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INITIATION

19 June 2006
Global
Entertainment

Equity Research

OVERWEIGHT

Global Music Industry

"Just the Two of Us"

- **We initiate coverage on Warner Music Group with an Outperform rating and a target price $30. We also reiterate our Outperform rating on EMI, raising our target price from 300p to 310p. In this report, we analyze the strengths, weaknesses, and strategic positioning of all four music Majors: Sony (Sony BMG—joint venture), Vivendi (UMG or Universal—subsidiary) as well as publicly listed WMG and EMI Group. We also present our global music industry model, digital growth scenario, margin comparison analysis, and industry consolidation scenarios.**
- **The recorded music industry sales outlook is improving. After five years of decline, we believe that we are nearing the inflexion point, where sales growth may turn positive. Year to date, the world's two largest music markets, the United States and Japan, are experiencing positive growth.**
- **Industry margins are also picking up. In addition to the turnaround in sales growth, margins are improving, reflecting a concerted effort among all the Majors to cut costs and increase efficiency. In addition, we are seeing the benefit of higher digital margins.**
- **We envisage further upside from a possible EMI/WMG merger. We believe a deal is forthcoming given its compelling strategic logic and the fact that the synergies are so substantial and tangible.**

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Executive Summary

We initiate coverage on Warner Music Group with an Outperform rating and a target price $30. We also reiterate our Outperform rating on EMI, raising our target price from 300p to 310p. In this report, we analyze the strengths, weaknesses, and strategic positioning of all four music Majors: Sony (Sony BMG—joint venture), Vivendi (UMG or Universal—subsidiary) as well as publicly listed WMG and EMI Group. We also present our global music industry model, digital growth scenario, margin comparison analysis, and industry consolidation scenarios.

The recorded music industry sales outlook is improving. After five years of decline, in which the global recorded music market has contracted from over $37 billion in 2000 to around $33 billion in 2005, we believe that we are nearing the inflexion point where sales growth may turn positive. Year to date, the world's two largest music markets, the United States and Japan, are experiencing positive growth. Piracy is being addressed and contained, digital sales are exploding, and new, incremental revenue streams are emerging.

Industry margins are also picking up. In addition to the turnaround in sales growth, margins are improving. We have witnessed a concerted effort among all the Majors to cut costs and increase efficiency, helping to protect and augment margins almost irrespective of industry outlook. We are also seeing the benefit of higher digital margins come through. Over the past three years, industry margins have expanded from 7.4% to an estimated 14.8% in 2006. We believe the industry has a two-to-three year window to exploit these higher digital margins before artists' contracts are renewed and artists begin to demand a share in the upside.

We envisage further upside from a possible EMI/WMG merger. We believe a deal will eventually be struck given its compelling strategic logic and the fact that the synergies are so substantial and tangible—possibly almost as much as the EBITDA generated by WMG alone—that both companies would materially benefit. The only issue is who will be the acquirer and how will the capitalized value of available synergies be split. We have modeled the potential acquisition assuming EMI is the likely acquirer, at a purchase price of $30 (higher than the initial $28.50), with £125 million p.a. in cost savings (about 4% of the combined cost base) and financing of net debt/EBITDA of 3 times. In this conservative scenario, the deal would be 18% accretive to EMI's earnings. Greater upside surprise could follow from a higher level of cost savings and from the sale of the Warner Chappell publishing business for a higher valuation than the 12.5 times EBITDA (£1 billion/$1.8 billion) we have assumed. The synergies are so substantial that the deal would also be significantly accretive if WMG were to be the acquirer.

Valuation—On a 2006 calendar-year-adjusted basis, EMI and WMG are trading on EBITDA multiples of 10.5 times and 11.2 times, respectively.

Warner Music

We initiate coverage of Warner Music with an Outperform rating and a $30 share price target. WMG is a global recorded music company and music publisher. Its recorded music market share is approximately 12% and its music publishing market share is approximately 16%.

Our share price target is based on an analysis of merger economics with EMI as well as a discounted cash flow valuation. EMI has recently made a $28.50 takeover offer for WMG. A $30 takeover price, a 5% premium to the previous offer, would still be highly EPS accretive to EMI.

Key risks

- Takeover premium? Arguably the market has awarded a valuation premium to WMG for a potential merger or takeover by EMI. There is, therefore, a risk of share price downside were this not to occur.
- Warner Music is not in compliance with Sarbanes-Oxley. The company needs to implement appropriate internal controls to achieve this. Two of three material weaknesses have been addressed. The remaining weakness relates to accounting for royalty payments.
- It is unclear whether WMG has been overly aggressive in reducing its A&R investment, which may affect its future release schedule. Since acquisition from Time Warner, the company has reduced its artist roster by approximately 30%.
- Risks of the music industry. The music industry revenue model is in the process of evolving, with downside risks associated with piracy and uncertainties over the upside opportunities of the emerging digital platforms.

EMI Group plc EMI.L / EMI LN

OUTPERFORM*

Price (15 Jun 06)	273 (p)
52 week high - low	294.00 - 207.00
Target price (12 months)	(from 300.00) 310.00 (p)
Analyst's Coverage Universe	Media
Weighting (vs. broad market)	OVERWEIGHT

*** Stock ratings are relative to the relevant country index.***

Year	3/06A	3/07E	3/08E
EPS (CS adj., p)	15.7	17.1	19.4
P/E (x)	17.4	15.9	14.1
P/E rel. (%)	130.0	129.7	121.2
Revenue (£ m)	2,079.9	2,115.5	2,151.7
EBITDA (£ m)	275.8	303.6	328.8
IC (£ m)	—	—	—
OCFPS (£)	—	—	—
ROIC	—	—	—
P/OCF (x)	—	—	—
EV/EBITDA (x)	11.5	10.3	9.3

Number of shares (m)	790.07	Enterprise value (£m)	2,969.15
Net debt (3/06A, £ m)	879.5	Dividend (3/06A, £)	8.00
Net debt/Total cap. (3/06A)	48.4%	Dividend yield	2.93%

Historical valuation

Year	3/05A	3/06A	3/07E
Y/E closing price (p)	2.36	2.53	272.75
Market cap. (£ m)	2,061.99	2,154.93	2,154.93
End year net debt (£ m)	837.3	879.5	814.2
Enterprise value (£ m)	2,992.23	3,034.43	2,969.15

Key historical ratios

EV/EBITDA (x)	11.0	10.9	9.7
EV/IC (x)	—	—	—
P/E at closing price (x)	15.0	14.8	14.1

Strategic analysis

Existing strengths: Music industry turnaround; strong management; good cost control; high exposure to music publishing.

Existing weaknesses: Music sales still volatile; continued threat of piracy; artists' royalty demands; relatively low U.S. exposure.

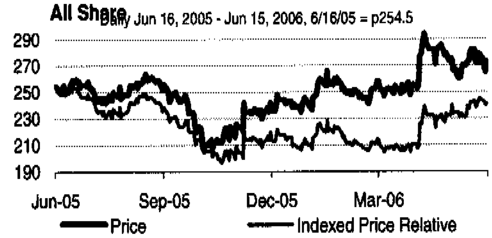
Existing opportunities: Industry consolidation; controlling piracy; higher digital margins; mobile phone music opportunities; lower cost of debt.

Existing threats: Possible cannibalization effect of digital music, power of physical and digital retailers.

Company description

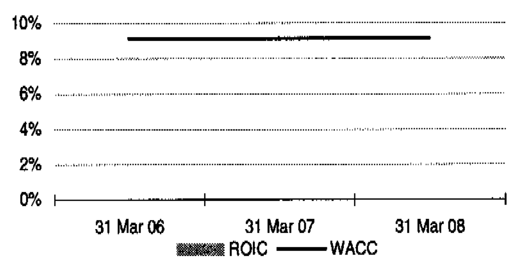
EMI is a leading global music company, with a 13% global market share in recorded music and the largest music publishing catalogue worldwide.

