NPD Music

NPD MusicWatch
Looking Back, Looking Forward

April 12, 2004

Prepared For:

NARM

Outline

- 2003 VS. 2002: Market Summary

- Trends to Watch
  - Music and the computer
  - Where teens are going
  - Women are buying more

Executive Summary

- Fundamental shift in channel share continued in 2003, with CD/Record Stores losing all age groups to Electronics, Discount/Mass Merchandising and Online.

- The Online channel is poised for significant growth in 2004, due to internet population growth, excellent customer satisfaction scores and high purchasing rates amongst its customers.

- Piracy is less of an issue than it was last year, and legal digital music is gaining a foothold.

- Teens will continue to be a tough market in the coming year - but more due to competition for wallet share and lack of appeal of music and less due to downloading. Further product integration at the retail level (co-packaging, integrated departments) and highly targeted marketing are keys to reaching this demographic.

- 2003 saw a shift towards women as the primary music consumers. TBD whether that continues in 2004.

NPD Music: Primary Sources of Information

- NPD MusicWatch: weekly tracking of music purchases from a panel of consumers
  - **Demographics, shopping habits, retailers, purchase motivators, pricing; Over 100,000 transactions captured annually.**
- MusicWatchDigital: ongoing tracking via a metered sample
  - **Acquisition and use of digital music files & music applications; 10,000 participating households.**
- MusicLab: bimonthly tracking of key music & entertainment topics
  - **Attitudes, desirable features; 5,000 respondents each wave.**
- Media Study: biannual survey of media habits - websites, tv shows, magazines
  - **Music buyers/non-buyers; 20,000 respondents each wave.**
- Peer-to-Peer Study: annual survey of digital music usage and physical purchasing behavior
  - **Bought more/less/same, legal and illegal digital music usage; 5,000 respondents.**

NPD Music: Methodology

MusicWatch, MusicLab, Media Study and Peer-to-Peer Study all sourced from NPD Panel - pool of 600,000 individuals in the U.S.

- Sample projected to 13+ U.S. population
- Total U.S. geographic representation
- All retailer coverage

MusicWatch Digital is a static panel that volunteers to let NPD directly monitor activity on their home computers.

- 10,000 households
- Actual behavior recorded and reported, rather than self-reported via online survey.

NPD Music: Retail Channel Definitions

Retail Channels - cover physical product only (no digital downloads)

- Online: all websites that sell physical product (e.g., amazon.com, borders.com, walmart.com, towerrecords.com)
- Book Store: (e.g., Borders, Barnes & Noble)
- CD/Record Store: (e.g., Tower, Virgin, Sam Goody)
- Discount/Mass Merchandising: (e.g., Wal-Mart, Target)
- Members Only Warehouse: wholesale outlets that require membership (e.g., CostCo, Sam's)
- Electronics: (e.g., Best Buy, Circuit City)
- Other: non-traditional music retail outlets (e.g., department stores, coffee shops, convenience stores)

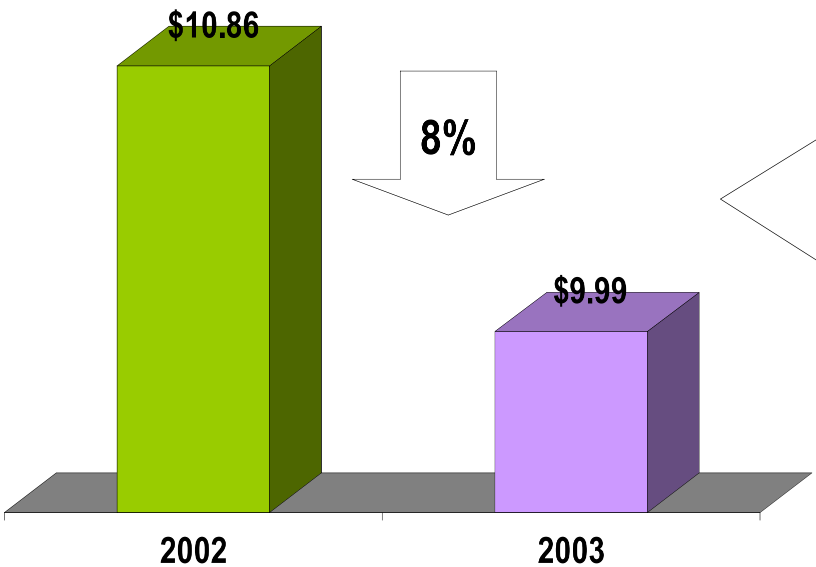
Market Summary: Sales and Demographics

Market Summary: Highlights

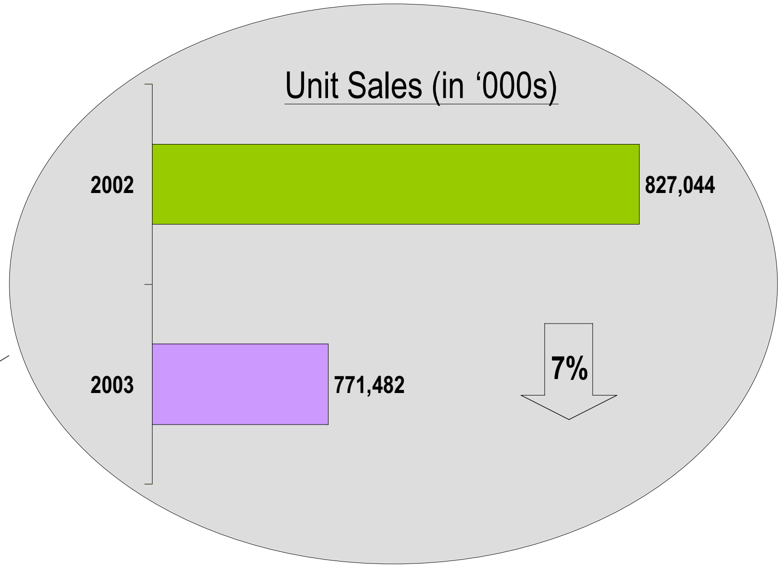
- Projected revenues on physical purchases were down 8% (dollar share, all lengths and formats).
- Prices and content remain issues among consumers.
- Competition for wallet share from other entertainment/technology products is listed as a growing cause for the sales decline, which suggests more emphasis should be placed on product integration.
- CD/Record Stores continued to lose share to Discount/Mass Merchandising and Electronics channels.
- Teens lost market share and shed more volume than other age groups.
- Physical singles increased their dollar share by one-third, suggesting a market that can be filled both in the physical and the digital arenas.

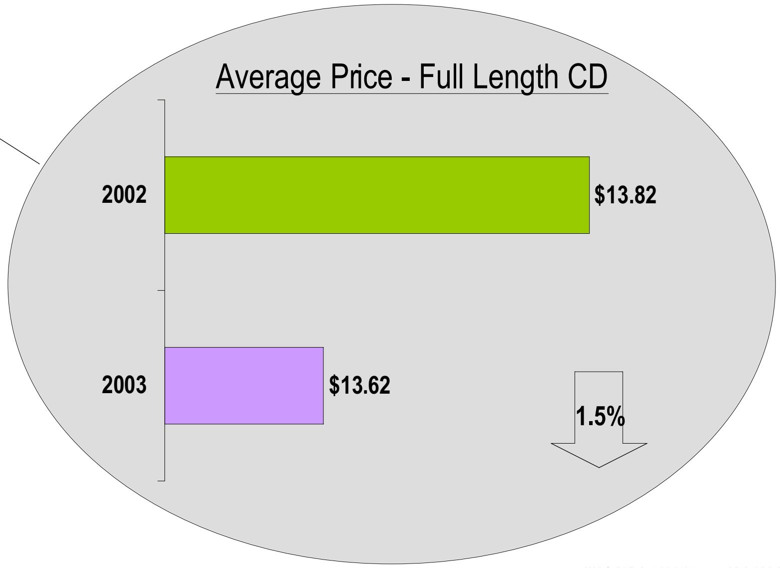
Market Summary: Dollar Decline

Projected Dollar Sales of Physical Product
(in billions)



