the "averages-based simulation"

The model and assumptions are described in Appendix 1. The main conclusions follow.

Main Conclusions

1. Broadcasters who already air 10-point drama in peak time could make a "windfall" bottom line difference of **+$XXXX** ("averages-based simulation") to **+$XXXX** ("market-based simulation") per year for 26 original hours plus 26 repeats.

2. In a typical situation, the 150% incentive for new 10-point dramas is borderline in terms of inducing broadcasters to program incremental drama acquired for the same level of licence fee as they do now. Model results show annualized results from **-$XXXX to +$XXXX** depending on whether the simulation was averages-based or market-based**.**

3. If we assume the average costs and average revenues for Canadian and US drama programming (the "averages-based simulation"), the combined incentives are moderately attractive, largely due to the credit of an extra minute of advertising. The model shows annualized benefits of **+$XXXX** for a hit drama series, and **+$XXXX** for series drama that does not reach hit status.

4. However, the model results are very sensitive to the model assumptions. In the "market-based simulation", where some assumptions are based on incremental costs/revenues, the payback could be substantial. For a drama series qualifying as a "hit" (i.e., one that has one million viewers), the annualized benefit is about **+$XXXX.** Even if the drama series does not reach one million viewers, the benefit is about **+$XXXX.**

Nordicity Group Ltd.
Le Groupe Nordicité ltée

Main Conclusions (continued)

5. For broadcasters who program a four-hour mini-series or the equivalent in movies of the week (MOWs), the incentives can be worth **+$XXXX** under the "averages-based simulation" and **+$XXXX** under the "market-based simulation". (Though this value looks to be relatively less than for hit drama series, the scenario encompasses only the value of one four-hour miniseries, rather than 26 original hours assumed for a drama series)

6. The equivalent range in daytime programming benefits is **+$XXXX to +$XXXX** in annualized benefits, depending on the simulation.

7. Broadcasters could **increase** the financial payback significantly if they make even more creative use of the incentives, e.g.
   - schedule hit Canadian programming, and manage to do so without losing US simulcast opportunities;
   - use their credits by scheduling U.S. drama for which the broadcaster is already paying licence fees, so that there is no incremental cost; or,
   - use the ad credit in a very high demand program.

Frame of Reference: Current Regulatory Framework

Canadian Content

- 60 percent of full broadcast day
- 50 percent of prime-time (6 p.m. to midnight)

Priority Programming

- 8 hours per week during peak viewing period (7 p.m. to 11 p.m.)
- Priority programming drawn from drama, music and dance, variety, long-form documentary, regional programming, and entertainment magazines

Credits

- 150 percent credit for ten point drama
- 125 percent credit for six to nine point drama
- For the multi-station ownership groups, both credits are only applied against Priority Programming requirements

Incentives Proposed by McQueen Report

150 Percent Credit	• 150 percent credit for ten point drama to be applied against Canadian content requirement
200 Percent 'Hit' Drama Credit	• 200 percent Canadian content credit for drama that draws 1 million viewers • Maximum credit of 1 hour per week • Broadcaster licence fees must be at least 25 percent of total production budget
Credit for 1 Minute of Extra Advertising	• Each hour of new ten point drama can earn an extra 2 minutes of advertising (1 minute for original, 1 minute for repeat) • Broadcaster licence fees must be at least 25 percent of total production budget

Incentives Proposed by McQueen Report (cont'd)

Drama Pilot Credit

- 50 percent priority programming credit for drama pilots not aired, but for which licence fees of 25% are paid by Canadian broadcasters (not covered in this analysis)

Alternative Drama Credit

- 150 percent credit would be applied to daytime Canadian content for:
  - Afternoon soaps
  - "Edgier" drama aired after midnight
  - Live-action children's drama

Star System Credit

- Entertainment magazine programs aired outside of prime time would earn:
  - 50 percent credit against priority programming, or
  - 125 percent credit against daytime Canadian content requirements

  (Neither covered in this analysis)

Potential Impacts of Broadcaster Incentives

	150 Percent Credit	200 Percent Credit	Advertising Credit
Costs	*The cost is the typical loss incurred because of the gap between revenues and licence fees paid by the broadcaster for Canadian drama programming. The net cost would be mitigated somewhat by the displacement of another priority program in the broadcaster's schedule.*	*Broadcasters would have to take steps to generate higher audiences. Possible measures include: increasing production values, locking in scheduling to a specific timeslot, and increasing marketing and promotion. (Where higher production budgets are contemplated, it is assumed that funds will be drawn from the $30 million proposal in the McQueen report)*	*No extra costs except for selling the advertising.*
Benefits	*One half hour immediate increase in US programming, which would generate "margins" of 20-70% over the licence fee costs of the programming.*	*Same as for the 150% benefit, except that broadcasters would be permitted to exhibit one hour for every hour of Canadian drama drawing an audience of one million or more.*	*Potential to significantly increase advertising revenues.* *Note: Assumptions* • *Extra minute would be sold as part of package on highest earning US programs* • *Existing ad inventory on top US programming is sold out*
Other Implications	*Broadcasters already programming 10-point drama productions would obtain a "windfall" from the proposed 150% credit.*	*Profitability created by incremental US programming, and by the elimination of the losses from the Canadian programming replaced by the US programming would need to be greater than the cost of the steps taken by the broadcaster to generate a hit Canadian show.*	

Broadcaster Incentive Scenarios
– in Addition to Status Quo

B. Extra Hour of Canadian Drama (No Extra Ad Minute)

*Broadcaster earns **150% Canadian content credit**.*

Displaces one hour of non-drama/non-news Canadian programming by one hour of new Canadian drama programming.

