

An Overview of the Direct Market in 2005

Introduction

The term "Direct Market" refers to the specialized system that has developed over the last thirty years that produce, distributes and sells comic books and related merchandise. This market is unique in that all comics are sold on a nonreturnable basis before publication!

The other comics distribution system in North America is termed the "Independent Distributor" market (or "I.D." market), in which local magazine and book distributors purchase comics from publishers on a fully-returnable basis and sell their comics product to accounts on the same basis.

The "I.D." market used to be the only distribution system for comics products, and was a marketplace characterized by inefficiency and disinterest in comics merchandise. Typical margins in this marketplace are 25-30% off cover price, which was too small a discount for traditional comics outlets (pharmacies, grocery stores and newsstands) to make an effort to continue selling comics. By the late 1960's many industry observers were predicting the demise of the entire comics industry.

A comic fan named Phil Seuling almost single-handedly created the foundations of the existing Direct Market when he approached Marvel Comics with the then-radical concept of selling comics directly to the very small number of specialty

comics retailers which had developed out of the so-called "underground comics" phenomenon.

His proposal was that comics publishers would solicit retailers every month for each title/issue combination, and print just enough copies (besides I.D. sales) to satisfy their needs; and sell these books on a nonreturnable basis at a much larger discount than to I.D. accounts. After considerable discussion Marvel agreed to this plan.

What has happened over the last thirty years is that the Direct Market has almost totally overwhelmed the I.D. market as the dominant method of selling comics. In recent years while both Marvel and DC (who are the two largest comics publishers in the U.S.) printed roughly equal numbers of copies each month for both marketplaces, almost 80% of their profits came from the direct market. In some metropolitan areas I.D. return rates approach 85%, while every book sold into the Direct Market is a final sale.

While Marvel Comics (and to a much lesser extent DC) continue to make efforts to expand sales to sources outside the Direct Market such as Walden Books, Blockbuster Video, ANSCO, etc.; they have had little to show for their efforts, although Graphic Novel products are starting to enjoy some success in these venues.

The Direct Market Ordering Process

The Direct Market's mechanism continues to be relatively simple. Every month, the major comics publishers provide Diamond Comic Distributors with a list of titles which they solicit orders for, along with basic information on each title (theme, creators, special physical attributes such as an embossed cover, etc.) and an expected shipping date.

Diamond then combines this information with information about products that they accept reorders for in their order forms and catalogs which are sent to their retail accounts or are downloaded from their website.

Each retailer then orders the quantity of new comics which they believe they will be able to sell, sixty days before the books are physically produced, on a nonreturnable basis.

All products ordered through Diamond are also sold on a nonreturnable basis, with rare exceptions.

Diamond then totals the quantity ordered by title and issue, and in some cases add an overage to their order if they believe that the retail community is seriously under-ordering a title. This only happens rarely, and in most all cases the total retailer order is increased by only 1% to cover damages in transit.

The publishers then take their distributor orders, total them, and produce just enough products to satisfy all orders; including their "I.D." needs. In a few cases publishers will print more copies of a book than their orders justify, especially if they feel that the book is being under-ordered. This is a rare occurrence, with the result that apart from "Independent" comics publishers there is almost no "back-list" activity by comics publishers; unlike the

book industry. This also creates a secondary collectibles marketplace for both recent and older comics back issues.

Orders for “reordered” products may also not be filled immediately, as Diamond does not maintain the inventory levels that a conventional distributor would have.

Another variance from conventional distribution is that while the majority of any given order is shipped on or near the scheduled publishing date, as much as one-third of any monthly order may arrive between three and eighteen months later.

Any given weekly shipment from Diamond may include items from many different orders, which creates some unique problems for anyone trying to automate this process at the retail level.

Market Size and Growth

The Direct Market (2005) is estimated as representing \$600,000,000 in retail sales from comics and all related products commonly found in specialty comics entertainment stores. About 60% of these sales are from new comics and related products.

This sales volume is generated by roughly 2,500 comics retailers who specialize in comics sales - for an average of about \$200,000 per store and another 1,000-1,500 stores with average sales of \$70,000-\$100,000 annually.

Stores range in size from mom-n-pops of \$40,000 in annual sales to very serious businesses grossing \$1,400,000 annually.

The Direct Market reached a sales peak in 1994 of roughly \$900,000,000 at the crest of a speculative boom, with most sales coming from New Comics. Diversification of product lines among progressive comics specialty entertainment retailers really began following the end of this particular speculative boom.