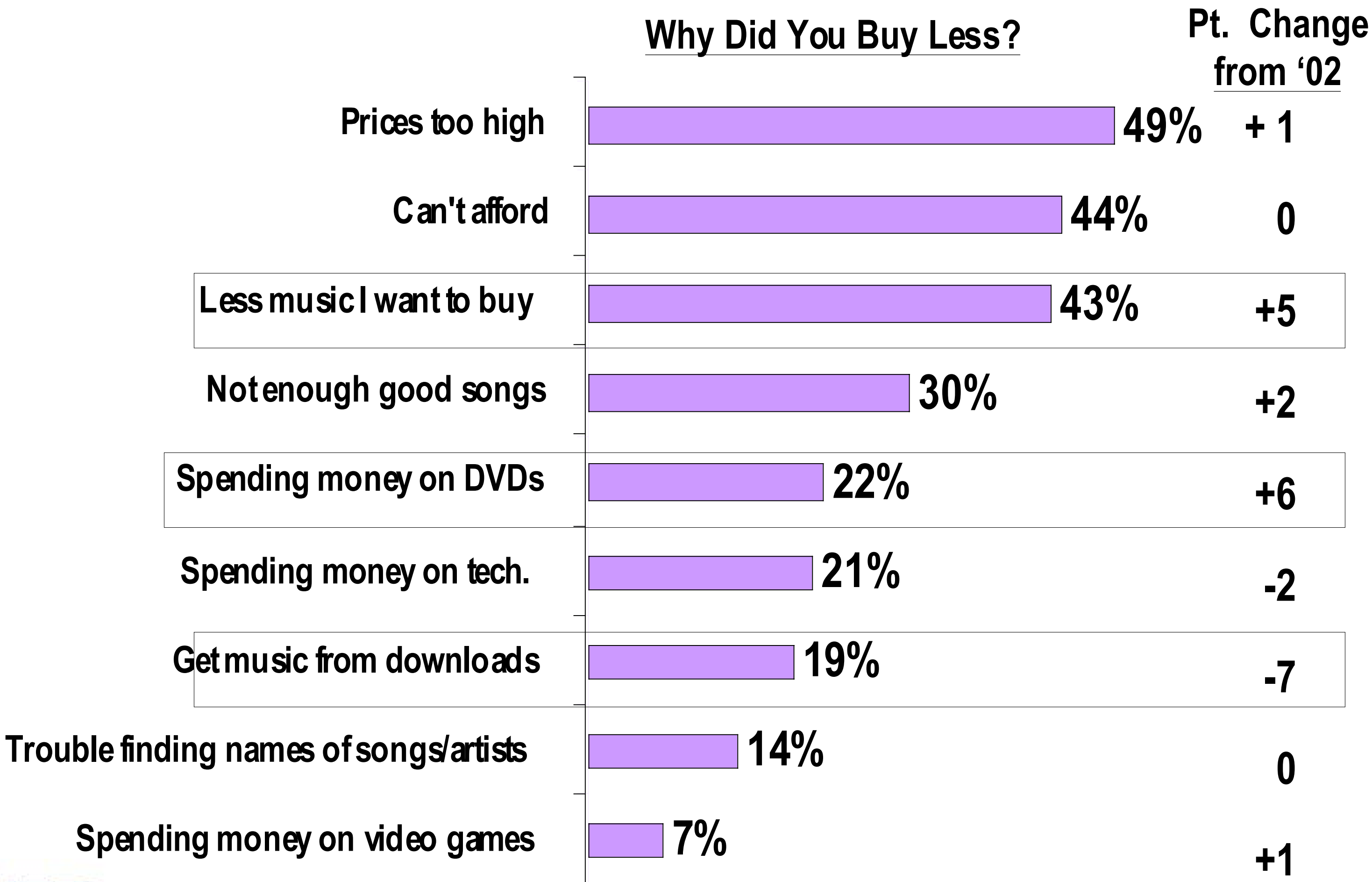
* includes all lengths and formats





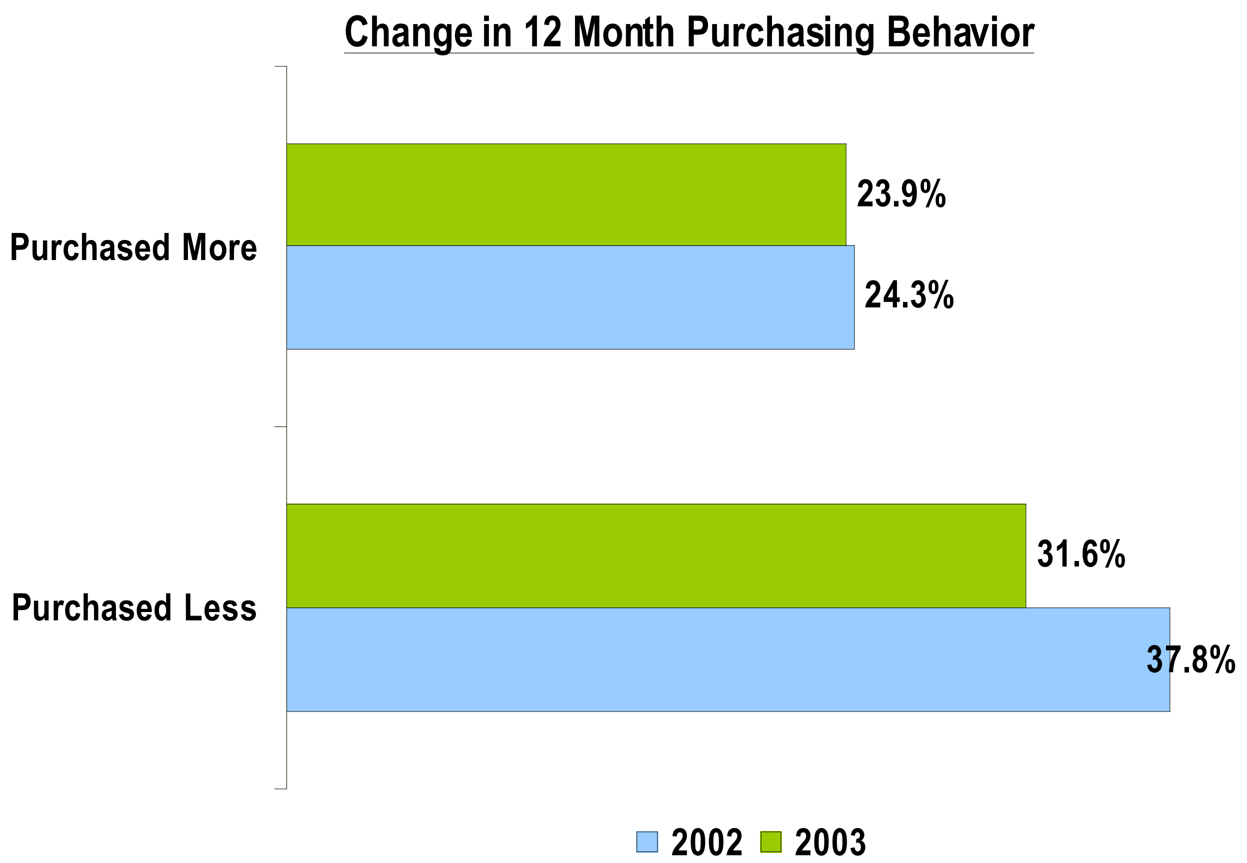
Market Trends: Why Are Unit Sales Down?

Although price was still an issue, lack of music appeal and competition for wallet share were growing factors. Downloading was not nearly as much of an issue in 2003 as it was in 2002.



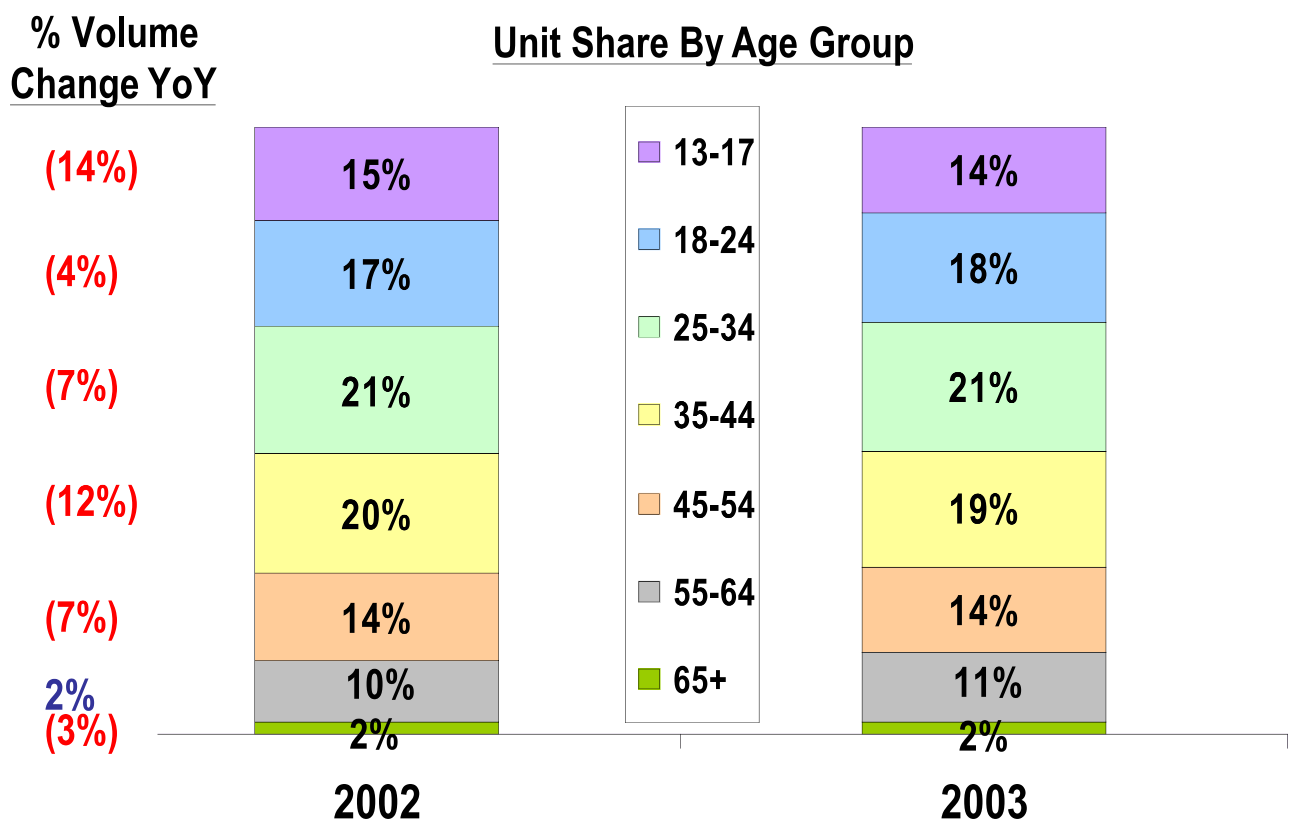
Market Trends: Leading Indicator

Fewer purchasers are negative on music than was the case a year ago, which suggests that the market is stabilizing.

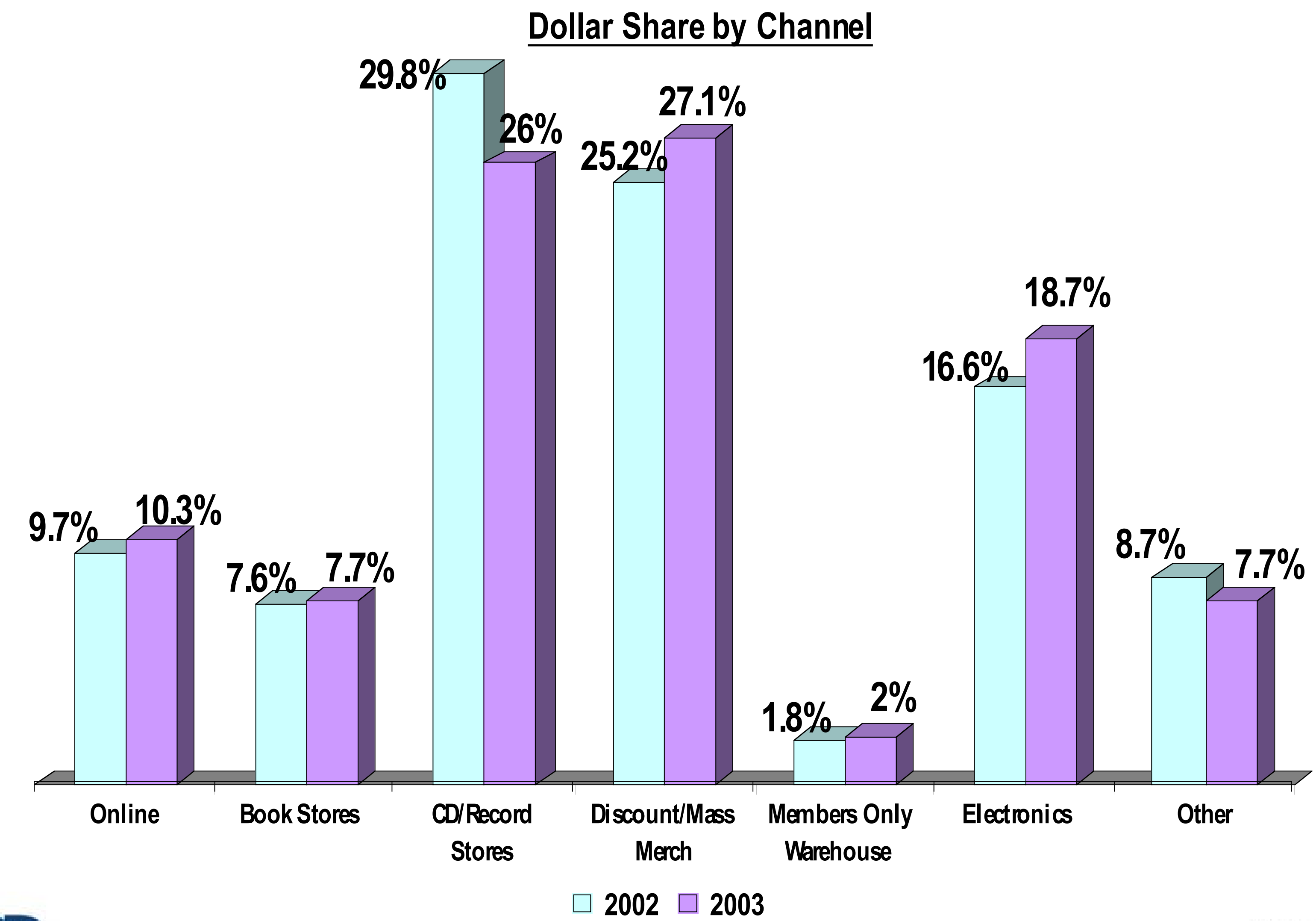


Market Trends: Unit Share By Age Group

Teens lost the most market share and shed the most volume in 2003. The 55-64 age group bought more vs. one year ago.



Market Trends: Channel Share



Source: NPD MusicWatch; Full-length

Market Trends: Age Groups By Channel

More than 10% of customers ages 13-24 (32% of the total market) left the CD/Record Store channel for the Discount and Electronics channels.