Also displaces one half-hour of non-drama/non-news Canadian programming by one half-hour of US drama programming.

*Broadcaster pays licence fee of **20%** of total production budget for the rights to exhibit the Canadian drama program.*

Because the broadcaster's license fee is less than 25%, the broadcaster does not receive extra minute of advertising.

C. Extra Hour of Canadian Drama at 25% licence fee (With Extra Ad Minute)

*Broadcaster earns **150% Canadian content credit**.*

Displaces one hour of non-drama/non-news Canadian programming by one half-hour of Canadian drama programming.

Also displaces one half hour of non-drama/non-news Canadian programming by one hour of US drama programming.

*Broadcaster pays licence fee of **25%** of total production budget for Canadian drama, and therefore does **earn an extra minute of advertising** in the following broadcast year.*

D. Daytime Credit (With Extra Half Ads Minute)

*Broadcaster airs a Canadian soap opera or late-night drama and earns a **150% Canadian content credit** that can be applied during the daytime period.*

Displaces one half hour of non-drama/non-news Canadian programming by one hour of US daytime programming.

*Broadcaster pays licence fee of **25%** of total production budget for Canadian drama, and therefore **earns an extra half minute of advertising** in the following broadcast year.*

E. Hit Drama (With Extra Ad Minute)

*Broadcaster earns **200% Canadian content credit** due to the creation of a drama series that garners an audience of **1 million** or more per episode.*

The 'Hit' status is related to higher production costs (absorbed by the new drama fund) and other measures taken by the broadcaster.

Displaces one hour of non-drama/non-news Canadian programming by one hour of US drama programming

*Broadcaster pays a licence fee of **25%** of total production budget for Canadian drama, and therefore **earns an extra minute of advertising** in the following broadcast year.*

F. MOW/ Mini-Series (With Extra Ad minute)

*Broadcaster earns **200% Canadian content credit** due to the creation of a drama mini-series that garners an audience of **1 million** or more per episode.*

Displaces one hour of non-drama/non-news Canadian programming by one hour of US drama programming.

*Broadcaster pays a licence fee of **25%** of total production budget for Canadian drama, and therefore **earns an extra minute of advertising** in the following broadcast year.*

Development of Financial Model

Sections of the Model

The financial model used in this analysis can be divided into three key sections:

1. Direct Benefit (Cost) of Canadian Programming

This section includes estimates for the cost and revenue impacts of Canadian drama programming, and in particular, the drama programming production that may be stimulated by the McQueen Report incentives. The main cost components in the model include the broadcaster licence fee, and any third-party marketing or promotion expenses. The benefits component is the advertising revenue generated by the Canadian drama programming.

2. Additional US Programming

This section includes estimates for the cost and revenue impacts associated with the additional US programming that the McQueen Report incentives would allow Canadian broadcasters to exhibit. The costs of this programming are represented by the licence fees paid by Canadian broadcasters for the Canadian rights to US programs.

The Model (cont'd)

There are two key revenue components in this section:

- The advertising revenue earned by Canadian broadcasters on the acquired US programming attributable to the incentives.
- The extra advertising revenue attributable to the extra minute of advertising granted to Canadian broadcasters. While Canadian broadcasters can use this extra minute anywhere in their schedules, the assumption throughout the model is that they will apply it to highly-rated programming.

3. Benefit from Displacing Canadian Programming

The third section of the model accounts for any displacement benefits. There are two sources of the displacement benefit:

- The additional US programming that replaces Canadian programming. In most cases this is one-half hour of programming; in the case of a 'Hit' drama this is one hour of programming.
- The replacement of a poorly performing Canadian program by any new Canadian drama exhibited by the broadcaster. In all cases this is modelled as one hour of programming.

Summary of Model Results

Annualized Financial Impact

(Dollars)

(1 original + 1 repeat)

	A. Status Quo (No Incentives)	B. Extra Hour of Canadian Drama* (No Extra Ad Minute)	C. Extra Hour of Canadian Drama* (With Extra Ad Minute)	D. Daytime Credit**	E. Hit Drama/ High Cost Drama***	F. MOW/Mini Series***
Market-based Simulation	(XXXX)	XXXX	XXXX	XXXX	XXXX	XXXX
Averages-based Simulation	(XXXX)	(XXXX)	XXXX	XXXX	XXXX	XXXX

Note: Annualized = 26 originals + 26 repeats <u>except</u> MOW/Mini Series
(only 4 original hours + 4 repeats)

* Extra half hour of US programming
** Extra half hour of US daytime programming
*** Extra hour of US programming

Scenarios: Extra Hour of Canadian Drama, with/without Extra Ad Minute, and Daytime Credits – Market-based Simulation