After the crash following the speculative period of the early 1990's, the overall market began to shift upward slightly starting in the year 2000. Most of the consistent growth came from Graphic Novel and “Other” merchandise. New Comics showed irregular growth, with peaks and valleys centering around the Holiday selling season.

In addition, “advance order increases” can be made for solicited products up to a 1-2 week period prior to publication, depending on the publisher.

Why does the retailer take the risk of ordering comics product 60-days in advance of publication, especially when sales on popular titles can be quite volatile? The answer is that retailer discounts from publishers are relatively generous compared to many other product categories. The smallest retailer can get a discount of 40% off retail, while larger retailers can qualify for discounts of 55% off retail.

We understand that the top discount for any retailer is 57-1/2% off retail.

Diamond Comic Distributors technically does not purchase comics products from publishers for resale to retailers, but handles orders and fulfillment on a “brokerage” basis and receives a fee based on the total value of merchandise processed.

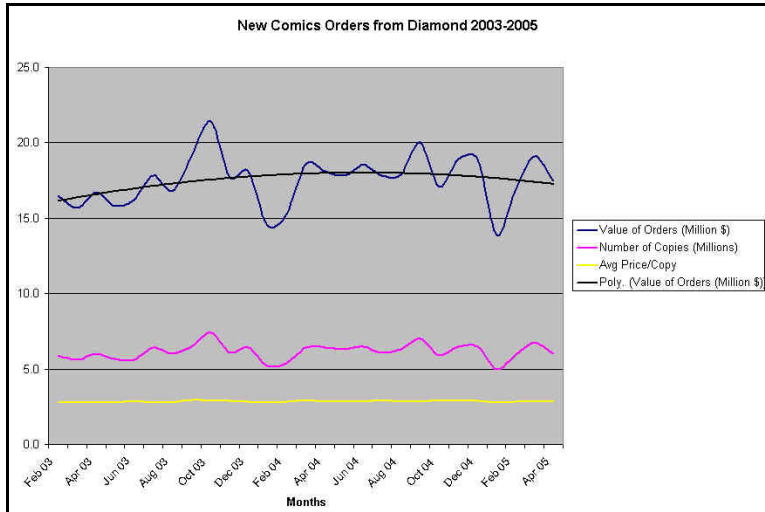
These figures are incomplete and are probably low, due to the following:

- Internet and eBay sales are not included
- We assume that on an industry-wide basis “Other” product represents roughly 40% of orders. In many cases this figure is too low, especially for larger retailers
- These figures do not include reorders for comics and graphic novels from independent distributors such as Cold Cut, Bulldog or FM International

All of our proprietary research indicates that the Direct Market could double or even triple in size by satisfying unmet consumer demand, based on the current product mix and the existing propensity to consume in the marketplace.

The limiting factor to this growth is the relative difficulty for the would-be consumer in finding a convenient comics retailer in the local community and the lack of familiarity with the product by the general consumer marketplace.

Whenever a properly located, merchandised and operated specialty comics store has opened, it has drawn the majority of its business from customers who had not previously been regular comics purchasers! Twenty years of proprietary customer source survey research has continually confirmed this behavior.



The chart **New Comics Orders from Diamond 2003-2005**, based on data from Diamond Comic Distributors and Comic Retailer Magazine, shows that New Comics orders have remained fairly stable during the last three years in terms of numbers of copies ordered. There has been a more dramatic fluctuation in terms of the retail value of new comics ordered, which is less surprising when we consider that the cover price of a specific issue can range from \$2.25-\$5.95. (These figures are based on the top 300 new comics).



The chart **Trade Paperback Orders from Diamond 2003-2005**, based on data from Diamond Comic Distributors and Comic Retailer Magazine, shows that there has been a steady slight increase in the retail value of orders over the last three years. (Unit orders are not available). What this chart does not show is the sharp increase in Trade Paperback/Graphic Novel inventory at key, larger retailers. Five years ago, 300 titles were considered to be a large assortment. Today, 1,000 titles are considered a basic inventory and some retailers approach 3,000 titles. (These figures are based on the top 100 trade paperbacks).

Comics Publishers

The two major comics publishers in the U.S. are Marvel Comics (whose stock is traded on the NYSE) and DC Comics, which is a subsidiary of Time-Warner. Marvel has had the largest market share for most of the last decade, averaging 50% of Direct Market sales. DC had experienced a slow

decline during the same period, and had been holding fairly steadily at a 18-20% share.