Price / Indexed Index - United Kingdom FTSE All Share

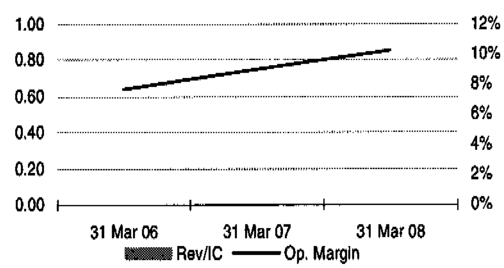


Year	3/06A	3/07E	3/08E
Q1 EPS			
Q2			
Q3			
Q4			

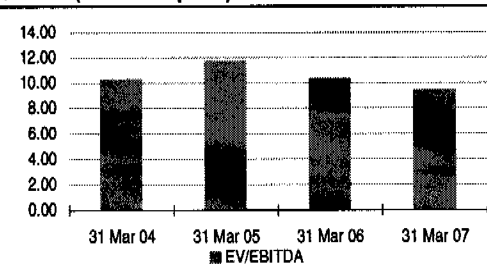
ROIC / WACC



REV / IC Op. Margin



EV/EBITDA (at historical prices)



Source: Company data, Credit Suisse estimates
On 06/15/06 the Index - United Kingdom FTSE All Share index closed at 2,860.89

Sony 6758 / 6758 JP

OUTPERFORM*

Price (15 Jun 06)	4720.00 (¥)
52 week high - low	6,150.00 - 3,670.00
Target price (12 months)	7500.00 - 64.00 (¥)
Analyst's Coverage Universe	Technology Hardware & Equipment
Weighting (vs. broad market)	MARKET WEIGHT

Stock ratings are relative to the relevant country index.

Year	3/06A	3/07E	3/08E
EPS (CS adj., ¥)	46.59	203.64	344.73
P/E (x)	101.3	23.2	13.7
P/E rel. (%)	484.7	129.2	83.1
Revenue (¥ m)	7,475.4	7,951.0	8,916.8
EBITDA (¥ m)	573.1	614.0	841.9
IC (¥ m)	7,353,500.0	—	7,924,616.2
OCFPS (¥)	535.26	587.21	805.08
ROIC	0.3%	1.1%	2.2%
P/OCF (x)	10.2	8.0	5.9
EV/EBITDA (x)	8.2	7.5	5.4

Number of shares (m)	1,001.90	Enterprise value (¥m)	4,625,008.51
Net debt (3/06A, ¥ m)	-101.7	Dividend (3/06A, ¥)	25.00
Net debt/Total cap. (3/06A)	-3.2%	Dividend yield	0.5%

Historical valuation

Year	3/05A	3/06A	3/07E
Y/E closing price (¥)	4,270.00	5,450.00	4,720.00
Market cap. (¥ m)	4,456,919.25	5,692,446.77	4,728,953.84
End year net debt (¥ m)	-307,692.0	-101.7	-103,945.3
Enterprise value (¥ m)	4,421,261.84	4,728,852.14	4,625,008.51

Key historical ratios

EV/EBITDA (x)	9.1	8.2	7.5
EV/IC (x)	0.7	0.6	—
P/E at closing price (x)	27.0	117.0	23.2

Strategic analysis

Existing strengths: Strong market shares in key product lines such as LCD televisions and PCs.

Existing weaknesses: Audio business is weak.

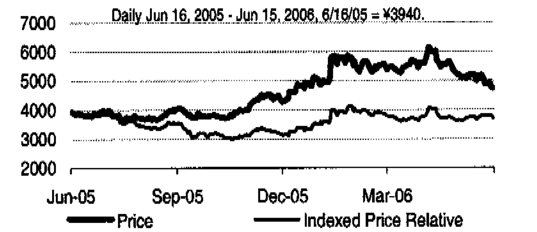
Existing opportunities: Margin recovery in electronics business.

Existing threats: Price erosion in key product lines.

Company description

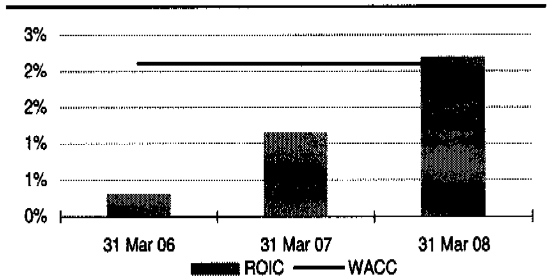
Sony is a prominent consumer electronics manufacturer, and top game equipment manufacturer. Sony is Japan's most famous brand.

Price / Indexed Japan TOPIX

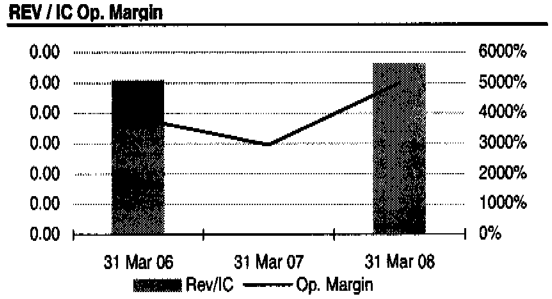


Year	3/06A	3/07E	3/08E
Q1 EPS	-8.68		
Q2	-43.13		
Q3	161.58		
Q4	-66.48		

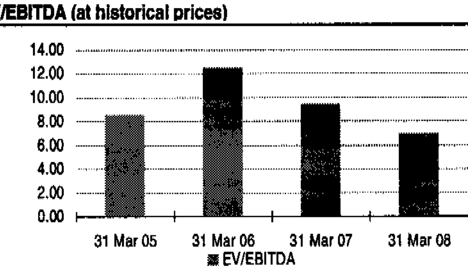
ROIC / WACC



REV / IC Op. Margin



EV/EBITDA (at historical prices)



Source: Company data, Credit Suisse estimates
On 06/15/06 the Japan TOPIX index closed at 1,466.14

Vivendi VIV.PA

NEUTRAL*

Price (15 Jun 06)	26.80 (eu)
52 week high - low	29.28 - 24.65
Target price (12 months)	24.00 (eu)
Analyst's Coverage Universe	Media
Weighting (vs. broad market)	OVERWEIGHT

Stock ratings are relative to the coverage universe in each analyst's or each team's respective sector.

Year	12/05A	12/06E	12/07E
EPS (CS adj., eu)	1.36		
P/E (x)	19.8	—	—
P/E rel. (%)	135.0	130.2	129.3
Revenue (eu m)	19,484.0	20,259.8	20,980.1
EBITDA (eu m)	5,331.0	5,860.5	6,163.8
IC (eu m)	—	—	—
OCFPS (eu)	—	—	—
ROIC	—	—	—
P/OCF (x)	—	—	—
EV/EBITDA (x)	5.1	4.6	4.2

Number of shares (m)	1,153.48	Enterprise value (eum)	26,968.67
Net debt (12/05A, eu m)	3,859.0	Dividend (12/05A, eu)	1.00
Net debt/Total cap. (12/05A)	20.6%	Dividend yield	3.7%

Valuation

Year	12/04A	12/05A	12/06E
Y/E closing price (eu)	23.49	26.46	26.80
Market cap. (eu m)	26,906.53	30,521.00	30,913.18
End year net debt (eu m)	3,135.0	3,859.0	3,869.4
Enterprise value (eu m)	67,779.44	26,958.22	26,968.67

Key ratios

EV/EBITDA (x)	13.7	5.1	4.6
EV/IC (x)	—	—	—
P/E at closing price (x)	30.9	19.5	—

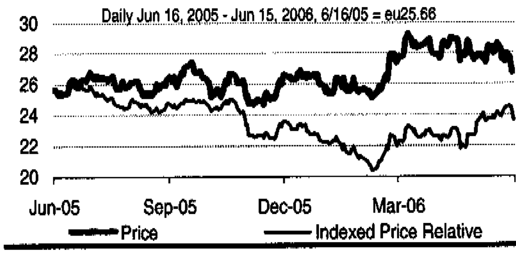
Strategic analysis

Existing strengths: Strong divisional management.
Existing weaknesses: Holding company structure.
Existing opportunities: Portfolio rationalization.
Existing threats: Regulatory environment.

Company description

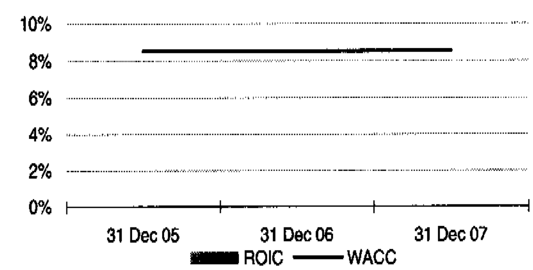
Vivendi is a Media and Telecom conglomerate with French distribution (mobile, pay-TV) and global content (music, movies, games).

Price / Indexed Europe Dow Jones Stoxx

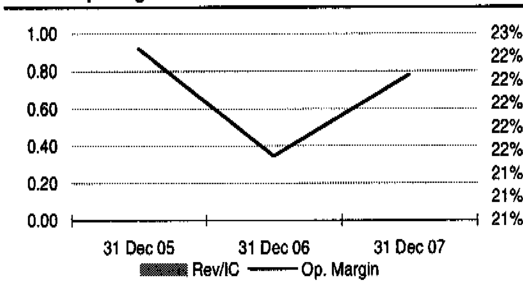


Year	12/05A	12/06E	12/07E
Q1 EPS			
Q2			
Q3			
Q4			

ROIC / WACC



REV / IC Op. Margin



Source: Company data, Credit Suisse estimates
On 06/15/06 the Europe Dow Jones Stoxx index closed at 328.31

Warner Music Group WMG

OUTPERFORM*

Price (15 Jun 06)	26.71 (US$)
52 week high - low	29.40 - 14.75
Target price (12 months)	30.00 (US$)
Analyst's Coverage Universe	Entertainment
Weighting (vs. broad market)	OVERWEIGHT

Stock ratings are relative to the coverage universe in each analyst's or each team's respective sector.