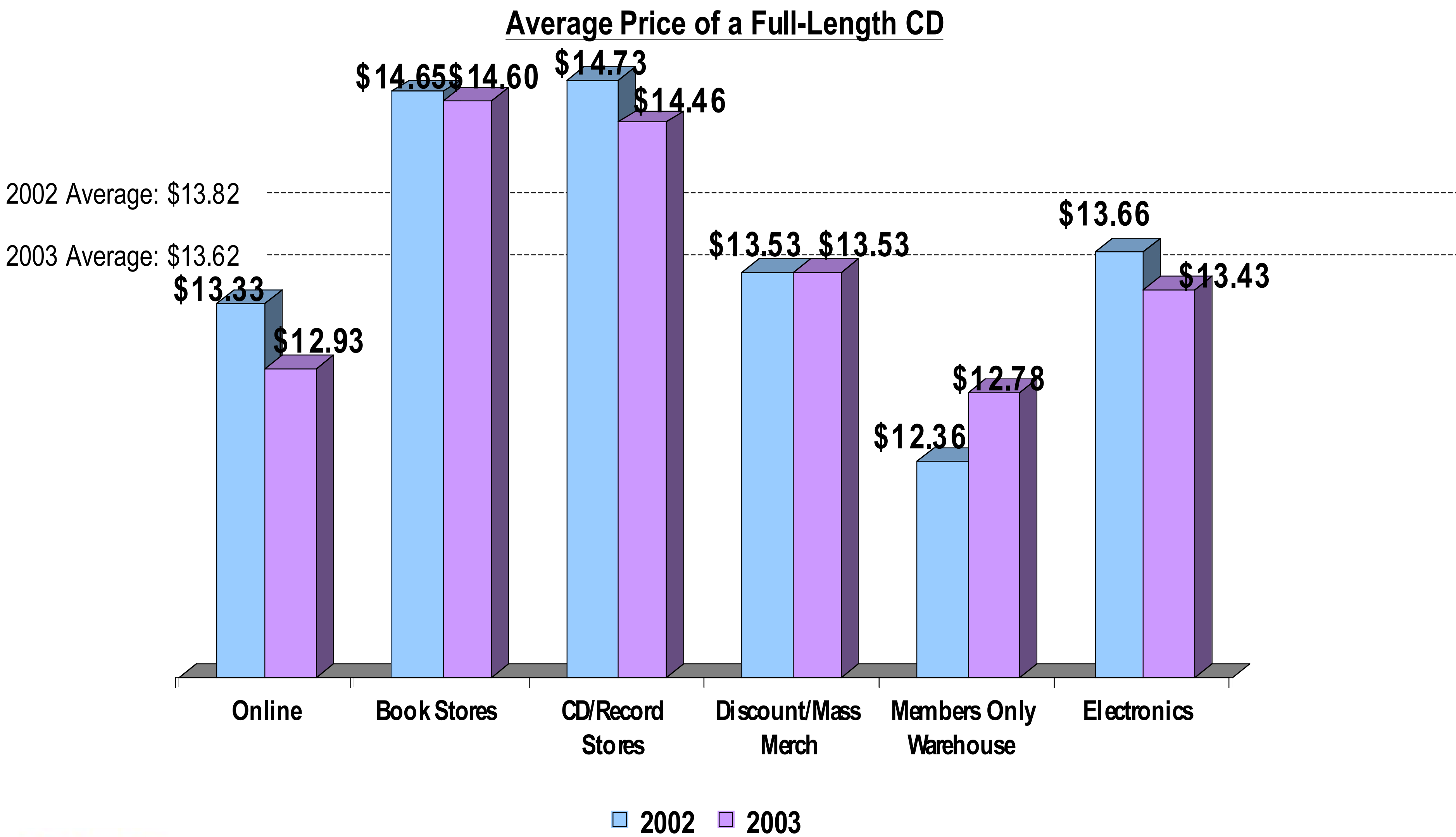
Age Group Share By Channel

	13-17		18-24		25-34		35-44		45-54		55-64		65+	
Retail Channels	2003	▲ YoY	2003	▲ YoY	2003	▲ YoY	2003	▲ YoY	2003	▲ YoY	2003	▲ YoY	2003	▲ YoY
Online	6.2	0.80	9	1.3	10.4	0.3	12.6	1.1	13.5	0.7	15.5	0.4	17.2	2.1
Book Stores	6.1	1.00	6.2	(0.6)	6.3	0.1	6.7	(0.6)	7.8	(0.9)	10.5	0.6	11.7	1.2
CD/Record Stores	29.4	(6.40)	29.7	(4.5)	27.6	(0.9)	22	(2.7)	19.7	(3.6)	16.1	(1.6)	14.3	(2.4)
Discount/Mass Merchandisers	30.3	3.80	23	2.4	25.4	0.2	29.2	0.5	27.8	1.2	29.2	2.1	25.3	0.6
Members Only Warehouse Stores	1.4	0.20	0.8	(0.7)	2	0.2	2.6	0.2	2.9	(0.2)	4	0.5	3.5	0.3
Electronics Stores	19.1	2.40	23.6	4.8	19.9	0.6	18	2.4	17.2	2.7	12.7	0.9	10.3	(1.2)

** excludes "other"/non-traditional retail outlets such as Department & Convenience Stores*

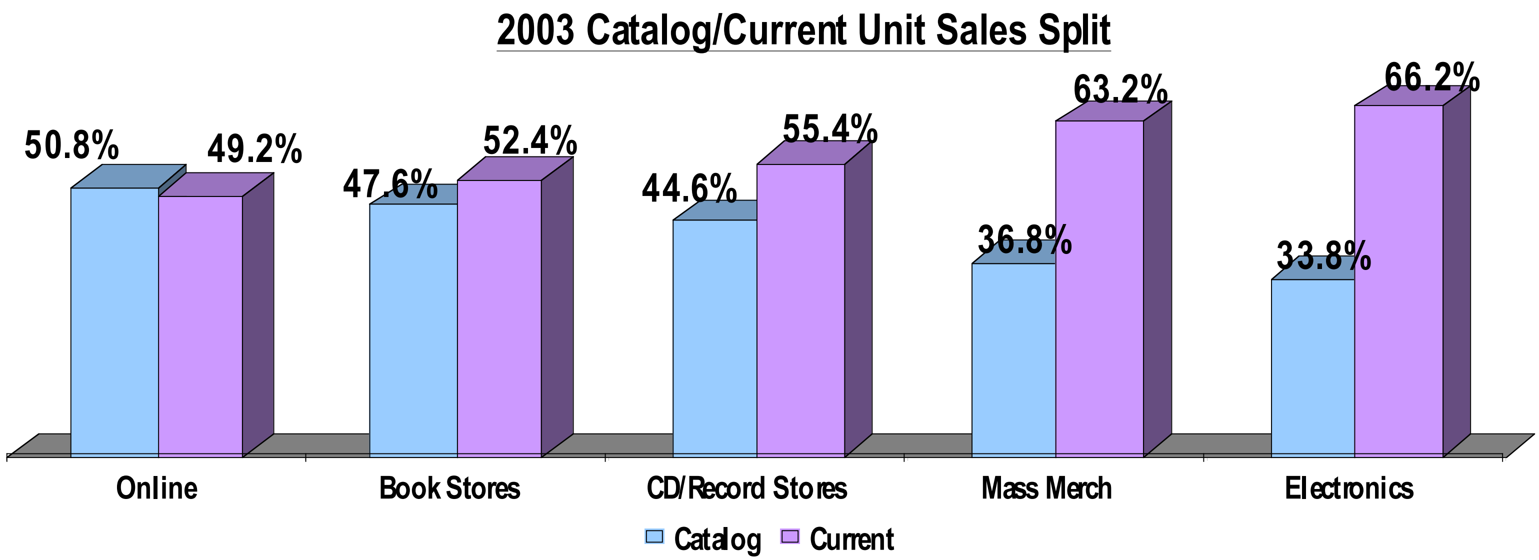
Source: NPD MusicWatch; Unit Share - Full Length

Market Summary: Average Price



Source: NPD MusicWatch; Full-length CD

Market Trends: Current Release Vs. Catalog

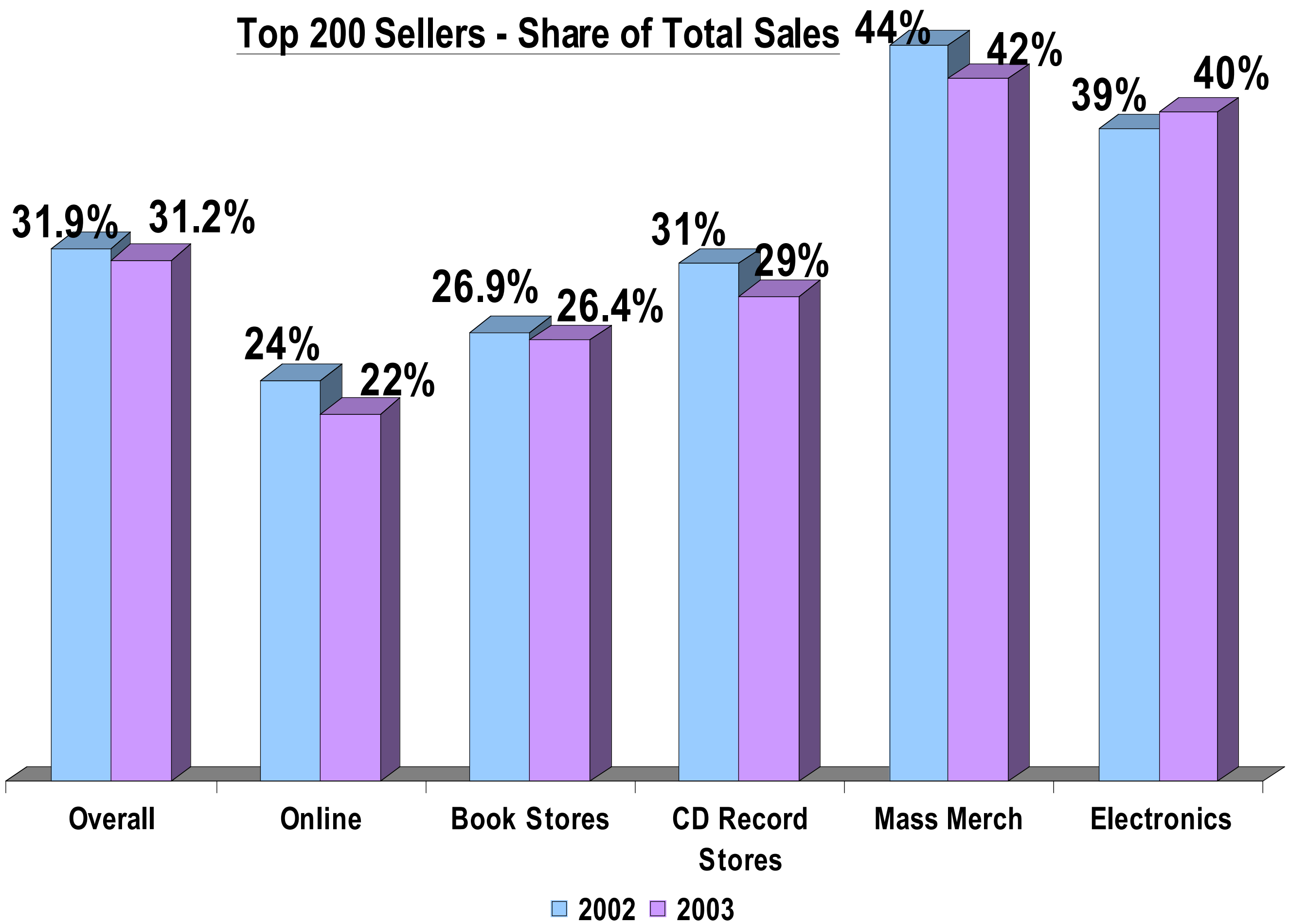


	Total	Online	Book Store	CD/Record Store	Mass Merch	Electronics
Catalog	**$13.33**	$12.45	$14.08	$13.98	$13.21	$13.76
Current	**$13.87**	$13.31	$15.13	$14.91	$13.81	$13.25

Source: NPD MusicWatch - Full Length. Catalog is defined as anything that has been out for 18+ months

Market Trends: Top 200 Sellers

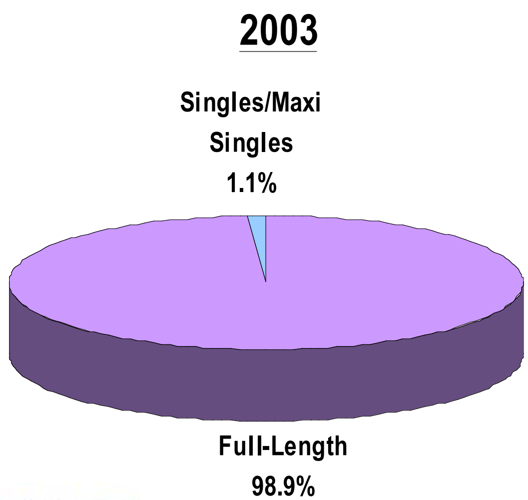
With the exception of Electronics, which focuses more on the new release market than any other retail type (see previous chart), customers in every channel reached deeper into stock to find music they wanted to buy.