In the last ten years there has been considerable management turmoil at Marvel and a fairly significant loss of market share due to significant

management blunders, including the ill-advised acquisition of Heroes World Distribution. There have also been a series of merchandising and marketing errors where Marvel over-produced titles and seriously diluted the interest of the customer base in a number of their key titles. Marvel also through this period of time seriously alienated many comics retailers, who function as “gatekeepers” to the comics customer base.

Meanwhile DC Comics has followed a more consistent policy of maintaining close relations with a rotating group of key retailers and has developed a much more positive image with comics retailers. At the same time they continued to improve the editorial content of much of their product line, with the result that DC Comics market shares exceeded Marvel’s through much of 2002.

Recently Marvel Comics has worked to improve the editorial content of its products and has seen an increased market share over the last three years. Marvel’s total market share is estimated as being between 25-40%, depending on the ordering month. DC’s market share has ranged between 25-37% in the same time period.

Unfortunately, the current and previous Marvel regimes have not been successful in convincing the majority of comics retailers that Marvel is interested in their growth and well-being.

Second-tier publishers Cross-Gen, Dark Horse and Image, and 3-4 other publishers represented perhaps 15% of the market. Then another 20-30 publishers

shared the remaining 15%.

Publisher mortality is quite high. Most small publishers are grossly under capitalized and are often founded by fans who want to be publishers. The cost of soliciting new titles through the Direct Market distribution network is low, but it is very difficult to get more than a small proportion of all retailers to try out a new book from an unknown publisher.

The major publisher casualty has been CrossGen, which failed due to business management issues rather than due to product content and market support.

A steady stream of products is imported from British and European publishers, mostly in more expensive formats and aimed at older and more affluent comics buyers. Anime’ (animated products from Japan) began being imported about ten years ago, and have seen considerable growth in the last five years. Increased anime’ presence on cable television (eg: The Cartoon Channel) has contributed to the growth of consumer interest in anime’ products of all types, ranging from graphic novels to DVDs.

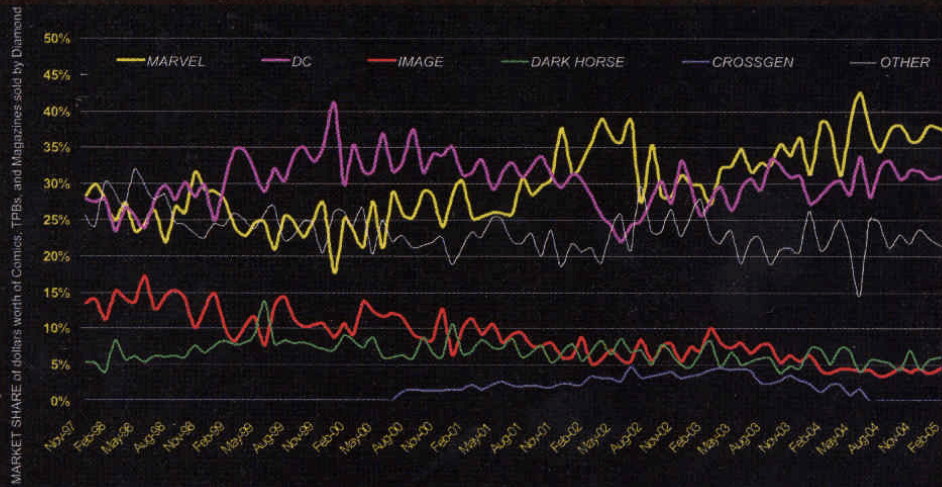
In the last fifteen years the total number of comics titles that are solicited each month has increased from 50-75 titles to 400+! This means that the range of products has increased sharply, including non-superhero genres, which has increased the attraction of comics products to prospective customers.

Final Diamond Market Shares for ALL comics, trade paperbacks, and magazines

Diamond-reported
DOLLAR SHARES
of final orders for ALL
comic-books, TPBs,
and magazines

Marvel.....	34.69%
DC.....	33.86%
Dark Horse.....	8.16%
Image.....	4.52%
Tokyopop.....	2.93%
Viz.....	2.44%
Wizard.....	2.29%
Devil's Due.....	1.34%
IDW.....	1.27%
ADV.....	0.47%
Fantagraphics.....	0.42%
Gemstone.....	0.40%
Dynamic.....	0.36%
Bongo.....	0.35%
Archie.....	0.33%
Antarctic.....	0.29%
Slave Labor.....	0.28%
Abstract.....	0.25%
Random House.....	0.23%
Aspen.....	0.21%
Others.....	4.89%

Overall Market shares (in percent) since 1997



The above graphic represents market shares, not specific dollars or units (although we've provided our estimate of what everything adds up to below). So it does not necessarily follow that a higher or lower market share above equates to higher or lower sales. Also, since Diamond figures into this calculation hundreds of thousands of dollars worth of non-comics magazines from such companies as Wizard, Beckett, Two Morrows, and Krause, the true market share of the comics publishers shown above is probably higher.