Year	9/05A	9/06E	9/07E
EPS (CS adj., US$)	1.23	1.34	1.51
P/E (x)	21.7	20.0	17.7
P/E rel. (%)	103.1	—	—
Revenue (US$ m)	3,502.0	3,532.3	3,632.8
EBITDA (US$ m)	466.0	497.3	541.0
IC (US$ m)	—	—	—
OCFPS (US$)	2.23	1.75	3.57
ROIC	—	—	—
P/OCF (x)	8.3	14.5	7.1
EV/EBITDA (x)	12.2	11.6	10.3

Number of shares (m)	141.90	Enterprise value (US$m)	6032
Net debt (9/05A, US$ m)	1,958.0	Dividend (Current, US$)	0.13
Net debt/Total cap. (9/05A)	2200.0%	Dividend yield	0.5%

Valuation

Year	9/04A	9/05A	9/06E
Y/E closing price (US$)	—	18.51	26.71
Market cap. (US$ m)	—	—	4,026.2
End year net debt (US$ m)	—	1,958.0	2,005.8
Enterprise value (US$ m)	—	5,984	6,032

Key ratios

EV/EBITDA (x)	—	9.5	11.6
EV/IC (x)	—	—	—
P/E at closing price (x)	—	15.1	20.0

Strategic analysis

Existing strengths: Strong artist roster, management depth, aggressive in transitioning to digital

Existing weaknesses: Weaknesses in financial reporting; highly geared balance sheet.

Existing opportunities: Economic rationale for a merger with EMI is strong.

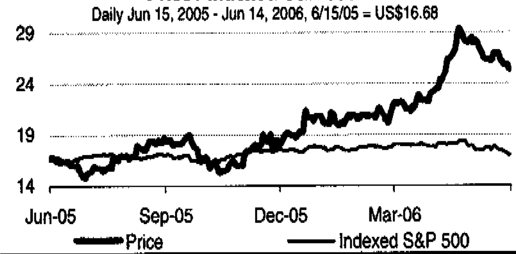
Existing threats: Not in compliance with Sarbanes Oxley.

Company description

Warner Music is a global recorded music company and music publisher.

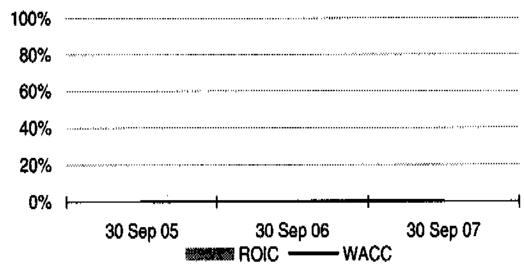
Price / Indexed S&P 500

Daily Jun 15, 2005 - Jun 14, 2006, 6/15/05 = US$16.68

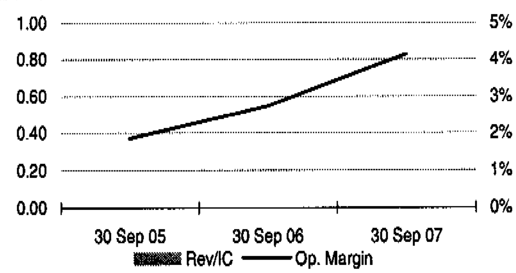


Year	9/05A	9/06E	9/07E
Q1 EPS	0.68	0.71	
Q2	0.34	0.21	
Q3	-0.05	0.08	
Q4	0.29	0.33	

ROIC / WACC



REV / IC Op. Margin



Source: Company data, Credit Suisse estimates
On 06/14/06 the S&P 500 index closed at 1,256.16

Music Industry SWOT Analysis

Strengths

- Digital platforms (downloads, mobile and subscription) are experiencing strong growth in demand, providing the opportunity for the music industry to offset the declines in physical sales, which have pressured revenues over the past five years. In addition, there is the potential to lift operating margins due to the absence of costs associated with physical manufacturing and distribution and the lower costs associated with increasing digital catalog sales.
- Music companies' reliance on any single artist is relatively low given the diversification in revenue source by number of artists and geography, and the split between frontline and catalog sales and music publishing.
- The capital expenditure requirements of music companies are low relative to other entertainment companies.
- The music industry's cost structure is relatively flexible, and it has been successful in achieving a major cost restructuring over the past four years. We expect industry-wide margins in 2006 to exceed those achieved in 2000 despite the considerable downward pressure on revenue that the industry has endured in the intervening period.
- The long-term nature of artists' contracts should limit talent cost inflation, at least in the short to medium term, and make the music industry less susceptible to significant margin pressure than other creative industries.

Weaknesses

- Physical sales are under continued downward pressure and the potential to more than offset with digital growth is not yet proven. However recent trends in key markets (United States and Japan) suggest a deceleration in the rate of physical decline.
- As with all creative industries, company profitability is highly dependent on successful releases, which are inherently difficult to predict and which result in significant quarter-to-quarter earnings volatility.
- The concentration of physical sales through major retailers and digital sales through Apple potentially shifts negotiating leverage from the music companies to distributors.

Opportunities

- The growth in digital platforms is expected to be substantial with increasing broadband penetration in developed markets. Music-enabled mobile phones are achieving significant growth in penetration in both developed and developing markets.
- Following significant industry restructuring, there is potential for noticeable margin expansion across the group. Further margin opportunity is available with the move to digital which should have a higher operating margin. From an industry-average EBITDA margin low of 7.4% in 2003, we expect margins to double in 2006.
- Further industry consolidation is possible with a Warner-EMI combination, bringing with it further cost reduction opportunities. In addition, we believe the scale benefits of

a more concentrated music industry potentially brings with it greater negotiating leverage in relation to physical and digital music retailers.

- Traditionally the music industry has maintained a separation of artists between its recorded music and music publishing businesses. The emergence of digital revenues and desire to clear rights expeditiously for digital platforms provides the opportunity for a greater alignment between the two business arms.

Threats

- Piracy remains a considerable threat to industry growth with increasing broadband penetration, notwithstanding recent progress in achieving favorable legal decisions. In particular, the core young demographic purchasing music has been considerably eroded by the ability to achieve free access to music through unlawful means.
- The digital opportunity arguably provides greater upside for already successful acts, bringing with it the risk of competition between music companies for talent. Upward pressure on operating costs brings with it the risk that the benefits arising from industry-wide restructuring and digital distribution could be eroded.
- The continued growth in share of mass-market retailers, such as Wal-Mart and the concentration of digital sales through Apple brings with it the risk of pricing erosion.
- The ability of consumers to "unbundle" music purchases brings with it a threat of continued downward pressure on industry sales as $15 album purchases are potentially replaced with two or three tracks for $2-3.
- As portable hard drives become increasingly prolific, so does the ease with which unprotected music collections can be rapidly and cheaply copied by the consumer.

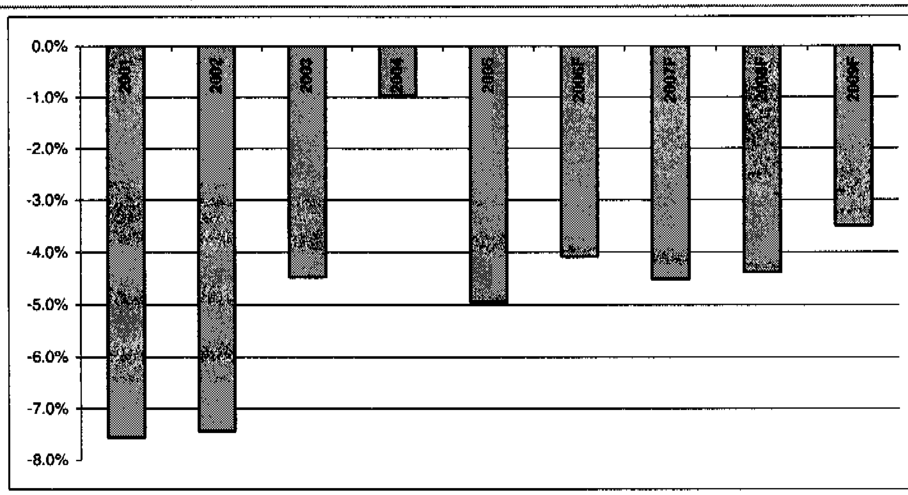
Global Physical Recorded Music Market

There have been many theories forwarded to explain the pressures the music industry has been experiencing over the course of the current decade. We examine some of the issues below, and discuss their current status in influencing the global physical music market.

