UNIVERSAL MUSIC GROUP

THE STATE UNIVERSITY OF MANAGEMENT (Moscow)
Music Business Worldwide

Presentation by

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Universal Music eLabs

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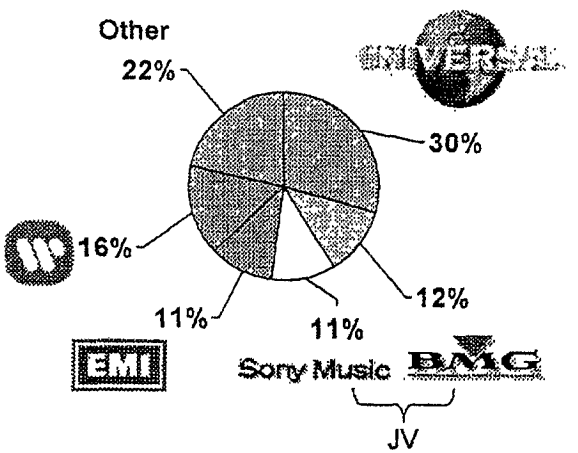
SDARS Ex. 51

Introduction

Universal Music Group is the world's No.1 music company. Our 2005 market share was 29.7% in the US and 25.4% globally.

2005 U.S. Market Share



Key Financials

(millions of Euros)	2005	2004
Revenue	4,893	4,819
Earnings From Operations	480	399

Select Artists

blink-182	Dr. Dre	Nelly
Andrea Bocelli	Eminem	No Doubt
Bon Jovi	50 Cent	Shania Twain
Mariah Carey	Gwen Stefani	Sting
Sheryl Crow	Diana Krall	U2

UMG's global operations primarily are comprised of the production and distribution of recorded music and music publishing.

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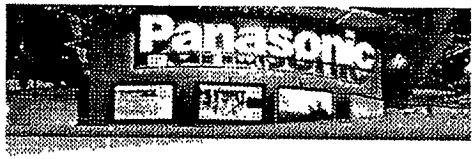
The Universal Music Group History

Universal Music Group and its corporate parent have been parties to several M&A transactions over the past 20 years

MCA

1990

Matsushita Electric Industrial Co., Ltd.



1995

PolyGram

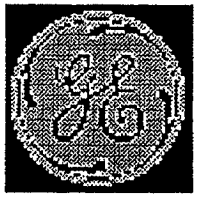
Acquires PolyGram in 1998

2000

VIVENDI UNIVERSAL

2004

vivendi



NBC UNIVERSAL

Vivendi retains UMG, 20% of NBC Universal

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Structure of UMG

UMG operates in over 70 countries, and our U.S. operations are primarily located in New York and Los Angeles.

Record Labels - UMG's diverse family of labels sign artists and produce / promote releases.

Distribution - Universal Music and Video Distribution (UMVD) handles distribution and sales for UMG's labels as well as 3rd party independent labels.

Music Publishing - Owns or administers more than 1 million copyrights, Universal Music Publishing Group (UMPG) is the third largest music publishing businesses in the world.

Corporate Functions - finance, IT, legal and HR, and eLabs.

Structure of UMG (cont'd)

The Labels:

- **Interscope/Geffen/A&M/Dreamworks**
  Notable Artists: Eminem, U2, Beck, No Doubt, Dr. Dre, 50 Cent, Black Eyed Peas

- **The Island Def Jam Music Group**
  Notable Artists: Jay Z, DMX, Kanye West, Shania Twain, Bon Jovi, Elvis Costello

- **Universal Motown**
  Notable Artists: Nelly, 3 Doors Down, Prince, Erykah Badu, Jack Johnson

- **The Verve Music Group**
  Notable Artists: John Coltrane, Shirley Horn, Jesse Harris, Nina Simone

- **MCA Nashville**
  Notable Artists: Reba McEntire, George Strait, Vince Gill, Lee Ann Womack

- **Universal Classics**
  Notable Artists: Andrea Bocelli, Esa-Pekka Salonen, Renée Fleming

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Role of record label

So what does a record label do?

A & R

- Find talent, fund recording, aid in the recording process

Legal

- Content clearances, protect artists' rights

Marketing

- Tour support, radio promotion, music videos, co-op at retail, product tie-ins

Distribution

- Fulfillment to physical retail and digital partners

New Business Opportunities

- Seek new ways to exploit content and grow the business

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What is eLabs?

eLabs is UMG's digital music strategy and biz dev group. eLabs is headquartered in LA with offices in NY and London.