	A Status Quo (No Incentives) (1 orig. + 1 repeat)	B Extra Hour of Canadian Drama (No Extra Ad Minute) (1 orig. + 1 repeat)	C Extra Hour of Canadian Drama (With Extra Ad Minute) (1 orig. + 1 repeat)	D Daytime Credit (1 orig. + 1 repeat)
Direct Benefit (Cost) of Canadian Programming				
Total Hourly Production Budget	$1,000,000	$1,000,000	$1,000,000	$350,000
Broadcaster's Licence Fee Share	20%	20%	25%	25%
Licence Fee per original hour (+ 1 repeat)	(200,000)	(200,000)	(250,000)	(87,500)
Advertising Revenue	XXXX	XXXX	XXXX	XXXX
Surplus (Deficit) on Canadian Program	(XXXX)	(XXXX)	(XXXX)	(XXXX)
Benefit from Displacing Canadian Programming				
Impact of Canadian Drama	-	XXXX	XXXX	XXXX
Impact of US Programming	-	XXXX	XXXX	XXXX
		Additional ½ hour of US programming	*Additional ½ hour of US programming*	*Additional½ hour of US daytime programming*
Additional US Programming				
Licence Fees	-	(XXXX)	(XXXX)	(XXXX)
Advertising Revenue	-	XXXX	XXXX	XXXX
Additional Minute of Advertising	-	-	XXXX	XXXX
Total Incentive Benefit	-	XXXX	XXXX	XXXX
Net Impact	**(XXXX)**	**XXXX**	**XXXX**	**XXXX**
Annualized Net Impact	**(XXXX)**	**XXXX**	**XXXX**	**XXXX**

Scenarios: Extra Hour of Canadian Drama, with/without Extra Ad Minute, and Daytime Credits - Averages-based Simulation

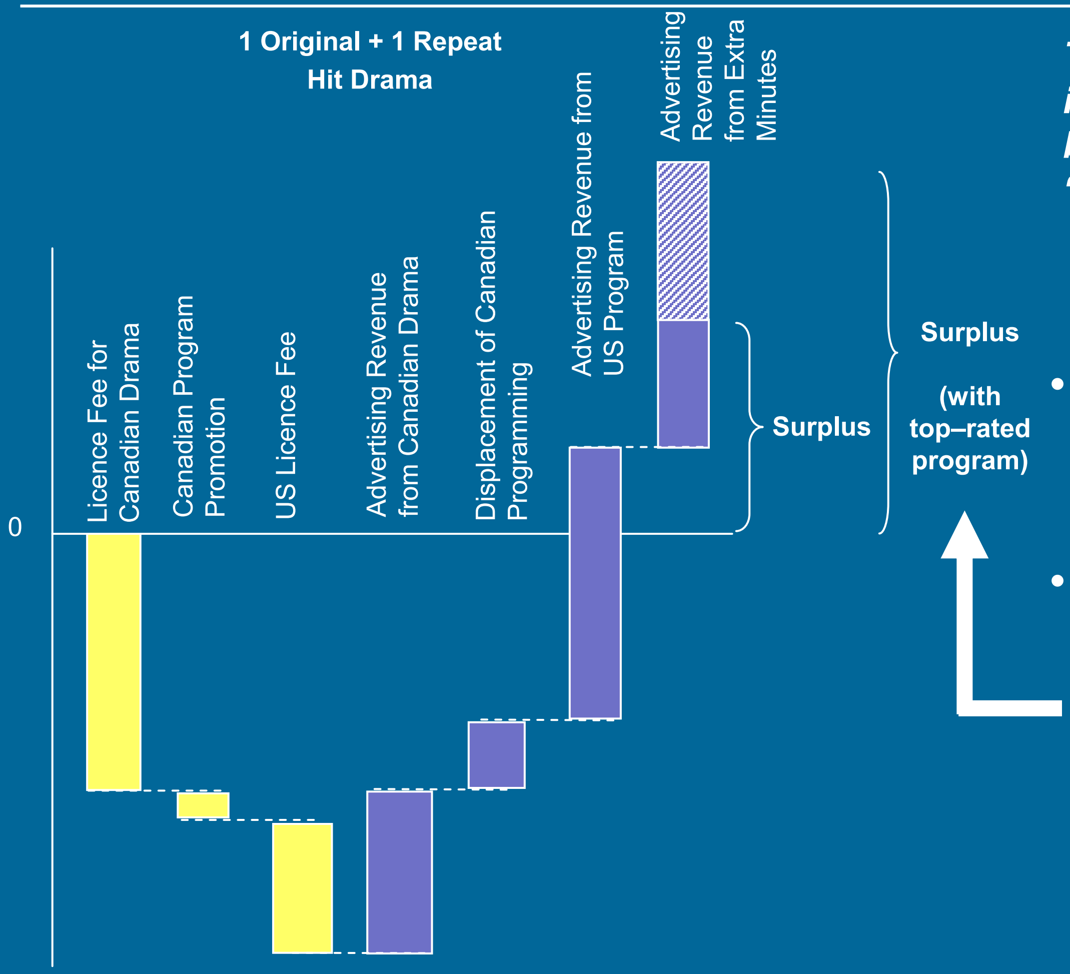
	A Status Quo (No Incentives) (1 orig. + 1 repeat)	B Extra Hour of Canadian Drama (No Extra Ad Minute) (1 orig. + 1 repeat)	C Extra Hour of Canadian Drama (With Extra Ad Minute) (1 orig. + 1 repeat)	D Daytime Credit (1 orig. + 1 repeat)
Direct Benefit (Cost) of Canadian Programming				
Total Hourly Production Budget	$1,000,000	$1,000,000	$1,000,000	$350,000
Broadcaster's Licence Fee Share	20%	20%	25%	25%
Licence Fee per original hour (+ 1 repeat)	(200,000)	(200,000)	(250,000)	(87,500)
Advertising Revenue	XXXX	XXXX	XXXX	XXXX
Surplus (Deficit) on Canadian Program	(XXXX)	(XXXX)	(XXXX)	(XXXX)
Benefit from Displacing Canadian Programming				
Impact of Canadian Drama	-	XXXX	XXXX	XXXX
Impact of US Programming	-	XXXX	XXXX	XXXX
		Additional ½ hour of US programming	*Additional ½ hour of US programming*	*Additional½ hour of US daytime programming*
Additional US Programming				
Licence Fees	-	(XXXX)	(XXXX)	(XXXX)
Advertising Revenue	-	XXXX	XXXX	XXXX
Additional Minute of Advertising	-	-	XXXX	XXXX
Total Incentive Benefit	-	XXXX	XXXX	XXXX
Net Impact	**(XXXX)**	**(XXXX)**	**XXXX**	**XXXX**
Annualized Net Impact	**(XXXX)**	**(XXXX)**	**XXXX**	**XXXX**