1. Piracy

The decline in global music sales highlighted in Exhibit 1 below has unquestionably in our view been driven by the growth of the Internet and the ease of peer-to-peer file sharing.

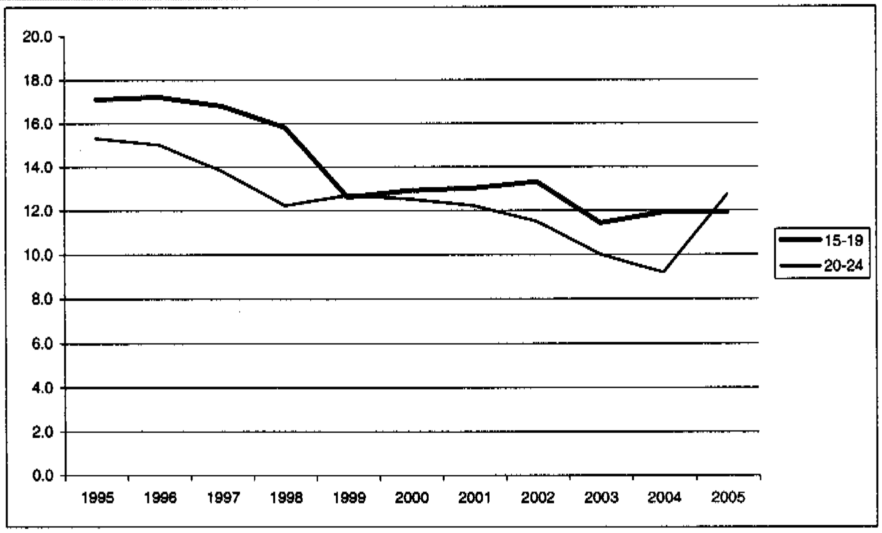
Exhibit 1: **Global Physical Music Sales (Units % Change)**



Source: IFPI

As highlighted in Exhibit 2 below, this trend has been particularly pronounced in younger demographics, which have historically been the largest purchasers of music. In the U.S. recorded music market, the 15-24 year old demographic had a combined share of purchase of close to one-third in 1995. This fell to a little over 20% in 2004, reflecting, in our view, the impact of new technologies in permitting file sharing.

Exhibit 2: **Music Purchase by Key Younger Demographics – Improving after a decade of decline**



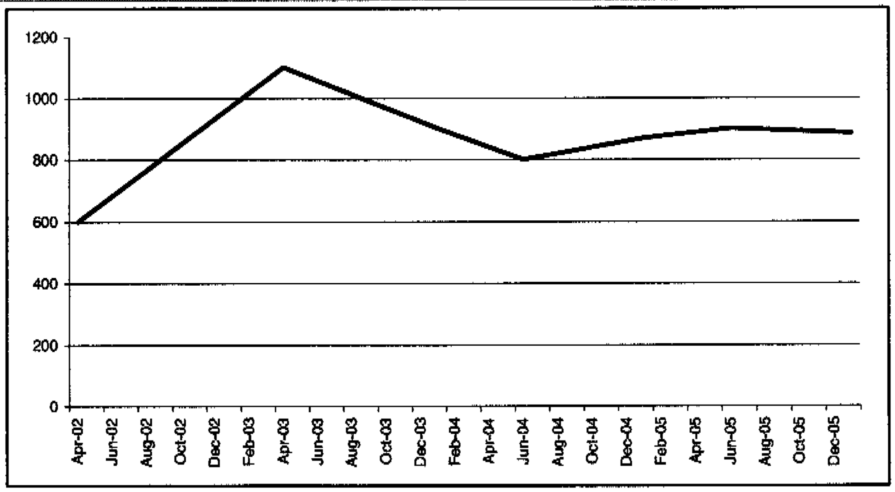
Source: RIAA.

Current status:

The most recent demographic sales data suggests that the growth in paid online music services is beginning to combat piracy among younger demographics. IFPI estimates a total of 335 service providers compared with 50 two years ago. In this past year alone, we have seen the first legal peer-to-peer agreement signed, iTunes expand to over 20 countries, the launch of portable subscription services, such as Napster To Go and Yahoo Music Unlimited, and the introduction of a la carte music video services. Consumers are now able to access up to 2m tracks and 165,000 albums in a legitimate digital environment. During 2005 there was a significant improvement in music purchase in the 20-24 demographic and a stabilization in the 15-19 demographic, reversing the negative trends of the past 10 years.

The campaign mounted by the music industry to combat piracy through peer-to-peer file sharing may be starting to have an effect. Over the past 18 months there have been notable legal victories against illegal peer to peer sites Grokster (U.S.), KaZaa (Australia), Kuro (Taiwan) and Soribada (South Korea), which have improved the landscape for legitimate music sales. The decisions have clarified the potential liability of unauthorized P2P network operators. While the scale of the piracy problem makes it impossible to decide with any certainty that the battle has been won, the response of the industry in terms of prosecutions, the ongoing educational program and the growth in legitimate alternatives has seen the rate of growth in illegitimate file sharing slow dramatically. IFPI data show the number of infringing music files on the Internet falling from 1.1 billion in April 2003 to 885 million in January 2006 as highlighted in Exhibit 3.

Exhibit 3: Infringing Music Files on the Internet

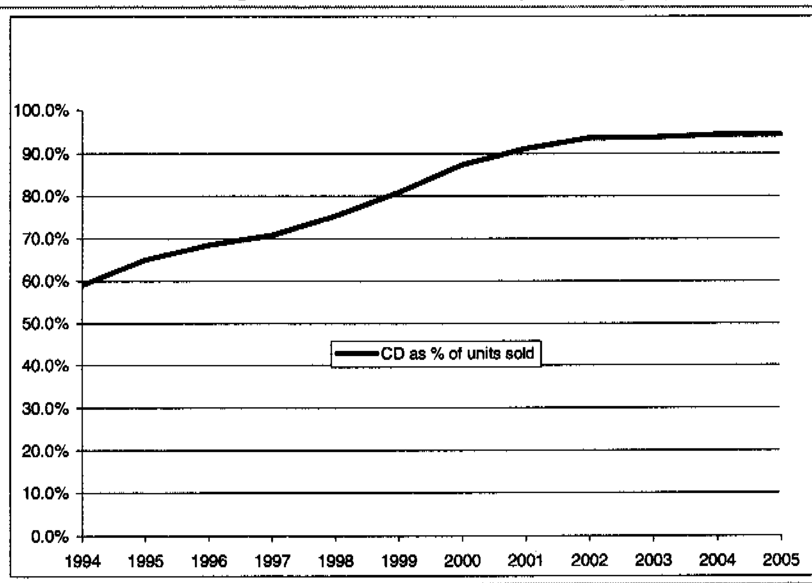


Source: IFPI.

2. End of CD replacement cycle

The impact of the CD replacement cycle, which began in 1986, clearly supported industry growth in the 1990s, with the maturity of that cycle contributing to the pressures the industry has been confronting since 2000. This trend is illustrated in Exhibit 4.

Exhibit 4: U.S. CDs Increasing as % of Total Unit Sales (excluding Digital)



Source: RIAA.

Current status

The takeup of digital does not bring with it a potential library replacement effect, as CDs did with vinyl and cassette tapes. Consequently, we see no change in the status of this issue.

3. Music Industry Rationalization

The industry crisis generated by piracy motivated a significant cost rationalization focus across music companies. We believe that an undetermined amount of the impact on global music sales results from the cost rationalization being undertaken by the industry. Some of this cost rationalization includes reductions in A&R (artists and repertoire) as the artist roster is narrowed to focus on more profitable artists. The Sony BMG joint venture was created in August 2004, and we believe a reduction in its artist repertoire has affected overall industry sales—it has certainly contributed towards the reduction in Sony BMG's market share in 2004 and 2005. Despite an estimated—3% fall in worldwide music sales in 2005, Warner, Universal (Vivendi), and EMI all reported revenue increases. Only Sony BMG has reported declining revenue, suggesting a direct link between its cost cutting measures and the broader impact on the market. The culture and management integration issues arising from the merger are also likely to be having an impact.

While rationalization appears to have negatively affected industry revenues and growth rates, there has been significant compensation in terms of profitability as margins across the industry are generally rising.

Current status

We believe that Sony BMG is coming to the end of the cost rationalization process. The negative impact on overall industry revenue growth should therefore reduce during 2006.

4. General Media Fragmentation

As highlighted in Exhibit 2, younger demographics have seen the greatest reduction in music purchase. While piracy is likely a primary explanation, we believe a secondary issue is the impact of general media fragmentation on consumers' available time and resources.