- eLabs is responsible for negotiating deals with third parties and crafting business models to exploit audio and video assets through new digital platforms. Examples:
  - Download stores
  - Subscription services
  - Anti-piracy
  - Mobile
  - New formats (DualDisc, SACD, DVD-A)
  - Music videos (online & VOD)
  - Tech due diligence for deals
  - Tech standards
- eLabs also works with the RIAA on cross-industry technical issues, webcasting rates negotiations, and more.
- Additionally, eLabs supports our record labels' new media groups with groupwide vendor deals and strategic initiatives such as paid artist fan clubs.

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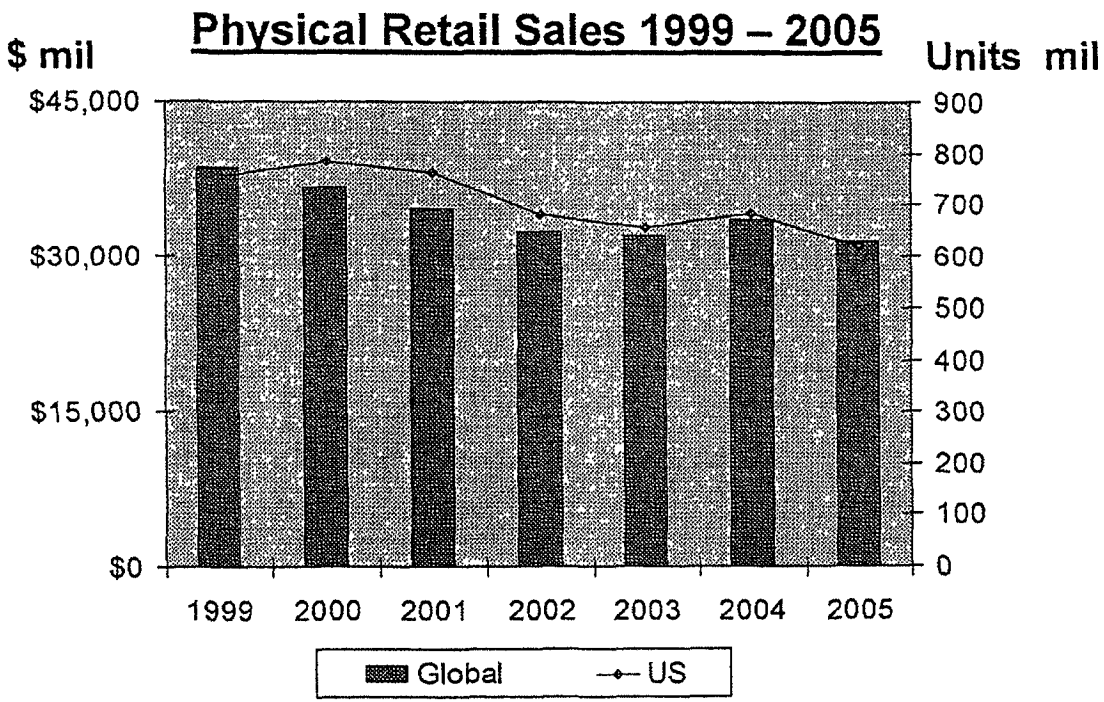
2005 Sales



- Globally, physical music retail sales were down 6.2% in 2005 from the prior year. Volume fell 7.9% & 5.1% in the US & UK, which together make up 46% of the value of the world market.
- Including digital sales, which more than doubled in 2005, total music retail sales declined 2.7% globally, and 2.8% & 2.7% in the US & UK.
- Germany & Japan, which had physical revenue declines of 1.3% & 3.7%, experienced growth in overall music sales due to significant increases in digital sales in both countries.

While physical revenue declined slightly, UMG's digital music sales grew nearly 175% from 2004 to 2005.

Source: IFPI and Soundscan

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Causes of the Huge Sales Decline

No single factor can be blamed, though piracy in all its forms is probably the single biggest component.

- Piracy on a mass scale became incredibly easy and of high quality
  - P2P (Napster, Kazaa, Limewire, etc.)
  - Physical CD burning (F2F piracy)
  - Commercial bootlegging
- A faltering economy
- Higher CD prices
- End of CD replacement cycle
- Retail outlets disappearing due to big box competition and lower sales
- Competition from other media (PS2 / X-box, gameboys, DVDs, etc.)

Pre-existing conditions

The new challenges of the last 5 years amplified existing problems within the industry.