Scenarios: Hit Drama/High Cost Drama and MOW/Mini- Series – Market-based Simulation

	E Hit Drama/High Cost Drama (1 orig. + 1 repeat)		F MOW/Mini-Series (1 orig. + 1 repeat)	
	First Run	**Second Run**	**First Run**	**Second Run**
Direct Benefit (Cost) of Canadian Programming				
Total Hourly Production Budget	$1,250,000	-	$1,500,000	-
Broadcaster's Licence Fee Share	25%	-	25%	-
Per Play Licence Fee (Based on 2 Plays)	(312,500)	-	(375,000)	-
Promotion of Canadian Program	(XXXX)	-	(XXXX)	-
Advertising Revenue	XXXX	XXXX	XXXX	XXXX
Surplus (Deficit) on Canadian Program	(XXXX)	XXXX	XXXX	XXXX
Displacement of Canadian Programming				
Impact of Canadian Drama	XXXX	XXXX	XXXX	XXXX
Impact of US Programming	XXXX	XXXX	XXXX	XXXX
	Additional hour of US programming	*Additional ½ hour of US programming*	*Additional hour of US programming*	*Additional ½ hour of US programming*
Additional US Programming				
Licence Fees	(XXXX)	(XXXX)	(XXXX)	(XXXX)
Advertising Revenue	XXXX*	XXXX	XXXX	XXXX
Additional Minute of Advertising	XXXX	XXXX	XXXX	XXXX
Total Incentive Benefit	XXXX	XXXX	XXXX	XXXX
Net Impact	**(XXXX)**	**XXXX**	**(XXXX)**	**XXXX**
Annualized Net Impact		**XXXX**		**XXXX**

* Advertising revenue discounted due to loss of simulcast opportunity

Economic Impact – Hit Drama – National Broadcasters

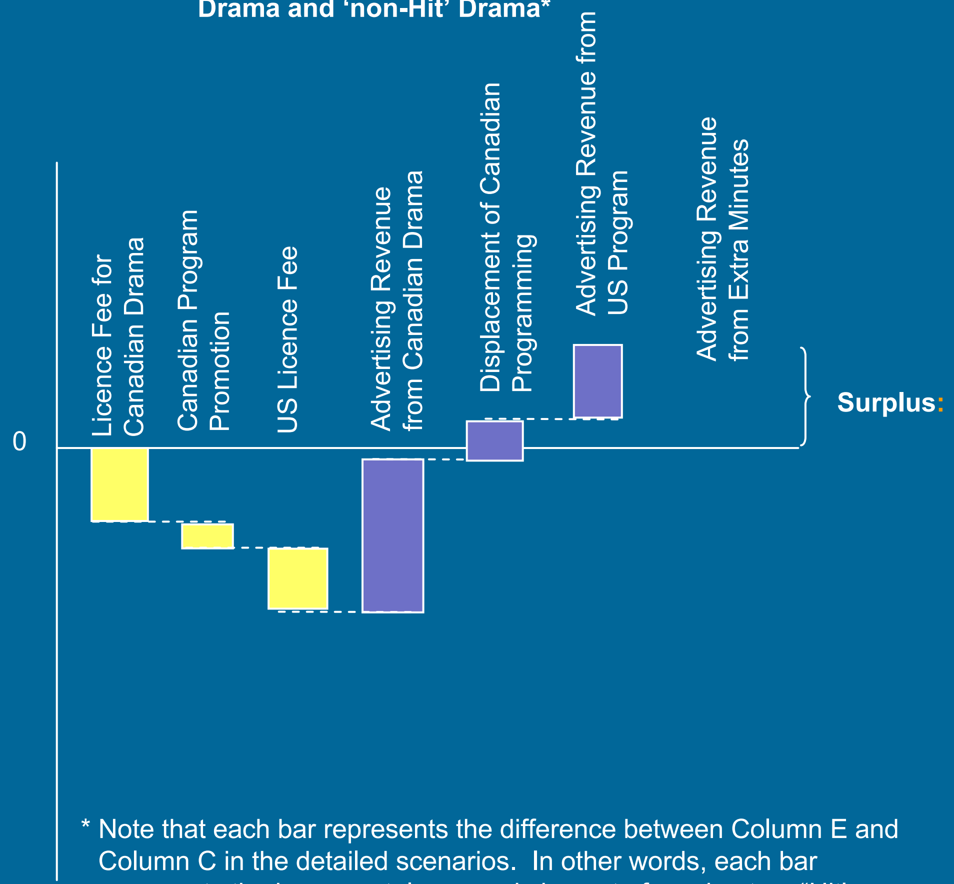


The market-based simulation indicates that broadcasters can benefit from the incentives outlined in 'Dramatic Choices'.