**Including non-Top 300 comics, non-Top 100 TPBs, and magazines,
final U.S. orders equal approximately \$31.58 million**

Source: Comics Retailer Magazine, August 2005

The Distribution Channel

One distribution company dominates the North American Direct Market distribution community. This is Diamond Comic Distributors (Baltimore, MD), which is the exclusive broker for the major comics publishing companies.

Diamond Comic Distributors does not act like conventional distribution company with some exceptions.

Their emphasis has been on soliciting orders for new comics, and then distributing new books on a weekly basis as quickly as possible to their retail accounts. Comics publishers print a number of new titles every week, and within 36 hours of production most of these books will be in specialty comics shops for sale to customers.

This aspect of the Direct Market has been very important when understanding some of the eccentricities of new comics distribution, since it places a premium on the ability to be an effective fast-freight forwarder for anyone who wants to distribute comics. It also creates a customer base which typically shops at their primary comics shop 3.8 times a month! And finally, it causes Marvel and DC to actively discourage retailers from

purchasing directly from them. It has also had the effect of making conventional comics distributors relatively unskillful at carrying and promoting reorder able items which are compatible with comics sales. This means that many larger retailers are forced to deal directly with companies selling specialty products which are compatible with comics.

A good example has been the re-order market for trade paperbacks and graphic novels. We estimate that while Diamond has a market share in excess of 85% for initial trade paperback/graphic novel orders, its market share for re-orders was less than 15%!

There are several specialty comics distribution companies which focus their attention on reorder able comics products, especially products from so-called "independent" comics publishers. Cold Cut Distribution, Bulldog and FM International are the three leading specialty comics distributors.

Comics and Pop Culture Retailers

We estimate that there are roughly 2,500 specialty comics stores in North America as of 2005. There are another 1,000 - 1,500 stores which also sell a limited number of comics (and order their merchandise from a comics distributor), but this second group of stores sells relatively little comics product and are primarily involved with other merchandise lines.

This number is down substantially from 1994, when there were an estimated 6,500 specialty comics stores in North America, in addition to another 7,000-9,000 specialty card shops which sold comics to speculators in addition to collectible card products. This was an artificially high number of shops due to a series of converging factors which contributed to the largest speculative comics boom ever.

The largest comics retail companies in North America have 6-8 stores with gross annual sales in the range of 2.2 - 3.5 million dollars. Only a few of these companies exhibit chain store characteristics, while most would be charitably described as poorly-run multi-store operations.

About 400 multi-store companies account for roughly 1,000 of the 2,500 estimated specialty comics stores. The remaining 1,500 primary stores are single-store operations. There is no particular pattern to store sizes based on whether they are single or multi-store operations, nor is there a pattern in terms of gross store sales for chain and non-chain operations.

Store sizes are between 400 s. f. and 4,000 s. f., with 1,200 s. f. and 2,000 s. f. being common footprints. Annual store sales vary from \$ 40,000 p.a. to \$ 1,400,000. Pre-tax profits (including owner's draw) vary from nil to 30%, with multi-store operations generally having lower profitability levels than their single-store counterparts.

Only a few existing comics retailers have a sufficient number of stores or a large enough volume to fully compensate them for the amount of central office overhead that they carry.

The main reasons why large comics chains do not exist are that:

- Capital for expansion has been in very short supply - most retailers grow from retained earnings
- Ignorance of basic business tools/techniques
- Until recently each store required a specialist employee who could order for the store independently

Most comics retailers have traditionally been fans or hobbyists who drifted into comics retailing accidentally. Many such retailers worked the weekend convention circuit, buying and selling comics for amusement and to increase their personal collection inexpensively. As their commitment (and inventory) grew they often opened a store in a remote and inexpensive part of their community.

Most of these retailers are ignorant of basic business tools and techniques, and have stayed in business only through the relatively high margins of their primary product and their willingness to accept a low rate of return for their labor.

One knowledgeable industry observer stated that the average comics retailer takes out \$20,000 p.a. or less from their store. Other retailers of our acquaintance, however, pay themselves salaries of \$75,000+ and still generate extra profits beyond this level from moderately sized operations.