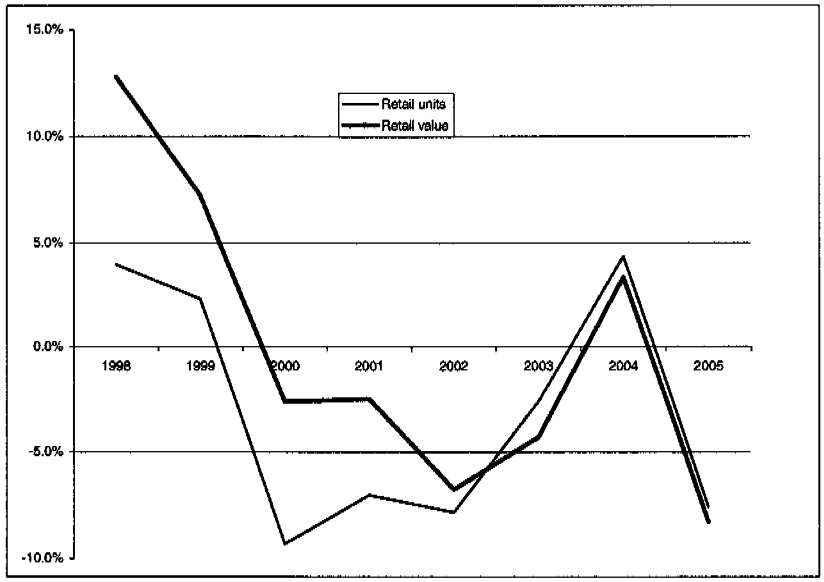
Current status

As with all other media, fragmentation is an ongoing fact of life, and therefore, is likely to continue to affect music volumes.

5. Pricing Pressure

The issue of pricing pressure is difficult to examine in a global context given the influence on the data of US dollar currency fluctuations. We have looked therefore solely at the U.S. market to determine the extent to which music pricing is being affected by greater bargaining power on the part of retailers. As highlighted in Exhibit 2, there has been a noticeable turnaround in the past three years. We believe this has been driven by a change in retail channels from record stores to general retailers, such as Wal-Mart, etc. This appears to have had the effect of driving down pricing between late 2002 to the current time where retail value has risen less than retail units in 2004 and declined more than retail units in 2005. We believe there are opposing views in the music industry about the extent of pricing pressure; some music companies are firmly of the view that lowering price does not stimulate consumer demand and are of the view that music retailers cannot afford not to stock hit product, thereby limiting their pricing leverage. Others, like Universal, have been prepared to lower price in an effort to stimulate demand.

Exhibit 5: **U.S. Music Industry—Retail Units versus Retail Value**



Source: RIAA.

Current status

The Majors have taken different approaches to pricing. Universal's view is that its price cutting strategy has generated incremental volumes, while Warner's view is that consumers have a dollar amount available for spend, irrespective of pricing. We believe that pricing pressure remains a risk due to the concentration of physical and digital sales channels through a limited number of retailers.

6. Inventory Management

Given the pressures the music industry has been experiencing, we believe music companies have focused on more careful inventory management in order to reduce the level of industry returns. We believe this has likely affected overall sales levels.

Current status

We expect ongoing measures by the music industry to contain cost given the pressures at the top line. Consequently, to the extent that this is having an effect on sales levels, we expect it to be ongoing.

7. Hit Cycle

An unquantifiable aspect of the volume pressure the music industry is experiencing is the degree to which the appeal of hit artists has reduced over time. To the extent that this is an issue, it likely reflects the general fragmentation of the media environment and the greater choice in artists through new outlets such as the Internet.

Global Digital Music Market

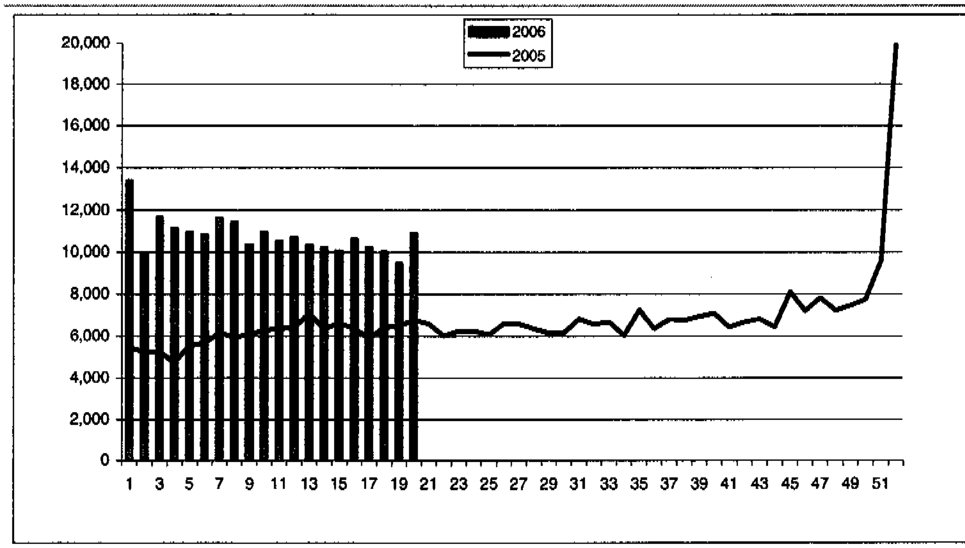
The key issue for the longer-term growth of the music market is whether the shift to legal digital downloads can restore the industry to growth, or merely represents a shift in format. We are of the view that the strong growth in digital has the potential to offset digital declines, but that the purchase is more replacement rather than incremental in nature. Historically, the industry has experienced periods of strong growth, coinciding with format changes—from vinyl to cassettes and from cassettes to CDs. The "new" format of hard disk clearly does not generate the same replacement cycle, particularly as digital sales facilitate the unbundling of albums into individual tracks. Consequently, we see the growth of digital largely at the expense of physical sales, rather than having the potential to grow the overall market. Our detailed forecasts for the digital market are outlined in Exhibit 13.

Components of digital sales

The digital music market expanded in 2005 to approximately 5% of music industry sales compared with 1.8% in 2004. We believe that the breakup of digital revenues globally in 2005 was approximately 51% online (downloads and subscriptions) and 49% mobile.

As highlighted in Figure 7 below, there are significant differences in the geographic penetration of digital downloads and mobile. The U.S. market is by far the largest digital market, and is larger in digital downloads, as the first market to launch iTunes, while mobile services and subscriptions are relatively smaller. U.S. digital downloads (single and album equivalents) grew 160% in 2005, representing in excess of 65% of global digital downloads. (The United States. represents approximately 36% of global physical sales.) Monthly trends in U.S. downloads are outlined in Exhibit 6, with the market experiencing a strong seasonal year-end surge in 2005.

Exhibit 6: **U.S. Weekly Digital Sales—2006 versus 2005**



Source: Nielsen Soundscan.

Conversely, to date, Japan has been overwhelmingly a mobile market. Japan leads the world market with 2.5G and 3G penetration estimated at over 70% of the mobile universe. In addition, iTunes reached the market relatively late (August 2005). This has resulted in an overwhelmingly mobile-dominated market, as highlighted in Figure 7. We estimate that the Japanese market accounts for approximately 43% of global mobile sales compared with 15% of physical sales.

Figure 7: **Break Down of the Top Ten Digital Markets in 2005**

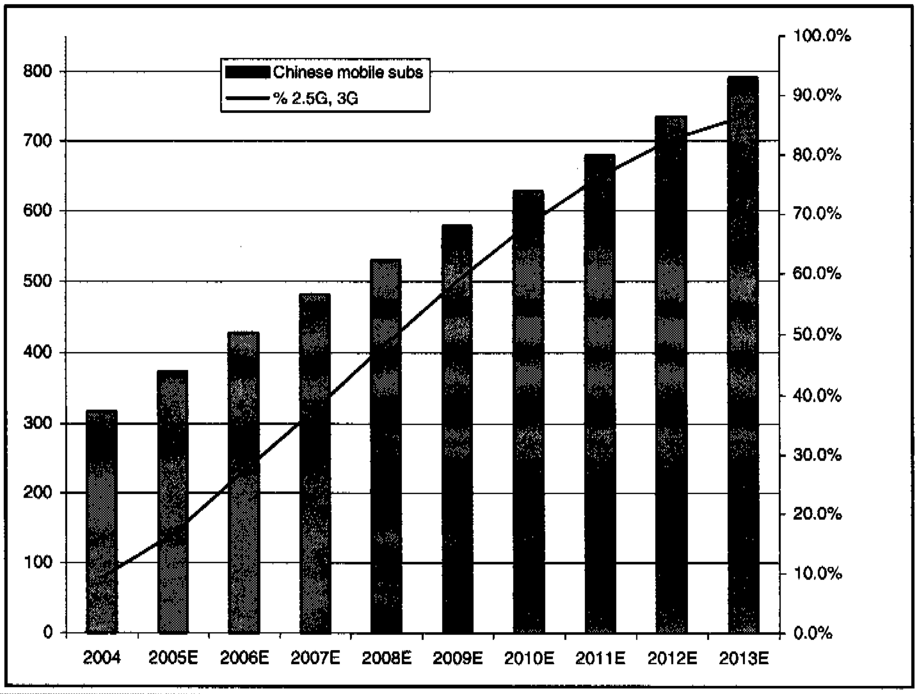
trade revenues in millions

	Total Digital Market			Digital Sales by Channel	
	US$	**Local currency**	**Local currency**	**Online**	**Mobile**
USA	636	USD	636	68%	32%
Japan	278	JPY	30587	9%	91%
UK	69	GBP	38	62%	38%
Germany	39	EUR	31	66%	34%
France	28	EUR	22	47%	53%
Italy	16	EUR	13	31%	69%
Canada	15	CAD	18	71%	29%
South Korea	12	LWR	12045	42%	58%
Australia	7	AUD	10	41%	59%
Netherlands	5	EUR	4	82%	18%

Note: online includes subscriptions.
Source: IFPI.