- If broadcasters are creative they can realize even greater benefits under the "Hit" drama scenario.
- A national broadcaster can apply its extra advertising minutes to a highly-rated program such as the Super Bowl or *Survivor*, and thereby potentially double the surplus.

Comparison of Canadian Hit Drama with non-Hit Drama Scenarios – Market-based Simulation

Difference between the Economic Impact of ‘Hit’ Drama and ‘non-Hit’ Drama*



* Note that each bar represents the difference between Column E and Column C in the detailed scenarios. In other words, each bar represents the incremental economic impact of moving to a “Hit’ drama from a ‘non-Hit’ drama.

On a per-episode basis, a hit drama yields an increase when compared with an original Canadian drama that does not reach 1 million viewers.

- While a ‘Hit’ Canadian drama costs the broadcaster more for licence fees, marketing and promotion, it generates more in advertising revenue.
- The ‘Hit’ status also allows the broadcaster to schedule an additional 30 minutes of US programming. This brings in more advertising revenue and increases the displacement benefit to the broadcaster.

Scenarios: Hit Drama/High Cost Drama and MOW/Mini-Series – Averages-based Simulation

	E Hit Drama/High Cost Drama (1 orig. + 1 repeat)		F MOW/Mini-Series (1 orig. + 1 repeat)	
	First Run	Second Run	First Run	Second Run
Direct Benefit (Cost) of Canadian Programming				
Total Hourly Production Budget	$1,250,000	-	$1,500,000	-
Broadcaster's Licence Fee Share	25%	-	25%	-
Per Play Licence Fee (Based on 2 Plays)	(312,500)	-	(375,000)	-
Promotion of Canadian Program	(XXXX)	-	XXXX	-
Advertising Revenue	XXXX	XXXX	XXXX	XXXX
Surplus (Deficit) on Canadian Program	XXXX	XXXX	XXXX	XXXX
Displacement of Canadian Programming				
Impact of Canadian Drama	XXXX	XXXX	XXXX	XXXX
Impact of US Programming	XXXX	XXXX	XXXX	XXXX
	Additional hour of US programming	*Additional ½ hour of US programming*	*Additional hour of US programming*	*Additional ½ hour of US programming*
Additional US Programming				
Licence Fees	(XXXX)	(XXXX)	(XXXX)	(XXXX)
Advertising Revenue	XXXX*	XXXX	XXXX	XXXX
Additional Minute of Advertising	XXXX	XXXX	XXXX	XXXX
Total Incentive Benefit	XXXX	XXXX	XXXX	XXXX
Net Impact	**(XXXX)**	**XXXX**	**(XXXX)**	**XXXX**
Annualized Net Impact	→	**XXXX**	→	**XXXX**

* Advertising revenue discounted due to loss of simulcast opportunity

Appendix 1
Economic Model Assumptions

Total Hourly Production Budget

- The data for total hourly production budgets were based on information published by Telefilm Canada and *Playback Magazine* as well as in other industry articles. Industry experts were also discretely canvassed to verify some assumptions.

  Status Quo (No Incentives), Extra Hour of Canadian Drama (No Extra Ad Minute), Extra Hour of Canadian Drama (With Extra Ad Minute)
- The total hourly budget of $1 million is based on the typical cost of an English-language Canadian drama production for prime-time.

  Daytime Credit
- The total hourly production budget for daytime drama was set at $350,000. This figure is based on the average costs of a French-language téléroman ($250,000) with an increment to reflect the higher production costs for English-language drama. Recent industry experience indicates a range of $100,000 to $250,000 per half hour.

  Hit Drama
- It is assumed that a higher cost production with higher production values will be required to attract an audience in excess of 1 million. For the model, an hourly production budget of $1.25 million was used. There are successful Canadian dramas produced at $1 million per hour, such as *DaVinci's Inquest*, which have been in the 1 million viewer range (*DaVinci's Inquest* achieves audiences of up to 900,000 viewers - ages 2 and up). However, we concluded that, at this stage, a higher production cost would not be an unreasonable assumption.

  MOW/Mini-Series
- For the model, the total hourly budget for an MOW/mini-series was set at $1.5 million. This may be considered to represent the hourly cost of an efficiently-produced Canadian MOW/mini-series. The CBC mini-series *Trudeau,* for example, had an hourly cost of $1.9 million. Another CBC mini-series, *Random Passage,* was produced at an hourly cost of $1.6 million. However, these CBC programs would be considered to be at the high end.

Appendix 1
Economic Model Assumptions

Broadcaster's Licence Fee Share

Status Quo (No Incentives), Extra Hour of Canadian Drama (No Extra Ad Minute)

- The broadcaster's licence fee was assumed to be equal to 20% of the total production budget, which is the average Canadian Television Fund (CTF) amount. Drama programming certified by the Canadian Audio-Visual Certification Office (CAVCO) in 2001/2 averaged 18%, and the Telefilm-backed productions averaged 24%. The CTF average lies in between the other two averages and likely is more representative of Canadian drama production licence fees under consideration.

Extra Hour of Canadian Drama (With Extra Ad Minute), Daytime Credit, Hit Drama/ High-Cost Drama, MOW/Mini-Series

- The broadcaster's licence fee was assumed to be 25% of the total production budget. This is the minimum share stipulated in the McQueen Report in order to obtain the extra minute of advertising.