Comics retailing is characterized by having a low barrier to entry. It was possible open a comics store for as little as \$8,000, including inventory and fixtures. Such a store was very marginal and could not generate high sales levels. Today the minimum cost to open a store is \$40,000 to \$60,000 depending on the quality of the location.

(Good strip center stores require roughly \$60,000 to open and regional center stores require between \$100,000 - \$150,000 to open).

The failure rate for the typical amateur-run, under-capitalized comics store is high - we estimate that for every ten stores which open in a given year in an area that seven to nine close. The primary reason for closure is poor ordering of non-returnable comics and under-capitalization, followed closely by a lack of business skills or experience.

Comics Customers

The typical comics customer is male, young, well-educated and modestly affluent. Until recently 90-95% of all comic store sales were to males, although some retailers obtain 30-35% of their sales from female customers by proper merchandising and store environments.

There are four major age groups for comics buyers:

- Pre-teen (< 13)
- Teenage (13-18)
- Young Adult (19-24)
- Adult (25-35, 35+)

Each age group has different buying patterns and interests. Marvel Comics, for example, attract younger readers (12- 19) more strongly than older readers.

Household income levels typically fall into the \$35,000-\$70,000 range, with close to three persons per household.

The greatest fall-off among new customers takes place in the third through fifth year of activity; after that there is more moderate customer loss in the sixth through fifteenth year of activity. After fifteen years of activity there is very little customer loss.

These age groups also break down into three interest groups:

- Primarily readers (about 15%)
- Reader/collectors (about 80%)
- Collector/speculators (about 5%)

This indicates that there are theoretically twelve major customer groups which a comics retailer should consider in their merchandising and marketing. Comics (and related products) form a highly attractive, marketable product which can appeal to a wide range of customers by age and taste, and with a wide range of products that appeals to each of these twelve subgroups.

Comics Merchandise

A properly merchandised comics specialty store contains a wide range of products, based on new topical comics. These merchandise categories can include: new comics, graphic novels, trade paperbacks, paperback books, clothing, videos, fantasy & role-playing games, etc.

New comics represent anywhere from 25-70% of a comics stores merchandise mix. Higher volume stores tend to have lower percent sales than low volume comics stores, but have much larger gross sales. A million-dollar comics store might sell \$ 250,000 of new comics yearly while in a store with sales of \$ 200,000 70% might come from comics.

Comic books retail from \$ 1.00 to \$ 6.95, and are published either on an annual, bi-monthly, monthly or bi-weekly basis. Some comics shift production frequency based on season.

Graphic Novels are larger comics featuring better quality paper, improved more permanent bindings and more pages. They retail from \$ 4.95 to \$ 24.95 or even more. They are usually back-listed and can be reordered. Graphic novels have become a major merchandise line for progressive comics retailers, and a minimum inventory would consist of at least 300 titles. Some stores which dominate a metro area have graphic novel merchandise mixes that include more than 1,000 titles.

Graphic Novels represent anywhere from 5-15% of gross sales in a comics store.

Trade Paperbacks are typically collections of current or old newspaper comic strips or cartoons, retailing for \$ 6.95 to \$15.95. Typical "trades" are "Calvin & Hobbes", "Garfield", "Doonesbury", or "For Better or for Worse", etc. They are usually back-listed and can be reordered. "Trades" can represent anywhere from 5-15% gross sales.

Back Issues are new comics which have been replaced with more current issues of the same title. Moderately saleable back issues are usually priced \$1.00-\$2.00 above their newsstand cover price, are "bagged and boarded" and held for sale for 1-4 years.

Many back issues were bought for 10 cents regardless of cover price from customers and are marked up 10-20 times for resale. Back issues require a large amount of labor to process, a significant level of specialist knowledge to buy and price, and require a great deal of store area to make them available to customers. Most comics retailers carry far too many slow-selling, over-priced back issues.

Between 1994 and 2001 Common Back Issues suffered a significant drop in customer interest, and many comics retailers either dropped this category or significantly reduced the amount of retail sales space allocated to this category. Recently there has been increased interest in back issues, and a number of retailers are beginning to focus their energy on this product category again.

The Internet has had a major role in expanding interest in the Back Issue market. Previously high-value back issue specialists required both a large metropolitan population and a very large

Trade Journals

There are two trade journals in the comics area: Comics Retailer and The Comics Buyers Guide (the CBG) both are published by Krause Publications (Iola, WI), Comics Retailer on a monthly basis and the CBG on a weekly basis. Both are long on advertising and short on editorial content. Comics Retailer is a controlled circulation publication and the CBG is sold on newsstands and by subscription.