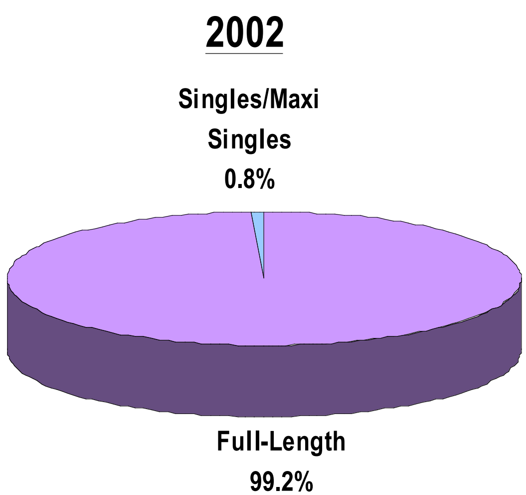


Market Trends: Singles

	Full-Length	Singles
Males	47%	38%
Females	53%	62%
Non-Black	83%	75%
Black	17%	25%

Physical singles increased their dollar share by a third over last year, with females and African-Americans largely driving the spike.





Trends to Watch in 2004

Music and the Computer

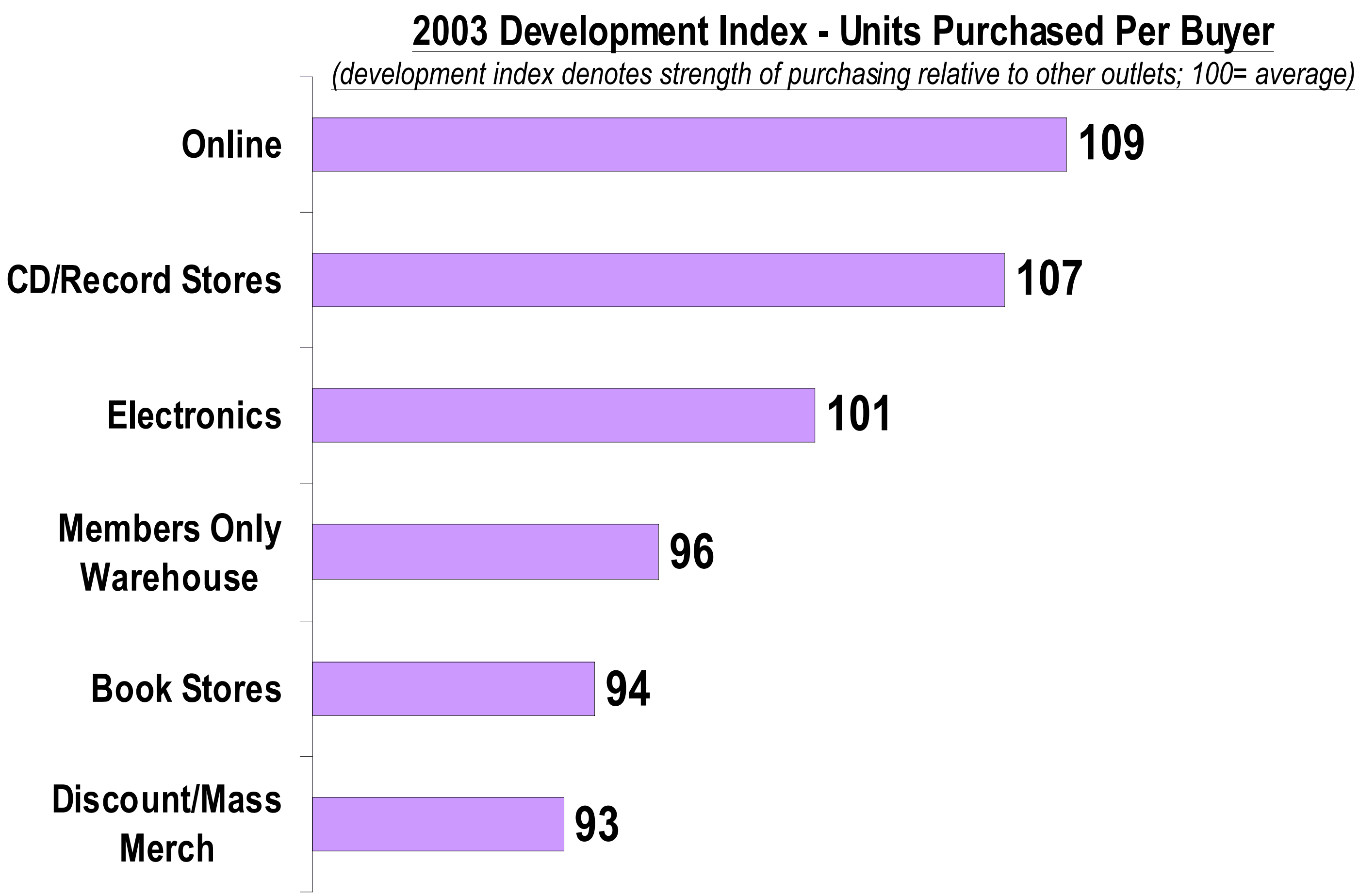
- Growth in the Online Channel
- Digital Music - Legal and Illegal

Music and the Computer: Highlights

- The Online channel's customers have the highest purchasing rate. The Online channel also has the best customer satisfaction scores (for physical product). That, combined with last year's considerable increase in internet population, suggests that the channel is poised for more growth in 2004.
- Digital music is no longer a niche market.
- Piracy is declining and legal digital music is gaining a foothold - especially among heavy physical music buyers who are beginning to substitute subscription services and legal downloads for some of their physical music purchases.

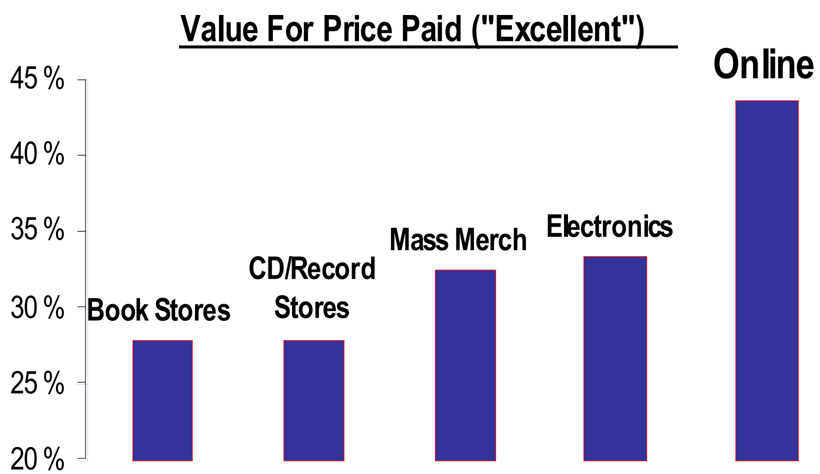
Music and the Computer: Online Channel

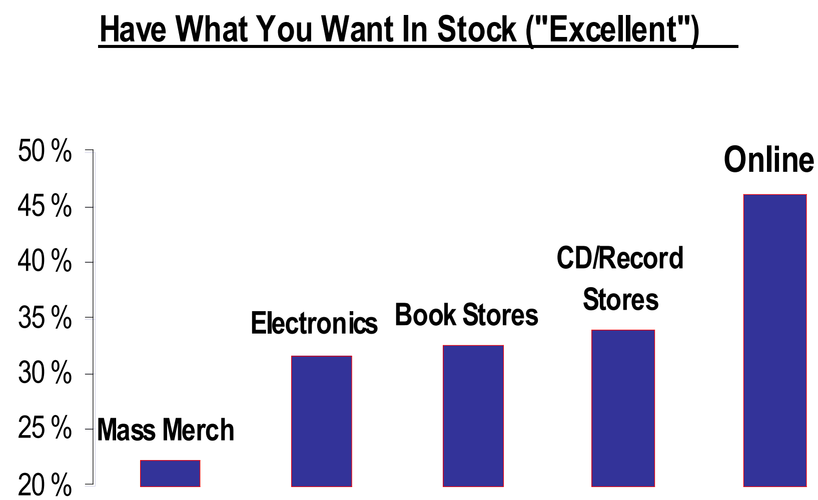
The Online channel's customers purchased about 9% more than the average buyer. That's better than any other major music retail channel.

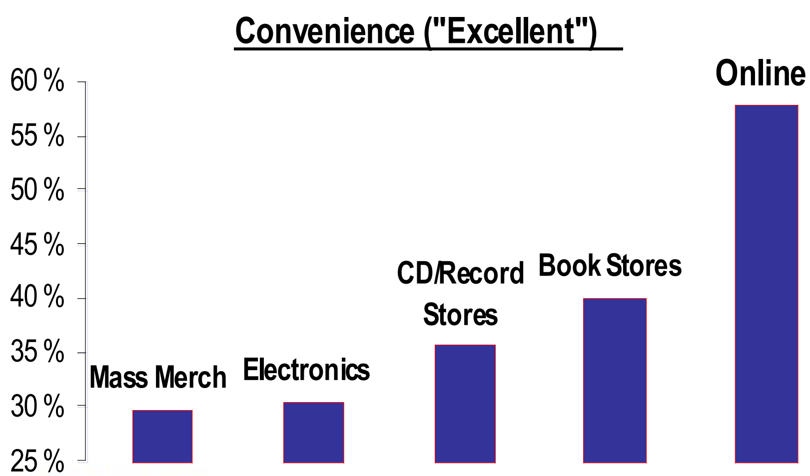


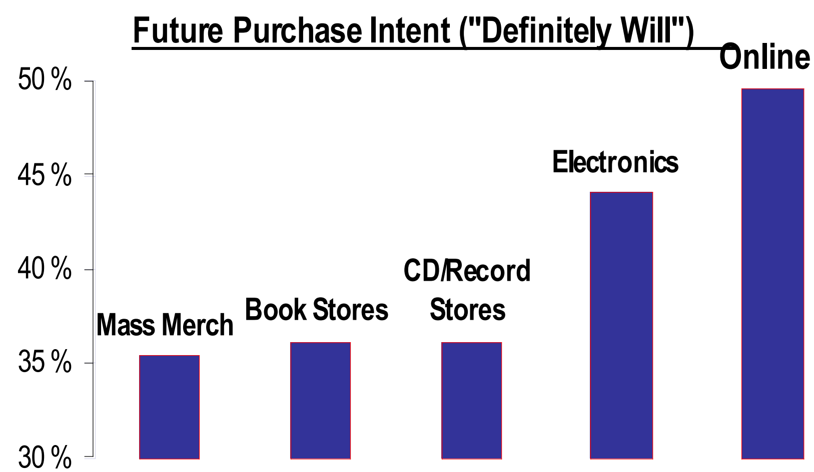
Music And The Computer: Online Channel

Online had by far the highest scores of any major channel in MusicWatch's battery of customer satisfaction questions.