- Talent / recording costs spiraling out of control
- Marketing costs following suit
  - Co-op
  - Radio promotion
  - Music videos
- Bloated overhead / cost structure
- Radio consolidation
- Quarter-to-quarter focus, "chasing hits"

The perfect storm required aggressive and decisive action.

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Aggressive and Decisive? Not so much.

Despite the best intentions of many in the industry, real progress was still several years away, for many good reasons.

- Surprise at scope and speed of the piracy problem
- Concerns over cannibalization of CD revenues
- "Channel conflict" - physical retailers concerned about digital competition
- Business model questions (CD burning, sales of singles, pricing, subscription?)
- Rights issues - Artists, music publishers, samples
- Technology issues

It really is harder than it looks to "offer consumers what they want". Perhaps a deal with the original Napster would have been a "magic bullet".

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The Demise of Napster and a Spark of Hope

In 2001, the industry was engaged in settlement discussions with Napster to transform it into a legitimate, sanctioned service.

- Plagued by some of the same issues highlighted previously, namely:
  - Artist issues
  - Music publishing rights (and share vs. labels)
  - Technology issues
  - Business model
- The discussions progressed towards a solution, until Napster hardened its position. A court shut down Napster later that year.
- Two years later, in April 2003, iTunes launched on the Mac and sold over 1m downloads in its first week.

iTunes proved that the right offer, supported by marketing, could succeed.

Beyond the hype - What's really going on today?

Successful labels are evolving from "record companies" into "music entertainment companies".

Sources of Revenue - 2001

- CD Sales
- Film & TV Licensing

Sources of Revenue – 2006+

- CD Sales
- Film & TV Licensing
- Audio Downloads
- Subscriptions
- Statutory radio and interactive radio
- Mobile
- Videos (VOD, downloads, broadcast)
- Ad-supported audio
- Artist partnerships
- Podcasting
- ??? TBD

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Selected Partners

Our list of digital partners continues to grow.

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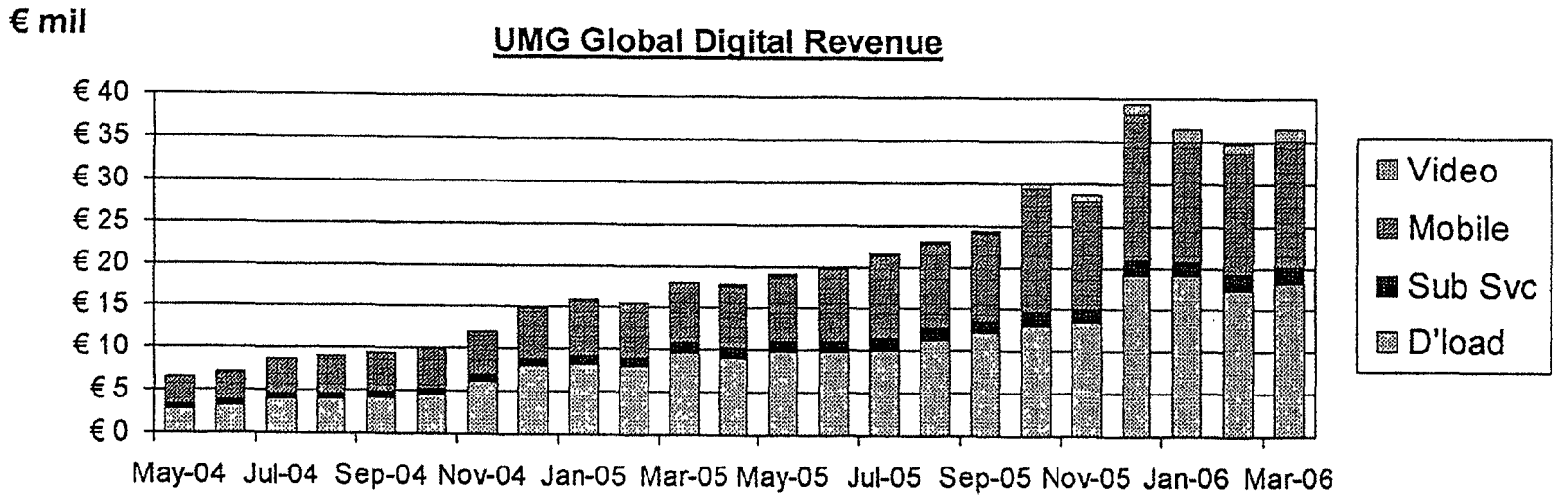
Some Key Stats on Digital Revenue and Growth



Growth trends are reversed between North America and Int'l.[1]

- Downloads and Subscriptions = +4% North America, +11% International
- Mobile = +9% North America, +4% International

OTA downloads and video are new and increasingly important sources of revenue.