Wizard is a slick-paper fan magazine published on a monthly basis, and is available by subscription or newsstand sales. We mention it because it has a very strong following among teenage comics buyers,

and especially so among those young consumers who are collector-speculators as it includes a monthly price guide update.

inventory of product, normally considered to be in excess of \$100,000 wholesale value. With the coming of both auction services such as eBay and low-cost web-hosting it has become much more practical for even a smaller retailer to dispose of surplus merchandise on the Internet and to aggressively market back issues to a literally worldwide marketplace.

Fantasy & Role-Playing Games are a merchandise category which is very compatible with comics. These game systems, similar to "Dungeons & Dragons" include specific games, miniature figures, dice, paints, rule-books, expansion modules, etc.etc. There are a number of effective game distributors with efficient new merchandise and back list operations.

Sports & Non-Sports Cards have been very popular in the past, but the Sports Card market has suffered significant sales declines due to over-production by manufacturers, and wide-spread and excessive speculation by dealers and customers.

Non-sports cards have gained in popularity while sports cards have sharply dropped. Non-sports cards fit better with comics as a sideline merchandise line, and are usually bought for amusement rather than speculation.

Miscellaneous Products

Other products commonly found in comics stores include (but aren't limited to): t-shirts, posters, buttons, novelty and popular culture items, used books, preservation supplies, video cartridges, game cartridges and records/cd's/tapes.

The Comics Journal is primarily a magazine for the comics fan, but does have a news section which sometimes has interesting and informative information not commonly found elsewhere.

Diamond Comic Distributors publishes a monthly magazine for their retail accounts. The magazine's focus is primarily on product sales and promotional events, although a limited amount of general useful information appears in each regularly in terms of publisher/title market share, etc.

The Internet

A Google search of the Internet will yield a large number of comics-related sites. Several provide useful and interesting material:

- **ICV2.com**

This website is maintained by one of the former owners of Capital City Distribution, and provides general information and news on the comics industry and popular culture marketing

- **MileHighComics.com**

This website is maintained by Mile High Comics, and offers news columns on comics topics.

- **TheComicsJournal.com**

This website is maintained by The Comics Journal and offers reprints of key articles, etc..

- **ComicsRetailer.Com**

This website is maintained by The Comics Retailer and offers reprints of key articles, etc.

- **Comtrac.net**

This website is maintained by Melchior Thompson & Associates, primarily for the benefit of their consulting and software clients. It offers some editorial materials on various aspects of the direct market.

Trade Associations

There are no current Trade Associations for Direct Market retailers. There have been several attempts to create such an organization, and all have failed.

There is an industry-wide trade association for game manufacturers, distributors and retailers (GAMA) which several hundred of the more progressive

direct market retailers belong to. They have an annual convention in Las Vegas, normally in March.

At this writing (July 2005) there is another attempt to create a retailers trade association. The name of this organization is **ComicPro**.

Trade Shows & Conventions

There is one industry-wide trade show for the Direct Market, the San Diego Comic Book Convention. There used to be a pre-show specifically for the direct market (San San Diego Comic Book Expo), but that has been discontinued due to low levels of exhibitor support.

The “Con” typically covers four days of festivities at the San Diego Convention Center. In August 2002 total attendance was between 70,000 and 78,000 person-days and set records for exhibitor and consumer attendance. The “Con” has a strong pop

culture flavor in addition to its basis of comics-oriented exhibitors and activities.

A few other well-known conventions include:

- Oakland Comic-Con
- Stars (Atlanta, GA)
- Wizard-Con (Chicago, IL)

Consultants

The only full-time consultancy to the Direct Market is Melchior Thompson & Associates, established in 1984. We specialize in data-driven consulting projects and work with all levels of retailers, publishers and distributors. We base our work on systematic analyses of clients businesses coupled with our proprietary set of information on the Direct Market.

There is very little public information available on Direct Market financials, performance ratios and other items which are taken for granted in more mainstream retail areas. We have developed our own data over nearly twenty-five years of work in the Direct Market using retailer surveys, consumer surveys, in-store customer source survey data and proprietary Point-of-Sale data.

There are several other persons consulting in the area of the Direct Market, but all are what you might

term “qualitative” consultants, who do not work from a base of solid performance information.

We also have developed and support ComTrac©, the only ordering and inventory system in wide use that has been custom designed for the needs of the specialty comics and game retail community.

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