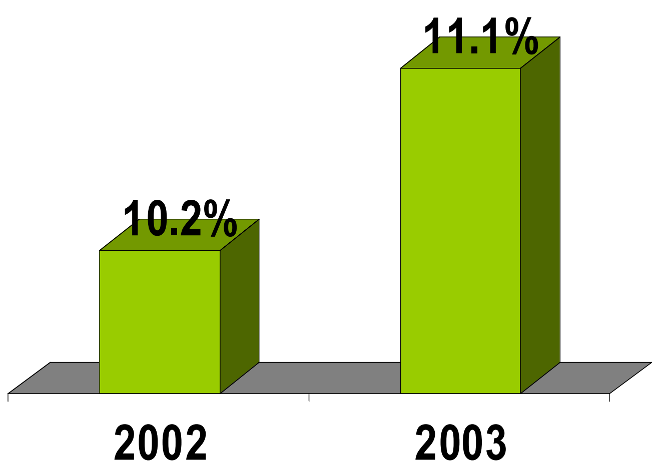




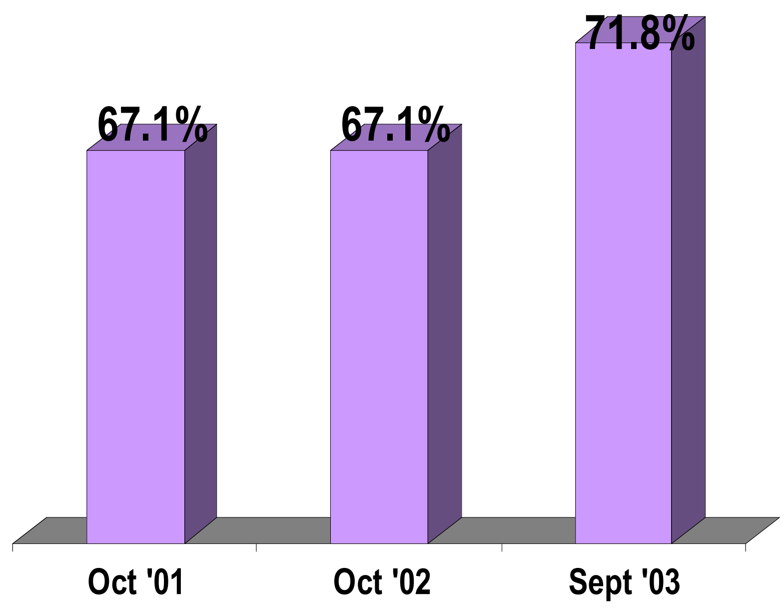
Music And The Computer: Online Channel

Online share grew in a year after internet penetration showed a moderate increase - likely in part due to high purchasing rates and excellent customer satisfaction scores. As the incremental 4.7% of the population that came online in 2003 gets accustomed to Online shopping, its share will grow even more in 2004.

Online Channel (Physical Product) - Unit Share

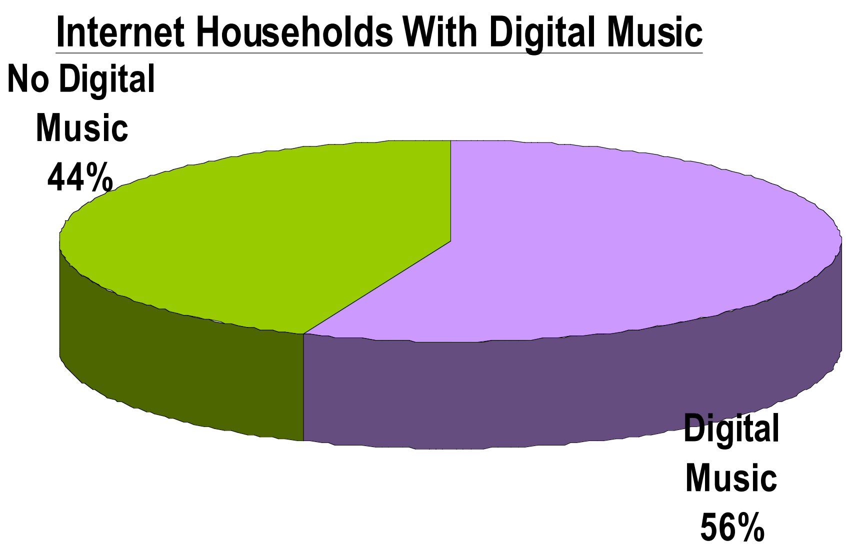


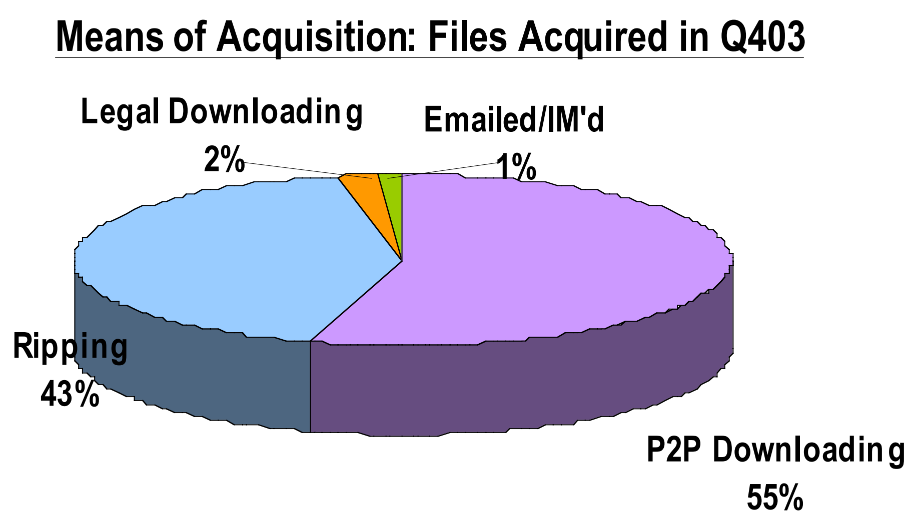
U.S. Internet Penetration
source: Ipsos-Reid - used with permission



Music and The Computer: Total Digital Music Market

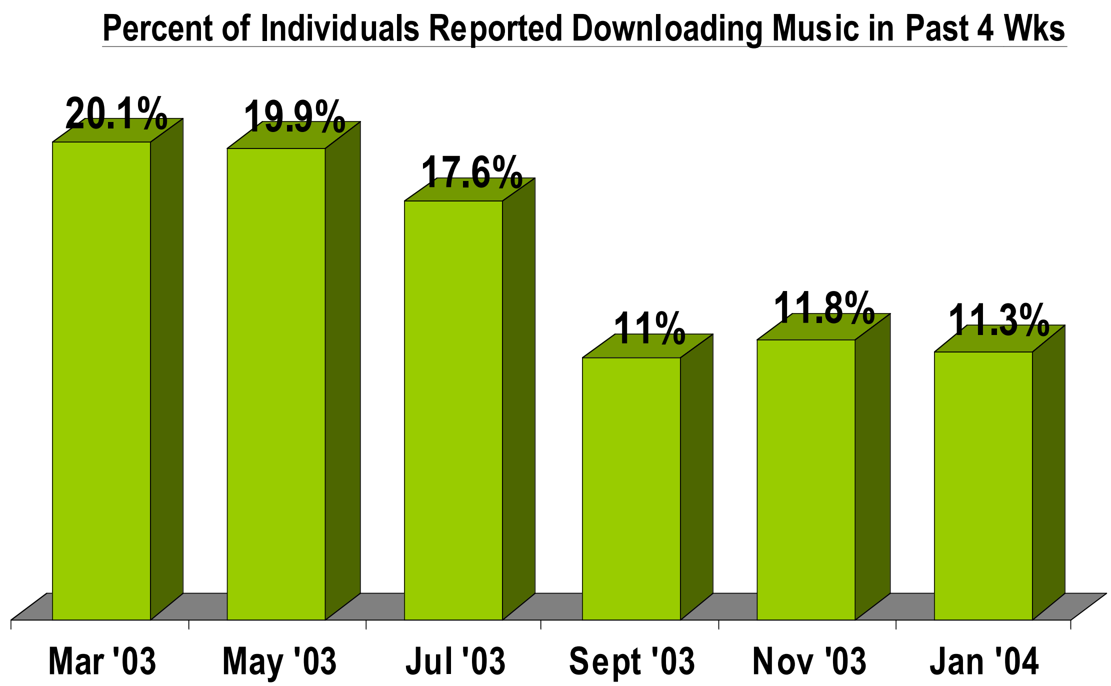
Digital music is no longer a niche market. By December, 2003, more than half of all internet households had at least one music file on their hard drive.





Music And The Computer: Legal Digital Music

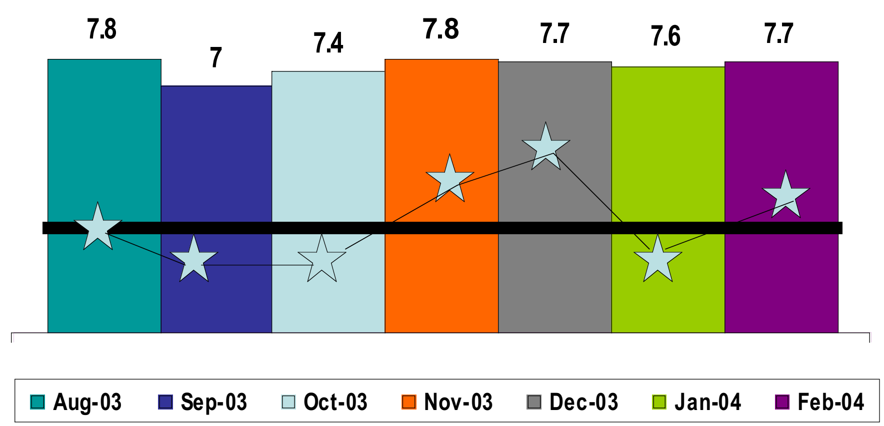
The proportion of individuals claiming that they recently used a P2P service has declined over the past year. The sharpest decline was coincident with the ramp-up of RIAA litigation initiatives.



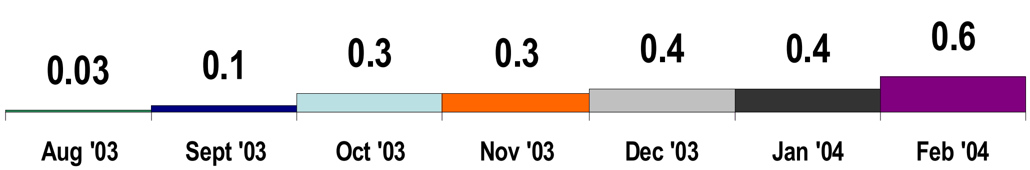
Music And The Computer: Legal Digital Music

Piracy has declined to the point that ebbs and flows are primarily seasonal. At the same time, legal digital music is quickly gaining a foothold.