- In the last 6 months, OTA downloads have increased from 1% of total downloads to over 9%, while video sales has grown to over 3% of digital revenue from less than 1%.

[1] Average monthly growth over last 12 months

Piracy Outlook

Although we continue to make tangible strides on technical, legislative, governmental, and legal fronts, piracy still looms as a major challenge to our business and industry as a whole.

- **Emerging Threats:**
  - Darknets, private networks, paid UseNet sites and other non-public sharing networks
  - Shift away from illegally downloading individual tracks towards downloading entire collections of music using Bittorrent
  - Unlicensed online music stores posing as legitimate sites and selling our content at cut-rate prices (e.g. – allofmp3.com, mp3sugar.com, and 3mp3.ru all hosted in Russia)
  - Mp3 blogs - Many contain dozens if not hundreds of albums available illegally
  - User posted content sites such as youtube.com and MySpace

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Piracy Outlook (2)

- **Emerging Threats Continued:**
  - The persistence of ripping and burning physical CDs
  - Portable Satellite Radio devices from XM and Sirius that allow users to record and build libraries of individual tracks.
  - Local Area Network sharing – MyTunes/OurTunes (hacks of iTunes), prevalent on campus
  - Unlicensed make your own ringtone applications are becoming easier to use

Consumer perception remains that "music is free" (improvement from "music should be free") and changing this attitude is very difficult.

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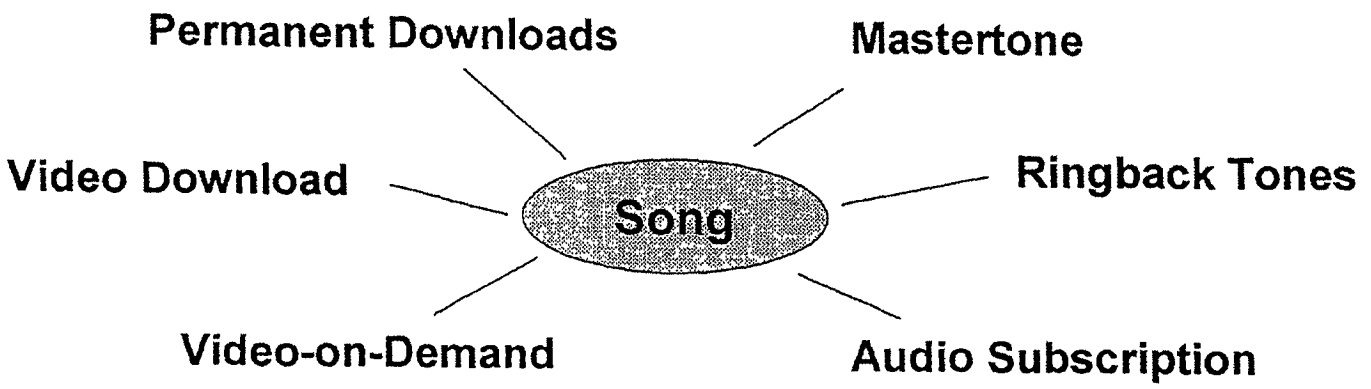
Evolution of Traditional Business Model

Labels have traditionally focused on selling album units but the digital market enables greater flexibility to create new products and services that generate revenue around singles.

- One hit song can generate millions in sales on an a la carte basis as downloads and mastertones. Additionally, UMG receives payment each time a song is played in various streaming and subscription services.



Strategies to Increase Digital Revenue

We expect continued strong organic growth in the digital music market in 2006 and to increase growth further by pursuing the following strategies:

- Enabling new business models, such as ad-supported music services

  Ad-supported services expected to launch in 2006:

  - Napster – Free-to-consumer tier of the company's for-pay subscription service
  - Zango – Low-fidelity subscription service
  - MusicLoads – Portable subscription audio and video service
- Clearing and digitizing more content
- Expanding the array of products for sale, such as EP's and audio-video bundles to "fill the gap" between the $0.99 single and a $9.99 album
- Creating premium albums with bonus audio and video content
- Direct to consumer sales for mobile personalization products

In Q1 2006, UMG digital revenue is 10% of overall sales!

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DISCUSSION