China is a potentially significant market for digital music in the future. The piracy issues as they relate to physical sales are well known, and broadband penetration is limited, restricting the opportunity for digital downloads. However, mobile penetration is growing rapidly, driving digital music sales that are estimated to well exceed the physical market in value.

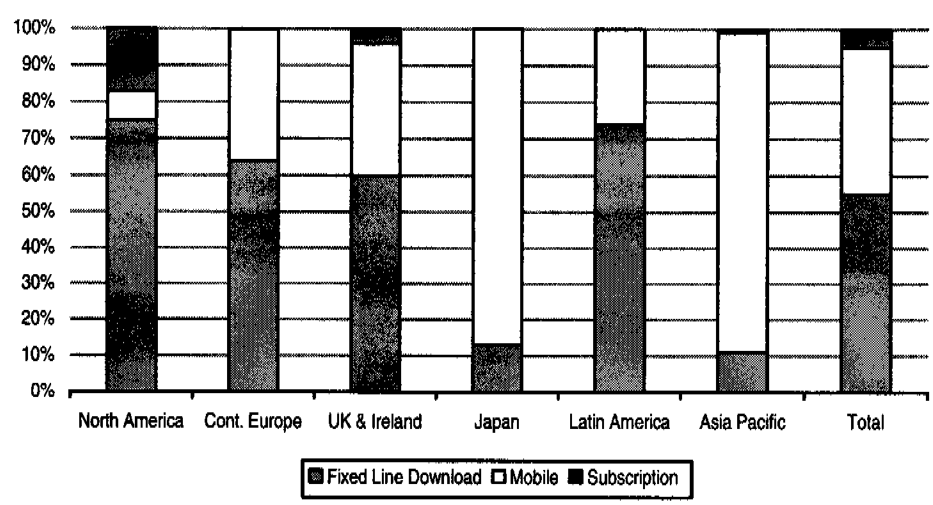
Exhibit 8: **Chinese Mobile Phone Market**



Source: Credit Suisse estimates,

Figure 9 illustrates EMI's digital revenue split by type and by region, which, in our view, is broadly representative for all the Majors. Master ringtones accounted for most (87%) of mobile revenues; though the highest growth was experienced in full-track downloads to mobile.

Figure 9: **EMI's Split of Digital Sales**



Source: Company data, Credit Suisse estimates.

Our estimates assume continued strong growth in digital downloads in 2006, but some maturing in its largest market (the United States).

Digital economics

We expect the growth in digital revenues to be substantial, expanding from an estimated 5% of industry revenues in 2005 to 24% by 2009. Importantly, we expect this revenue stream to generate higher margins than physical sales despite the fact that music companies achieve lower wholesale margins on digital than on physical sales.

Exhibit 10: **Margin on Wholesale Revenues**

	Physical	Digital
Wholesale revenue	100%	100%
Royalties/Publishing	-30%	-38%
Manufacturing	-20%	0%
Marketing/A&R	-25%	-25%
Fixed costs	-13%	-13%
Margin	**12%**	**24%**

Source: Company data, Credit Suisse estimates.

Exhibit 11: **Margin on Retail Revenues**

	Physical	Digital
Retail revenue	100%	100%
Wholesale share	63%	56%
Royalties/Publishing	-19%	-21%
Manufacturing	-13%	0%
Marketing/A&R	-16%	-14%
Fixed costs	-8%	-7%
Margin	**8%**	**13%**

Source: Company data, Credit Suisse estimates.

The growth in digital sales as a percentage of total should therefore have the effect of lifting the overall margins recorded by the industry. As highlighted in Exhibit 12, digital revenues are becoming a meaningful proportion of group revenues.

Exhibit 12: **Digital Revenues as % of Total**

	6 mos to March 06	March 06 Qtr
WMG	8.6%	11.3%
EMI	5.8%	7.2%
Universal	5.3%	9.9%

Source: Company data, Credit Suisse estimates. Note Sony digital sales not available.

EMI management has a target of reaching around 25% of sales by 2010. It also suggests the beneficial impact of digital sales could improve group margins from 12% to a return to the mid-teens levels not experienced since the 1990s CD replacement cycle. EMI management does acknowledge however that, in the short term, any margin improvement could be dampened by fixed digital infrastructure costs, and that in the medium term the artists would demand (and be paid) a commensurate share of this margin upside. With regard to the latter, we believe there is a two-to-three-year window of opportunity for the industry to exploit these higher digital margins before the contracts of major artists are renewed and they start to demand their share of this margin upside.

Issues

Unbundling

The issue of unbundling is important in determining the extent to which digital revenues can grow the overall music market. There are two schools of thought—one, that consumers will purchase two or three tracks of an album for $2-3 as opposed to a $10-$15 expenditure on an album, effectively reducing the overall music industry take. The other school of thought holds that a fixed level of expenditure is likely spread more widely across single purchases, but that the overall spend is not affected. A further argument to allow consumers to experience the benefits of unbundling is that the modest costs involved for buying individual songs reduces the appeal of piracy.

Pricing power

An issue of concern in the digital world is our view that the majors tend to be price takers rather than price setters, particularly given the rising power of Apple and iTunes and of powerful discount retailers like Wal-Mart. The majors vehemently argue the opposite; they believe the balance of power will not shift to retailers. They say the majors are consolidating from five to four (and maybe eventually down to three), whereas the retailers are fragmenting in the online world, given the multitude of different ways of buying music electronically. Given the view of some of the majors that differential pricing on individual downloads should be permitted, the outcome of the debate may highlight where pricing power actually resides.

Credit Suisse Global Digital Music Model

Our estimates for the global digital music market are outlined in Exhibit 13. Our estimates assume that the download market growth in the U.S. will moderate, given its current elevated base, but that similar trends will be experienced in other markets as iTunes and other providers launch services. In Japan, however, we expect the trend to be the reverse as the market shifts more towards a download model. The United States by contrast is expected to see stronger mobile than download growth given the current rollout of new services.