Percent of Households Observed Downloading Music Via P2P
(compared to seasonal index of physical sales)



Percent of Households Observed Downloading Music Legally
(does not include Streaming Subscription Services such as Rhapsody)

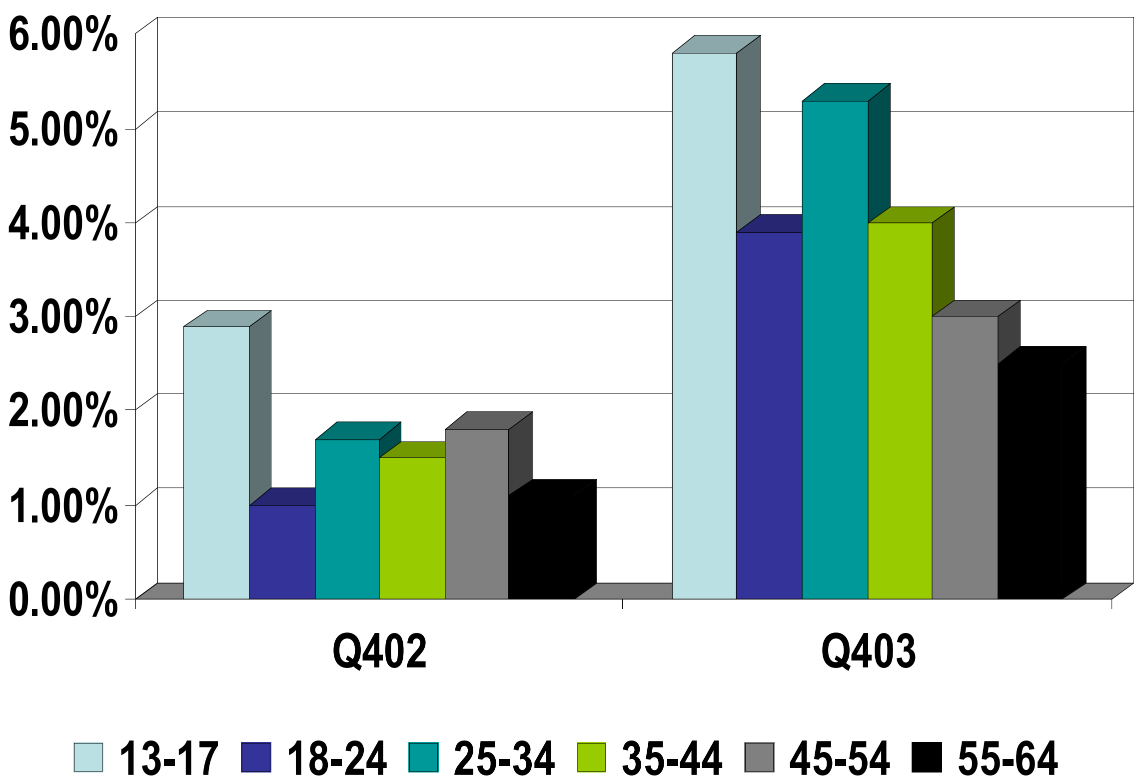


Source: NPD MusicWatch Digital, NPD MusicWatch

Music And The Computer: Legal Digital Music and Physical Buyers

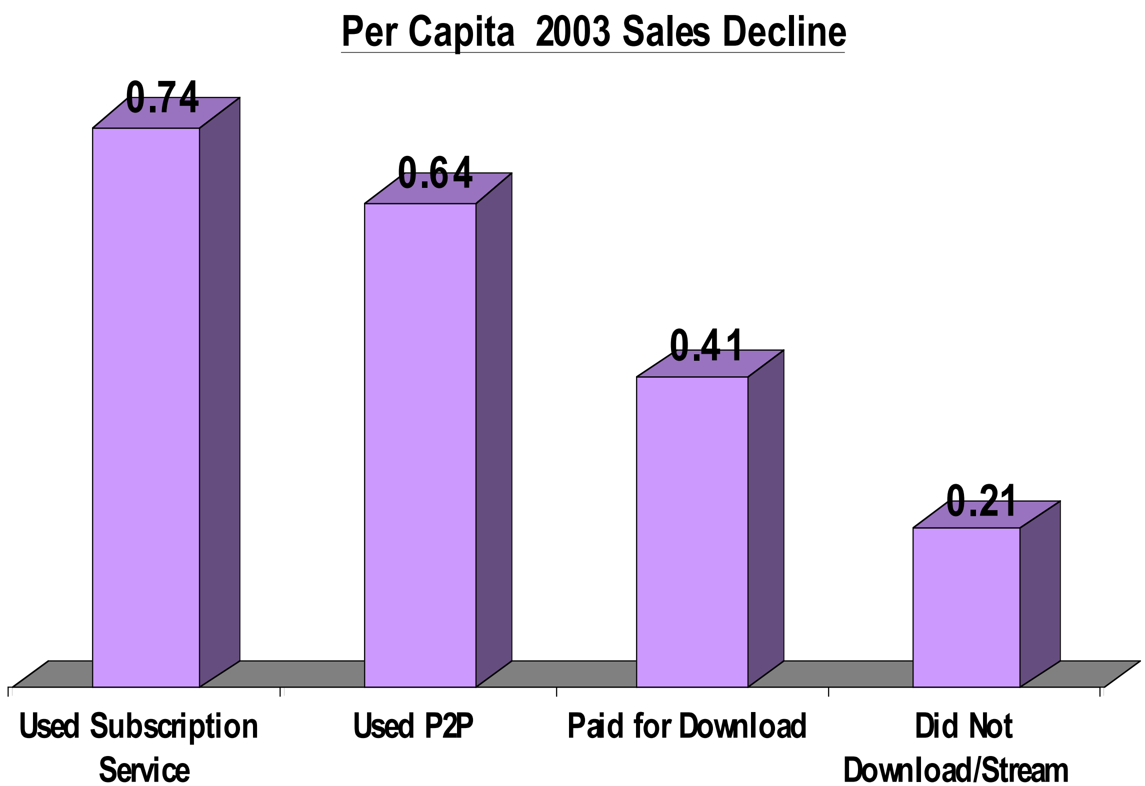
Legal digital music usage more than doubled among consumers who also purchased physical music last year.

Music Buyers Who Also Paid For Legal Digital Music in "Past Week"
(includes legal downloads and streaming subscription services)



Music And The Computer: Legal Digital Music

Users of legal digital music services are generally heavier physical music buyers than average. Not surprisingly some of their legal digital music substitutes for physical purchases- but they do remain heavy physical buyers overall.



	Used Subscription Service	Used P2P	Paid for Download	Did Not Download/Stream
Past 12 Months Physical Units Purchased (Mean):	11.2	8.4	9.9	6.3

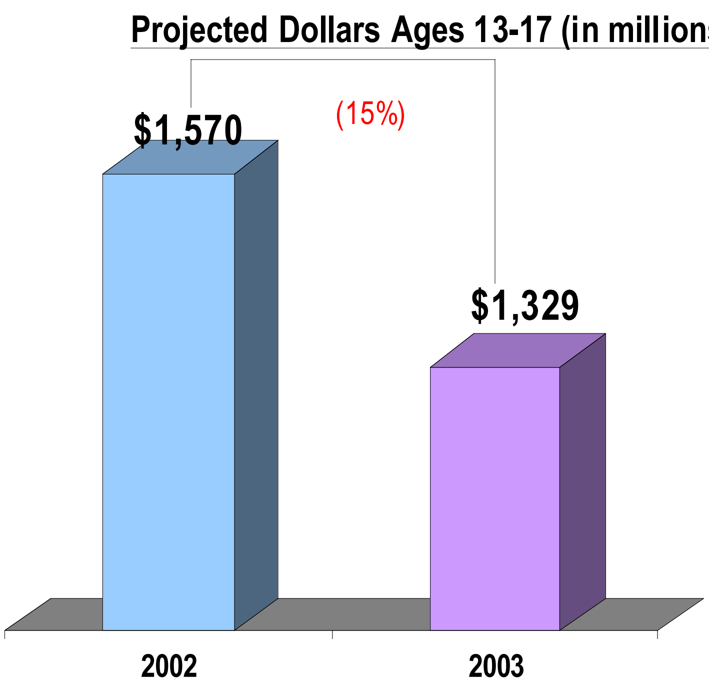
Source: NPD MusicWatch P2P Study, Feb '04; 2004 P2P Study - Units Purchased denotes Full Length only

Teens

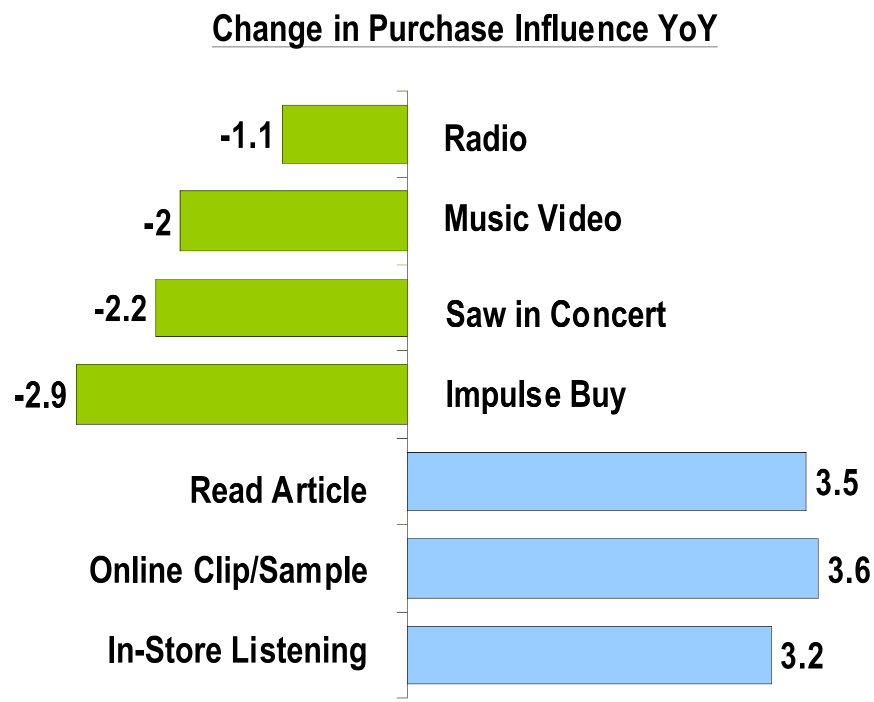
Teens: Highlights

- Teens reported buying less in 2003 due to competition for wallet share, but also because there was less interest in the music that was released.
- An important portion of a current year's best sellers have historically been released the previous year. Since the 2003 crop of releases were relatively light for teens, this suggests that 2004 will also be a struggle for that demographic.
- Targeted communication and marketing is especially key to reaching the teen demographic.