Original Plus Repeat

All Low Audience Scenarios (A,B,C, and D)

- In all low audience scenarios, the broadcaster's licence fee for new Canadian drama is assumed to cover the original play plus one repeat, for a total of two hours of programming aired.

Promotion of Canadian Programs

Hit Drama, MOW/Mini-Series

- Costs for promotion of a Canadian program represent the amounts paid by a broadcaster to third-party media advertising and promotion of programs. Note that broadcasters will do much of their promotion using their own airtime for on-air promotion. Since they are permitted to exceed advertising limits when promoting Canadian programming, it was not assumed that there would be any foregone revenue.

- While we did not have any benchmarks for program promotion, we assumed that $XXXX would be spent for each original episode of Hit drama. For the MOW/mini-series, we assumed that a higher amount of $XXXX was spent, because of the special event nature of the program.

Appendix 1
Economic Model Assumptions

Advertising Revenue - Canadian Drama

- The figures for advertising revenue used in the model are based on calculations of the average revenue earned by broadcasters for each hour of programming scheduled within a particular category of programming.

- To estimate the revenues for a particular type of program, such as Canadian drama, we examined data for the tuning share for each category of programming aired by each broadcaster. The tuning data were from the BBM fall 2001 survey of Canadian television viewing. The tuning share for each category of programming was then multiplied by the total revenues (excluding "second networks") for the broadcast group to arrive at the revenue attributable to each category of programming.

- There are two further adjustments that could be made:
  - One that would lower the revenue assumption – to account for the fact that advertisers pay a higher 'cost-per-thousand' rate for US programs. Our research indicates that the 'cost-per-thousand' differential between US and Canadian programming ranges from 1.5x to as high as 4.0x.
  - Another adjustment would raise the revenue assumption – to account for the fact that BBM survey results are in the annual sweeps period, which favours US programming.

- However, it is difficult to obtain precise estimates of either factor. It was therefore concluded that they would cancel themselves out, and that no further adjustments were necessary.

Appendix 1
Economic Model Assumptions

Advertising Revenue – Canadian Drama (cont'd)

Status Quo (No Incentives), Extra Hour of Canadian Drama (No Extra Ad Minute), Extra Hour of Canadian Drama (With Extra Ad Minute)
- The average advertising revenue per hour for a Canadian peak-period drama series was applied.

Daytime Credit
- To estimate the average hourly advertising revenue we developed a ratio, and calculated the amount as a ratio of peak-period Canadian drama. The ratio was derived by comparing the average revenue for daytime US programming airing in Canada to average revenue for peak-period US programming airing in Canada.

Hit Drama
- Our estimate of $XXXX was verified as being "reasonable" by discrete industry enquiry.
- For the second run, advertising revenue was assumed to revert to the average for a Canadian prime-time drama original and repeat.

MOW/Mini-Series
- With no specific hourly earnings figures for Canadian MOW/mini-Series, it was assumed that advertising revenue would be about 20% higher than for a hit Canadian drama series. While a successful Canadian drama such as *DaVinci's Inquest* has about 900,000 viewers, many MOW/mini-Series frequently attract audiences in excess of 1 million (see Appendix 3).
- For the second run of a reasonably successful MOW/mini-series, it was assumed that advertising revenue would still reach the average for a Canadian prime-time drama. Industry experts maintain that Canadian drama that does well in its original broadcast also does reasonably well in the second run, partly because it is not scheduled against popular US programs.

Appendix 1
Economic Model Assumptions

Displacement of Canadian Programming

- Canadian programming is displaced in two instances.
  - Canadian non-drama programming is displaced in order to air a Canadian drama.
  - A Canadian program is displaced by the additional US programming resulting from the incentive system.
- In both instances, the displaced programming is likely to be non-drama, non-news, non-sports programming. The candidate programming for displacement, then, lies in the categories of children's, variety, and documentary programming
- The displacement benefits in the model represent the savings that a broadcaster earns from replacing the highest-loss priority Canadian programming with an hour of Canadian drama, and US programming that is permitted by the incentive. There are two ways to calculate these displacement benefits:
  - As a conservative approach, the first is based on calculations of the average revenues and programming costs for peak period non-news, non-drama, non-sports programming.
  - As a more likely approach, the second way to calculate benefits is to assume that the worst performing and the second worst performing Canadian non-drama priority programs are replaced by the new Canadian drama and the US program triggered by the drama credit.
- Displacement of underperforming Canadian drama programming was not calculated, since the incentives would already apply. Obviously, however, if a hit drama program displaced a non-hit drama program, it would trigger the 200% incentive and provide a larger payback to broadcasters.

Daytime Credit

- Due to a lack of data to estimate average costs and revenues, we have set the displacement benefits equal to zero for this scenario.

Appendix 1
Economic Model Assumptions

Additional US Programming - Advertising Revenue

- One approach is to calculate advertising revenue to be generated by US programming in a manner similar to the approach taken with respect to Canadian drama – by dividing the total revenues by the total number of hours of programming exhibited by broadcasters. However, this approach may overestimate the revenue because the US programs to be selected would be the marginal ones not yet simulcast by Canadian broadcasters, i.e. lower than the average hourly advertising revenue earned by Canadian broadcasters from US programming. Thus, both the average and a lower-than-average approach were modeled.

Extra Hour of Canadian Drama (No Extra Ad Minute), Extra Hour of Canadian Drama (With Extra Ad Minute)

- The advertising revenues correspond with one-half hour of US programming.