Exhibit 13: Credit Suisse Global Digital Music Market Forecasts

YE Dec	2004	2005	2006F	2007F	2008F	2009F
Downloads (M)						
US - single track	143	353	564	734	880	1,012
US - albums as tracks	55	162	259	337	404	465
Japan	1	9	36	72	108	146
UK	6	26	66	132	198	267
Rest of Europe	8	36	90	180	270	365
Rest of World	4	68	340	510	765	1,033
World	**216**	**654**	**1,356**	**1,965**	**2,626**	**3,288**
On-line Subscribers (M)						
US	1.0	1.5	1.9	2.3	2.6	2.8
Rest of World	0.5	1.3	2.6	3.9	5.1	6.1
Mobile units (M)						
US	183	170	306	459	597	716
Japan	149	258	464	697	906	1087
REVENUES (US$m)						
Downloads						
US - single track	141	349	559	726	872	1,002
US - albums	54	160	257	334	400	460
Japan	1	43	47	94	140	190
UK	8	74	86	172	257	347
Rest of Europe	30	90	117	234	351	474
Rest of World	20	60	442	663	995	1,343
Total downloads	**254**	**777**	**1,507**	**2,222**	**3,015**	**3,816**
Subscription						
US	46	149	158	176	202	222
Rest of World	25	77	156	234	304	365
Total Subscription	**71**	**226**	**314**	**410**	**506**	**587**
Mobile						
US	150	422	760	1,139	1,481	1,777
Japan	170	436	785	1,177	1,530	1,836
UK	10	45	99	168	252	303
Rest of Europe	39	75	165	281	421	505
Rest of World	15	45	180	360	648	972
Total Mobile	**384**	**1,023**	**1,988**	**3,125**	**4,333**	**5,394**
Total Digital Retail Revenues	**709**	**2,026**	**3,809**	**5,757**	**7,854**	**9,797**
Total Digital Wholesale Revenues	397	1,143	2,141	3,221	4,385	5,471
% total						
Downloads	35.8%	38.3%	39.6%	38.6%	38.4%	39.0%
Subscription	10.0%	11.2%	8.2%	7.1%	6.4%	6.0%
Mobile	54.1%	50.5%	52.2%	54.3%	55.2%	55.1%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
% change						
MP3 players		*440.0%*	*51.9%*	*34.1%*	*18.2%*	*15.0%*
Downloads						
US - single track	*392%*	*147.3%*	*60%*	*30%*	*20%*	*15%*
US - album downloads		*195.6%*	*60%*	*30%*	*20%*	*15%*
Japan		*800.0%*	*300%*	*100%*	*50%*	*35%*
UK		*355.2%*	*150%*	*100%*	*50%*	*35%*
Continental Europe		*350.0%*	*150%*	*100%*	*50%*	*35%*
Rest of World		*1600.0%*	*400%*	*50%*	*50%*	*35%*
Total Downloads		*205.4%*	*94.0%*	*47.5%*	*35.7%*	*26.6%*
Subscription						
US		*50.0%*	*25.0%*	*20.0%*	*15.0%*	*10.0%*
Rest of World		*160.0%*	*100.0%*	*50.0%*	*30.0%*	*20.0%*
Total Subscription		*218.3%*	*38.7%*	*30.6%*	*23.6%*	*16.0%*
Mobile						
US		*181.3%*	*80.0%*	*50.0%*	*30.0%*	*20.0%*
Japan		*156.5%*	*80.0%*	*50.0%*	*30.0%*	*20.0%*
UK		*350.0%*	*120.0%*	*70.0%*	*50.0%*	*20.0%*
Continental Europe		*92.3%*	*120.0%*	*70.0%*	*50.0%*	*20.0%*
Rest of World		*200.0%*	*300.0%*	*100.0%*	*80.0%*	*50.0%*
Total Mobile		*166.4%*	*94.4%*	*57.2%*	*38.6%*	*24.5%*
Total Digital		*185.6%*	*88.0%*	*51.1%*	*36.4%*	*24.7%*

Source: IFPI, Company data, Credit Suisse estimates.

Credit Suisse Global Music Industry Forecast

Figure 14 breaks down the total recorded music sales in 2005 by market, with Figure 15 analyzing sales by format. In 2005 overall recorded music sales fell by 3%, driven by sales of physical formats down 6.7% in value and 8.0% in units. Digital sales grew 188% in the year, with trade revenues from digital sales growing from $400 million to $1.1 billion.

The 5 largest digital markets by revenues were the United States (9% of sales), Japan (7%), UK (3%), Germany (3%), and France (2%). Interestingly, countries with a higher percentage of digital sales were the strongest market for music sales overall.

Figure 14: **Total Music Sales by Market In 2005**
physical and digital, values in millions

		Trade Revenues 2005					Retail Value 2005	
		US$	Local currency		% Change	% Digital	US$	Local currency
1	USA	7,012	USD	7,012	-3%	9%	12,269	12,269
2	Japan	3,718	JPY	409,845	1%	7%	5,448	600,497
3	UK	2,612	GBP	1,189	-3%	3%	3,446	1,895
4	Germany	1,457	EUR	1,166	0%	3%	2,211	1,769
5	France	1,248	EUR	999	-2%	2%	1,990	1,592
6	Canada	544	CAD	659	-3%	3%	732	886
7	Australia	440	AUD	576	-10%	2%	674	883
8	Italy	428	EUR	343	0%	4%	669	535
9	Spain	369	EUR	295	-5%	1%	555	444
10	Brazil	265	BRL	645	-12%	1%	394	958
11	Mexico	263	MSP	2,863	10%	<1%	412	4,487
12	Netherlands	246	EUR	197	-14%	2%	431	345
13	Switzerland	206	CHF	257	-3%	1%	267	334
14	Russia	194	RUB	5,477	-37%	-	388	10,961
15	Belgium	162	EUR	129	-7%	2%	262	209
16	South Africa	159	CAR	1,010	10%	<1%	254	1,618
17	Sweden	148	SEK	1,107	-9%	2%	240	1,795
18	Austria	139	EUR	111	-5%	3%	285	228
19	Norway	133	NOK	857	-12%	1%	253	1,627
20	Denmark	113	DKK	679	-2%	1%	180	1,080
	Other	1,387			-8%	6%	2,096	
	Total	**20,795**			**-3%**	**5%**	**33,456**	

Source: IFPI.

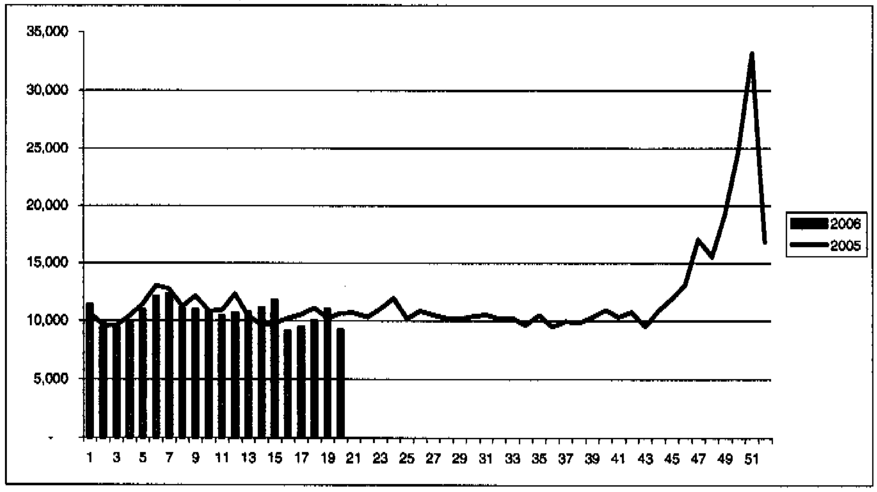
Figure 15: **Trade Revenues by Format**
USD in millions

	2004	2005	Growth
CD	18,109	17,019	-6%
DVD	1,610	1,540	-4%
Digital sales	397	1,143	188%
Singles	821	721	-12%
Other physical*	531	372	-30%
	21,468	20,795	

** Cassettes, LPs, VHS, and other.*
Source: IFPI.

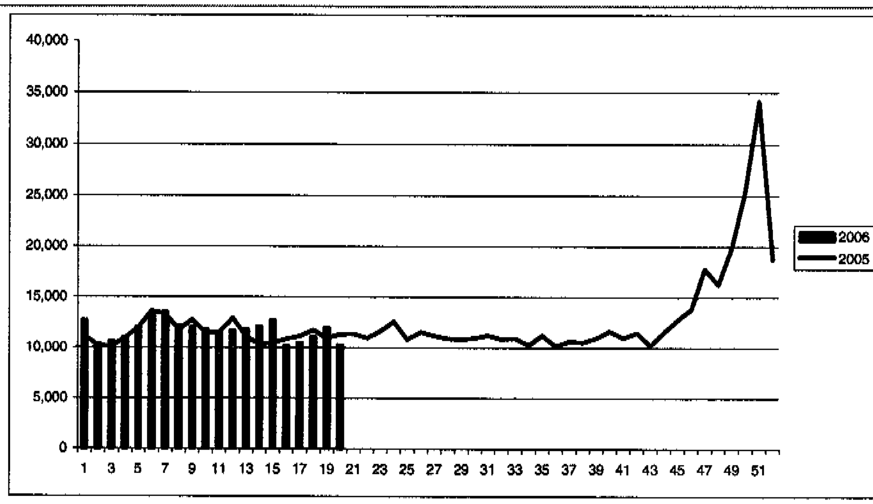
There are some encouraging signs in 2006 year to date, as the rate of decline in physical is slowing. In the United States, physical sales are down 2.3% year to date, while physical and digital sales combined are up 2%.

Exhibit 16: **U.S. Weekly Physical Sales**



Source: Soundscan

Exhibit 17: **U.S. Weekly Physical and Digital Equivalent Sales**



Source: Soundscan

In Japan, physical sales are up year to date despite a continued surge in digital sales. Given the hit driven nature of the music business, we are cautious in extrapolating these trends for the full year. However, our forecasts for 2006 assume a moderation in the rate of decline of physical sales and continued (though moderating) growth in digital. This underpins our estimate for modest overall industry growth in 2006 following the declines of 2005. Looking forward to 2007 and beyond, we have assumed the decline in physical sales moderates in the minus 3-4% range. Combined with digital growth, we expect overall industry revenues to grow in the 2% range.