Teens: Shifting Dollars, Shifting Influences

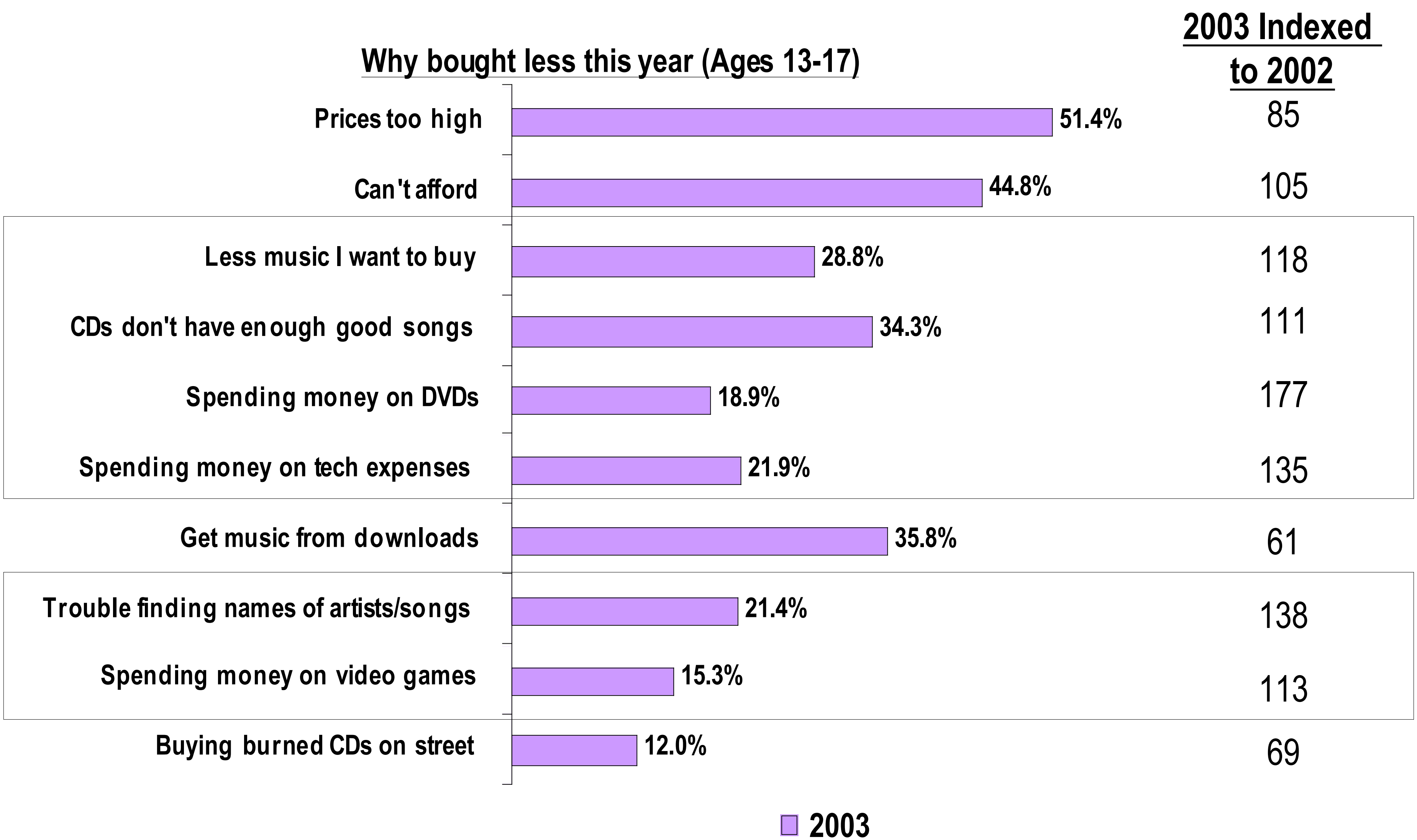


Full-length only



Among Buyers - not units bought

Teens: Why Did They Buy Less?



Source: P2P Study - February, 2004; P2P Study - September, 2002

Teens: Less Music They Wanted To Buy in 2003

2002	
Eminem	The Eminem Show
Avril Lavigne	Let Go
Nelly	Nellyville
Linkin Park	Hybrid Theory
Ludacris	Word of Mouf
Ja Rule	Pain is Love
Ashanti	Ashanti
Pink	Missundaztood
Nickelback	Silver Side Up
Puddle Of Mudd	Come Clean
Linkin Park	Reanimation
Original Soundtack	8 Mile
Korn	Untouchables
Creed	Weathered
P.O.D.	Satellite
System Of A Do	Toxicity
Hoobastank	Hoobastank
Good Charlotte	The Young And the Hopeless
Usher	8701
New Found Glory	Sticks And Stories
Alicia Keys	Songs in A Minor
Blink 182	Take Off Your Pants And Jacket
B2K	B2K
Incubus (Rock)	Morning View
Britney Spears	Britney
Christina Aguilera	Stripped
No Doubt	Rock Steady
Justin Timberlake	Justified
Eminem	The Marshall Mathers LP
Michelle Branch	The Spirit Room

Less than half as many CDs went "gold" for teens. And out of those that did, only 36% were released in 2003. In 2002, 45% of the CDs that went gold for teens were released that same year. Even if other forms of entertainment are competing for wallet share, this proportion should not be affected. That it is, is additional evidence that the 2003 product held less appeal for this age group.

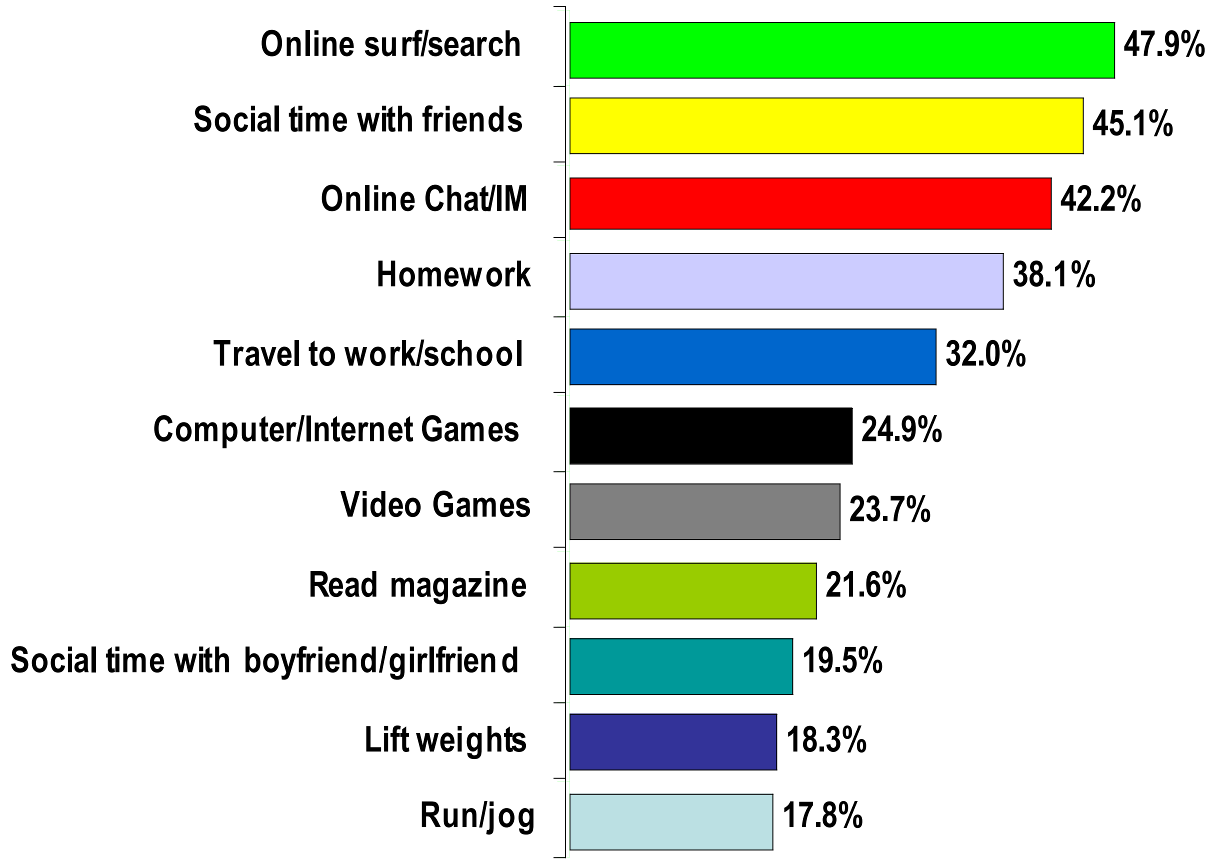
2003	
50 Cent	Get Rich Or Die Trying
Linkin Park	Meteora
Good Charlotte	The Young And The Hopeless
Simple Plan	No Pads No HelmetsÉ
Eminem	The Eminem Show
Evanescence	Fallen
The All-American Rejects	The All-American Rejects
Christina Aguilera	Stripped
Justin Timberlake	Justified
Beyonce	Dangerously In Love
Nelly	Nellyville
Avril Lavigne	Let Go
Trapt	Trapt
Outkast	Speakerboxxx/The Love Below

Source: NPD MusicWatch - Full Length; Gold Status defined as sales of 500k units

Teens: Targeted Communication Is Key

Online/Computer activity is the primary venue for music listening.

Ages 13-17; What do you like to do when you listen to music?



Teens: Websites They Visit

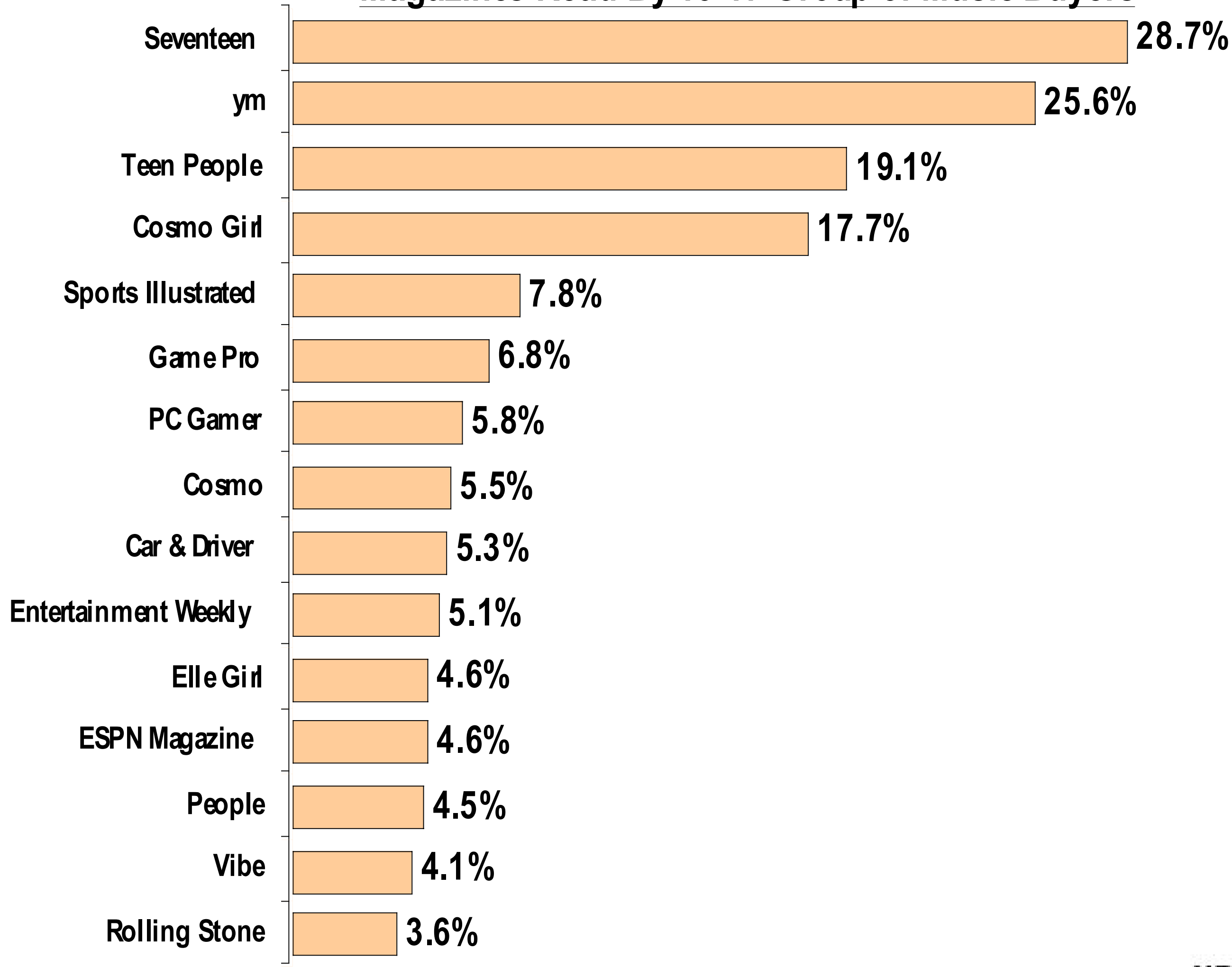
Teens ignore community sites, for the most part, but flock to instant messaging services.