Hit Drama Scenario

- The advertising revenues correspond to a full hour of US programming, but for the first run the amount was discounted to account for the revenue drop attributable to the loss of a simulcast opportunity. The assumption is that a Canadian broadcaster will likely have to drop a simulcast slot in order to schedule the Canadian drama to gain the audience in excess of 1 million.

- In the second run, the broadcaster is assumed to schedule the Canadian drama to avoid a conflict with a simulcast opportunity. However, since it is assumed that the audience would be less than 1 million, it is also assumed the advertising revenues would only correspond to those earned during one-half hour of US programming.

MOW/Mini-Series Scenario

- In the first run, the advertising revenue for the US show corresponds to a full hour. No discount is applied because the MOW/mini-Series entails less disruption to the schedule.

- In the second run, the Canadian program is assumed not to achieve an audience of 1 million, and would therefore earn only a credit of one-half hour of US programming and its associated revenues.

Appendix 1
Economic Model Assumptions

Additional US Programming - Advertising Revenue (cont'd)

Daytime Credit

- The advertising revenues correspond to calculations based on estimates of revenue and hours of US daytime programming.
- The estimate of total foreign daytime revenues was divided by the estimate of total foreign hours during daytime to arrive at an estimate of the hourly average revenue of daytime foreign programming.

Appendix 1
Economic Model Assumptions

Additional US Programming - Licence Fees

Extra Hour of Canadian Drama (No Extra Ad Minute), Extra Hour of Canadian Drama (With Extra Ad Minute), Daytime Credit, Hit Drama/ High-Cost Drama, MOW/Mini-Series

- The licence fees are based on the average per-play cost of an hour of prime-time US drama. In scenarios B and C, the advertising revenue corresponds with one-half hour of US prime-time drama.

- The licence fees for US daytime programming in scenario F were based on allocating foreign program expenditures to daytime and peak period based on the viewing share. That is, X% of foreign programming viewed is done so outside of the peak period. Therefore X% of foreign programming expenditures were allocated to daytime. The resulting amount was then divided by an estimate of the annual number of hours of foreign programming during the daytime.

    - This approach might overestimate the licence fees of incremental US programming, because all the high profile programming – which also contributed to the average – would be already taken by broadcasters. As well, broadcasters tend to over-buy US programming, and the costs of programming not used would still be part of the averages calculated from actual figures.
    - Accordingly, both approaches were used – the average licence fee and a lower one, based on the relatively lower cost of the US programs still available.

- The result of the averages approach is a margin of approximately 35% on US programming. However, in practice, it is expected that a 50% margin would be obtainable – likely with lower than average costs matching the lower than average revenues. Again, as stated above, both approaches were modeled.

- To arrive at the number of hours of foreign programming, we referred to CRTC logs for the flagship stations, and assumed that the logs for other network stations would be similar.

Appendix 1
Economic Model Assumptions

Additional Minute of Advertising

- The value of an additional minute of advertising is set to $XXXX.
- While the value of an additional minute based on the average revenue of a US program is about $XXXX, the key assumption of the model is that broadcasters will apply their exemption and additional minutes to highly rated programming. A top-rated series can command substantial premiums for its ad spots. For example, a recent newspaper story documented that a 30-second slot for *CSI* sold for $42,000 in 2002.
- For exceptional programs, like the Super Bowl or Academy Awards, rates as high as $80,000 per 30-second slot could be sold. However, to be conservative, the value of the extra minute over the course of a year is assumed to be $XXXX, which would comprise two 30-second spots of $XXXX.

Appendix 2
Assumptions About Broadcaster Practices

How Incentives Would Affect Canadian Programming

- Multi-station broadcasters are likely to choose MOWs and mini-series over drama series as MOWs and mini-series generate larger audiences (reference: CRTC Research data 2002) and lower investment / financial risk:
  - For each qualifying program, the broadcaster would accumulate credits to replace peak time Canadian programming with US programming.
  - Broadcasters would likely use the credits on US series, even though they might earn them via Canadian specials/movies
  - The Canadian program that would be replaced in prime time would likely be dropped, rather than rescheduled.

Ads on Canadian Programming

- Canadian programs do not sell as well (in terms of ad rates and percentage of ad inventory sold) as US programs
- US programming earns as much as 1.5x to 4.0x more advertising revenues per viewer than Canadian programming for the following reasons:
  - Branding and star promotion of US programming
  - Critical mass of high quality US drama
  - US shows are ‘safe’ buys for media buyers;
- Canadian drama typically draws lower audiences than “average” US drama simulcast in peak time. If a Canadian program draws a “2” rating vs a US average of “5”, the ad revenues for the US could be <u>4 times</u> the Canadian program.

Appendix 2
Assumptions About Broadcaster Practices

US Program Acquisition and Scheduling

- Broadcasters' profit maximization model drives on-going modifications to the schedule in order to ensure simulcasting of US programs.
- Canadian drama series get re-scheduled as a by-product of simulcast, making it difficult to build loyal audiences.
- Large Canadian broadcasters typically overbuy US programming for the following reasons:
    - US distributors force linkage of strong and weak programs; and
    - Canadian broadcasters need additional programming to respond to cancellations by US networks.
- This extra US programming could be used to substitute for Canadian programming if the 150% or 200% credits were earned.

Impact of Incentives on US Program Acquisition

- A Canadian broadcaster will know at the time of the Hollywood buy the impact of any incentives. The ability to buy an extra program gives a Canadian broadcaster the ability to use packaging and price creatively to buy the best programs.
- Because the success of any new program is uncertain, the more programs a broadcaster buys, the more likely it is to have bought a hit.
- If a program becomes a hit, a broadcaster will be obliged to pay a higher licence fee for it in the subsequent year. The broadcaster would also be required to acquire, as part of the package, programs of lesser value. On occasion, certain of these less valued programs will become hits.
- Thus, with the incentive in place, a broadcaster may acquire an extra program that is more likely to increase rather than decrease margins.

Appendix 2
Assumptions About Broadcaster Practices

Taking Advantage of Extra Advertising Minutes

- Broadcasters usually sell the bulk of their ad inventory on US programming when their schedules are announced (May to June) based on expected tuning.
  - If the audience is 10% less than forecast, advertisers expect “make-good” airtime.
  - If audiences exceed expectations, however, the advertiser does not pay extra and thus obtains all the benefits of the increased exposure.
  - An extra ad minute would likely be used by broadcasters in the following year, on the highest rated US programs (e.g., Superbowl, or where there is an unexpected hit, e.g. the Bachelorette).

Daytime Soaps and Post Midnight “Edgier” Drama

- There are unexploited opportunities for Canadian broadcasters to schedule additional US daytime programming
  - US daytime programming has high margins and low risks
    - Daytime audiences tend to loyal and influential buyers
    - License fees are significantly lower than for peak drama
    - The difference between peak time and daytime ad rates is much less than the difference in programming costs
    - Broadcasters generally exceed the 60% Cancon requirement for the broadcast day; thus, could add additional US programming.
  - Therefore, there is value in an incentive to schedule more US programming in daytime.

Appendix 2
Assumptions About Broadcaster Practices

Foregone Revenue from Loss of Simulcast on Canadian drama in Peak Hours

- Canadian drama series
  - Assuming that sticking with the schedule for a Canadian program means foregoing the possible simulcast of a US program, there is a potential revenue drop of 20-30%.
    - Simulcast US programming generates about a third more in audience than non-simulcast US programming
    - Because broadcasters can schedule US programming outside simulcast slot, the net effect is less than one third foregone revenue.
- Canadian drama miniseries
  - 2-6 part miniseries have significantly less impact on Canadian broadcasters' schedules than series drama. They also generate better audiences than series drama.

Promotional expenses for Canadian Peak Programming

Broadcasters' promotional activities

- Mostly on-air promotions, but some top up spending on third party media
  - On-air promotions
    - Designed to build awareness among target demographic
    - Promos are typically placed in unsold ad inventory; thus, there is little opportunity cost (displaced ads) for the broadcaster
  - Third party media spending
    - Targets building 'top of mind' recognition for new programs
    - Typically ads in TV Guide and other print schedules
    - Often as low as 10%-20% of total value

Appendix 3
Top Canadian Television Drama Programs

TOP CANADIAN DRAMA (CATEGORIES 07A, 07B, 07C, 07E) PROGRAMS
BROADCAST ON CBC AND CTV
FROM SEPTEMBER 3, 2001 TO SEPTEMBER 1, 2002, INCLUSIVE
MONDAY TO SUNDAY, 7 PM TO 11 PM

Rank	Network	Program	Date	Rating	Estimated Audience (2+)
1	CBC	Trudeau (Part 1)	March 31/02	6.6	2,008,446
2	CBC	Trudeau (Part 2)	April 1/02	5.7	1,734,567
3	CTV	CTV Monday Movie: Tagged The Jonathan Wamback Story	March 11/02	5.0	1,521,550
4	CTV	CTV Tuesday Movie: Stolen Miracle	Dec. 18/01	4.4	1,338,964
5	CBC	Random Passage	Jan. 28/02	4.1	1,247,671
6	CBC	Random Passage	Feb. 4/02	4.1	1,247,671
7	CBC	Random Passage	Jan. 27/02	3.9	1,186,809
8	CTV	CTV Monday Movie: Torso The Evelyn Dick Story	March 18/02	3.9	1,186,809
9	CBC	Random Passage	Feb. 3/02	3.7	1,125,947
10	CTV	CTV Sunday Movie: Borrowed Hearts	Dec. 21/01	3.6	1,095,516
11	CTV	CTV Saturday Movie: The Matthew Sheppard Story	March 16/02	3.5	1,065,085
12	CBC	The Last Chapter (Part 1)	March 3/02	3.4	1,034,654
13	CTV	CTV Wednesday Movie: Rent a Kid	Dec. 26/01	3.3	1,004,223
14	CTV	CTV Monday Movie: Verdict in Blood	May 27/02	3.1	943,361
15	CBC	Da Vinci's Inquest	Jan. 6/02	3.0	912,930
16	CBC	Da Vinci's Inquest	Jan. 20/02	3.0	912,930
17	CBC	Da Vinci's Inquest	Jan. 21/02	3.0	912,930
18	CTV	Degrassi: Next Generation	Oct. 14/01	2.9	882,499
19	CTV	CTV Monday Movie: Criminal Instinct-The Wandering Soul Murders	June 3/02	2.8	852,068
20	CTV	CTV Tuesday Movie: A Killing Spring	Jan. 29/02	2.8	852,068

Source: Nielsen Media Research (Media Advisor) and CRTC; Nordicity calculations of estimated audience based on audience rating