	Category	High Usage of Individual Sites
Teens use More	Music/Entertainment	AOL Music, Launch, Live 365, BET
	Gaming	Yahoo Games, Gamefaqs, Gamespot
	Teen Sites	Bored, Neopets
Teens use less	Search Engines	AskJeeves skews high
	Shopping	Alloy
	Community	AOL Instant Message

Teens: Magazines They Read

As shown earlier, teens are more influenced to purchase music by articles they read - but music magazines are below lifestyle, gaming and sports magazines.

Magazines Read By 13-17 Group of Music Buyers



Source: NPD MusicWatch Media Study - Among Music Buyers

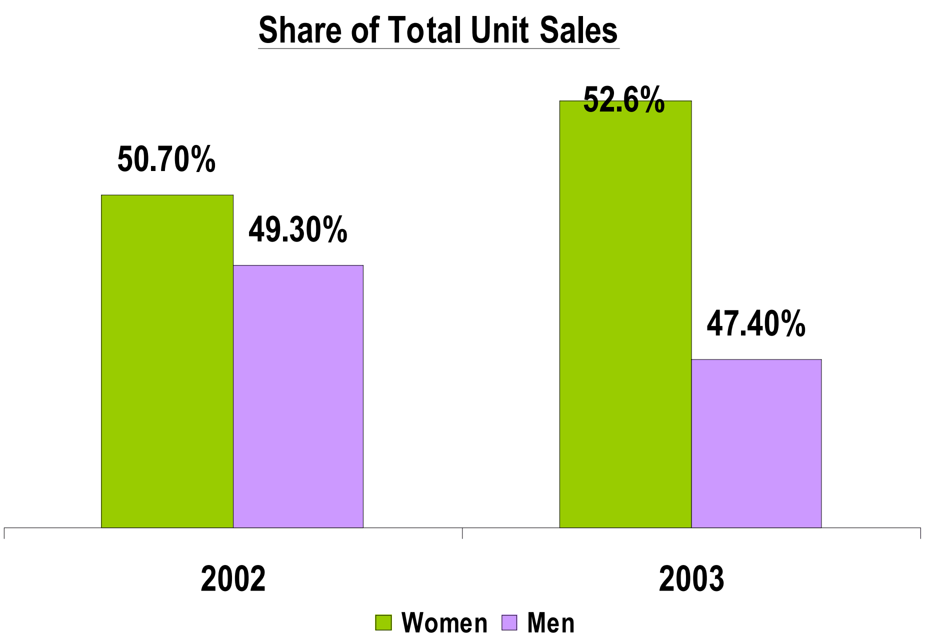
Women Buying More

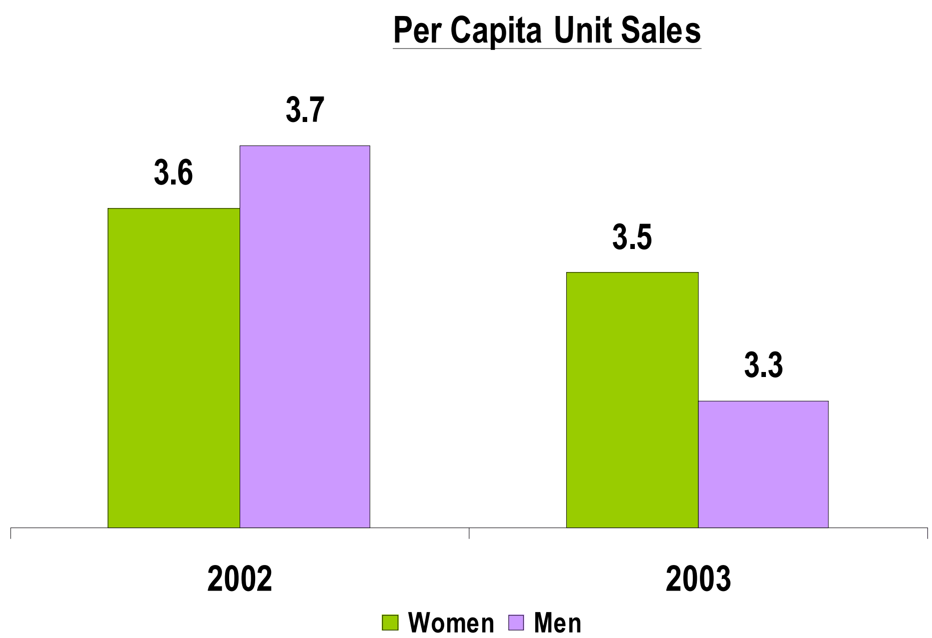
Women Buying More: Highlights

- The primary market for music appears to be shifting from men to women.
- Certain age groups within the female demographic purchased more music in 2003 than they did in 2002.

Women Buying More: Share and Per Capita

Women's share of total unit sales increased by 2%. Their per-capita purchasing rate is now higher than the men's.

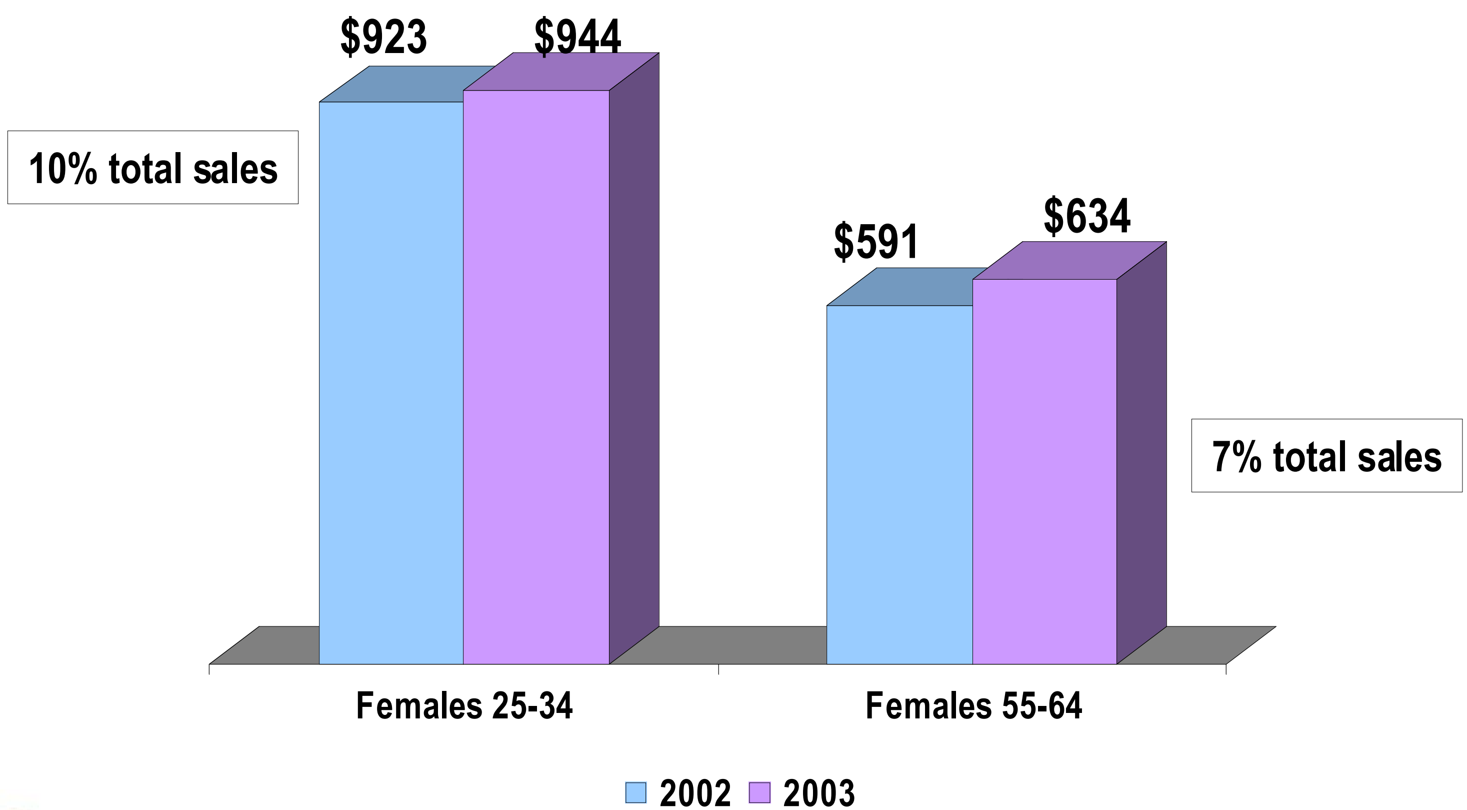




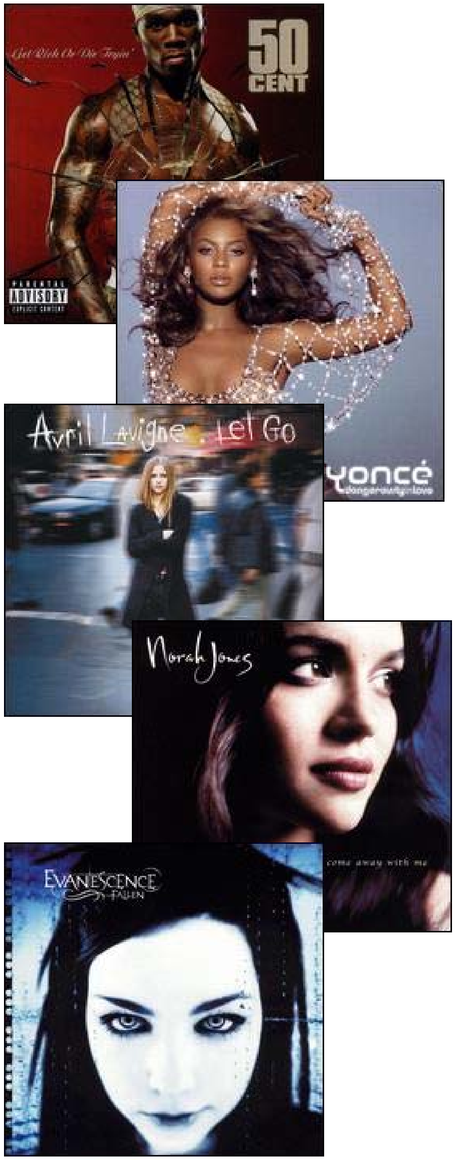
Women Buying More: Net Sales Gains in Some Age Groups

Females ages 25-34 - who account for 10% of total sales - posted a 2% gain year-over-year. Females ages 55-64 spent 7% more in 2003 than in 2002.

Dollar Sales Of Female Age Groups That Bought More in 2003 (in millions)



Women Buying More: 25-34 - What Did They Buy?



The usual suspects were the top sellers, but 105 releases had mass appeal (100k sold). That's more than any other gender/age group split - an indication that music product in general is more attractive to this demographic than to any other.

<u>100k + Units Sold to Women 25-34</u>
(105 CDs)
50 Cent
Beyonce
Avril Lavigne
Norah Jones
Evanescence
.
.
.
Kem
Kidz Bop Kids
Coldplay
Jay-Z
3 Doors Down

Conclusion

- Fundamental shift in channel share continued in 2003, with CD/Record Stores losing all age groups to Electronics, Discount/Mass Merchandising and Online.
- The Online channel is poised for significant growth in 2004, due to internet population growth, excellent customer satisfaction scores and high purchasing rates amongst its customers.
- Piracy is less of an issue than it was last year, and legal digital music is gaining a foothold.
- Teens will continue to be a tough market in the coming year - but more due to competition for wallet share and perceived quality of music and less due to downloading. Further product integration at the retail level (co-packaging, integrated departments) and highly targeted marketing are keys to reaching this demographic.
- 2003 saw a shift towards women as the primary music consumers. TBD whether that continues in 2004.

Questions, Comments or Additional Information:

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