Exhibit 18: Credit Suisse Global Music Forecast

YE Dec	2001	2002	2003	2004	2005	2006F	2007F	2008F	2009F
Physical Units Shipped (M)									
US	954	855	790	810	748	722	697	672	649
Japan	305	275	260	256	251	251	241	231	223
UK	251	248	189	194	189	179	171	164	159
Germany	226	215	184	181	179	170	162	156	150
France	149	153	139	127	136	129	123	119	114
Australia	58	57	51	48	37	35	33	32	31
Canada	65	61	59	60	61	58	55	53	51
Italy	46	50	43	38	35	33	31	30	29
Spain	79	65	46	38	33	32	30	29	28
Netherlands	34	32	31	30	25	24	23	22	21
Top 10 countries	2,166	2,011	1,791	1,781	1,693	1,632	1,568	1,508	1,455
Rest of World	981	902	992	975	926	879	840	798	770
World	**3147**	**2,913**	**2,783**	**2,756**	**2,619**	**2,512**	**2,407**	**2,306**	**2,225**
Retail Sales (USDm)									
US	13,739	12,609	11,848	12,153	11,188	10,797	10,419	10,054	9,702
Japan	5,689	5,001	4,910	5,168	4,969	4,969	4,770	4,579	4,419
UK	2,876	2,936	3,216	3,509	3,327	3,161	3,018	2,898	2,796
Germany	2,149	2,053	2,022	2,149	2,144	2,037	1,945	1,867	1,802
France	1,892	2,070	2,115	1,979	1,942	1,845	1,762	1,691	1,632
Australia	538	532	674	717	662	629	601	577	556
Canada	687	621	676	694	706	671	641	615	593
Italy	531	565	645	653	641	609	582	559	539
Spain	620	551	596	573	555	527	504	483	466
Netherlands	446	440	499	508	422	401	383	368	355
Top 10 countries	29,167	27,379	27,199	28,102	26,557	25,645	24,624	23,691	22,862
Rest of World	5,325	4,849	4,813	5,512	4,873	4,678	4,514	4,334	4,225
Total Physical Sales	34,492	32,228	32,012	33,614	31,430	30,324	29,139	28,025	27,088
Digital Sales	NA	NA	NA	709	2,026	3,809	5,757	7,854	9,797
Global Sales	**34,492**	**32,228**	**32,012**	**34,323**	**33,456**	**34,132**	**34,896**	**35,879**	**36,884**
Digital as % of total				2.1%	6.1%	11.2%	16.5%	21.9%	26.6%
Wholesale Sales (USDm)									
Physical	21,730	20,304	20,168	21,071	19,652	19,104	18,357	17,656	17,065
Digital	NA	NA	NA	397	1,143	2,141	3,221	4,385	5,471
Total Industry	**21,730**	**20,304**	**20,168**	**21,468**	**20,795**	**21,245**	**21,578**	**22,041**	**22,536**
Digital as % of total				1.8%	5.5%	10.1%	14.9%	19.9%	24.3%
% change									
Physical Units Shipped (M)									
US	-7.8%	-10.4%	-7.7%	2.6%	-7.6%	-3.5%	-3.5%	-3.5%	-3.5%
Japan	-8.2%	-9.9%	-5.3%	-1.8%	-1.8%	0.0%	-4.0%	-4.0%	-3.5%
UK	5.1%	-0.9%	-24.1%	3.0%	-2.7%	-5.0%	-4.5%	-4.0%	-3.5%
Germany	-7.8%	-4.7%	-14.5%	-1.4%	-1.4%	-5.0%	-4.5%	-4.0%	-3.5%
France	10.6%	3.0%	-9.1%	-9.1%	7.5%	-5.0%	-4.5%	-4.0%	-3.5%
Australia	14.5%	-2.9%	-10.4%	-6.1%	-22.9%	-5.0%	-4.5%	-4.0%	-3.5%
Canada	-6.2%	-5.3%	-4.2%	2.7%	0.7%	-5.0%	-4.5%	-4.0%	-3.5%
Italy	-8.4%	8.1%	-14.6%	-11.5%	-8.4%	-5.0%	-4.5%	-4.0%	-3.5%
Spain	2.1%	-17.6%	-29.2%	-17.1%	-13.4%	-5.0%	-4.5%	-4.0%	-3.5%
Netherlands	-6.1%	-6.7%	-1.9%	-4.2%	-15.0%	-5.0%	-4.5%	-4.0%	-3.5%
Top 10 countries	-4.5%	-7.2%	-10.9%	-0.5%	-4.9%	-3.6%	-4.0%	-3.8%	-3.5%
Rest of World	-13.7%	-8.0%	9.9%	-1.7%	-5.0%	-5.0%	-4.5%	-5.0%	-3.5%
World	**-7.6%**	**-7.4%**	**-4.5%**	**-1.0%**	**-5.0%**	**-4.1%**	**-4.2%**	**-4.2%**	**-3.5%**
Retail Sales									
US	-2.2%	-8.2%	-6.0%	2.6%	-7.9%	-3.5%	-3.5%	-3.5%	-3.5%
Japan	-13.0%	-12.1%	-1.8%	5.3%	-3.8%	0.0%	-4.0%	-4.0%	-3.5%
UK	1.7%	2.1%	9.5%	9.1%	-5.2%	-5.0%	-4.5%	-4.0%	-3.5%
Germany	-11.0%	-4.5%	-1.5%	6.3%	-0.2%	-5.0%	-4.5%	-4.0%	-3.5%
France	10.2%	9.4%	2.2%	-6.4%	-1.9%	-5.0%	-4.5%	-4.0%	-3.5%
Australia	-4.1%	-1.1%	26.6%	6.4%	-7.6%	-5.0%	-4.5%	-4.0%	-3.5%
Canada	-9.8%	-9.6%	8.8%	2.6%	1.8%	-5.0%	-4.5%	-4.0%	-3.5%
Italy	-10.2%	6.3%	14.1%	1.2%	-1.7%	-5.0%	-4.5%	-4.0%	-3.5%
Spain	-0.8%	-11.2%	8.1%	-3.8%	-3.1%	-5.0%	-4.5%	-4.0%	-3.5%
Netherlands	-1.9%	-1.3%	13.3%	1.8%	-16.8%	-5.0%	-4.5%	-4.0%	-3.5%
Top 10 countries	-4.5%	-6.1%	-0.7%	3.3%	-5.5%	-3.4%	-4.0%	-3.8%	-3.5%
Rest of World	-16.9%	-8.9%	-0.7%	14.5%	-11.6%	-4.0%	-3.5%	-4.0%	-2.5%
Total Physical Sales	-6.6%	-6.6%	-0.7%	5.0%	-6.5%	-3.5%	-3.9%	-3.8%	-3.3%
Digital Sales	NM	NM	NM	NM	185.6%	88.0%	51.1%	36.4%	24.7%
Global Sales	**-6.6%**	**-6.6%**	**-0.7%**	**7.2%**	**-2.5%**	**2.0%**	**2.2%**	**2.8%**	**2.8%**
Wholesale Sales									
Physical	-6.6%	-6.6%	-0.7%	4.5%	-6.7%	-2.8%	-3.9%	-3.8%	-3.3%
Digital	NM	NM	NM	NM	188.0%	87.3%	50.4%	36.1%	24.8%
Total Industry	**-6.6%**	**-6.6%**	**-0.7%**	**6.4%**	**-3.1%**	**2.2%**	**1.6%**	**2.1%**	**2.2%**

Source: IFPI, RIAA, RIAJ, Company data, Credit Suisse estimates.

Music Publishing

We are positive on the prospects for music publishing. In general we anticipate stronger growth coming from:

- *More efficient collection of royalties.* The collection agencies, many of which have enjoyed a de facto monopolistic position in their particular territories, are improving their operational effectiveness and efficiency, largely precipitated by anti-trust pressures. Likewise, the music publishers themselves are investing in IT systems to improve collection efficiency. The publishers' increased representation on society boards is facilitating this.
- *More rigorous collection of royalties.* Music publishers are becoming more rigorous in auditing licenses and in legally enforcing the collection of royalties, particularly in lesser-developed countries from a copyright perspective where Intellectual Property protection laws are steadily improving.
- *Quicker collection of royalties.* With greater efficiency comes quicker collection, faster distribution from the collection agencies and improved working capital management.
- *More revenue streams.* Publishers are taking advantage of new products and formats (e.g., DVDs, dual discs, enhanced content discs, video on demand), technologies and media channels, and also new territories such as in South East Asia (including China), where synchronization is especially strong, and in Central and Eastern Europe.

One negative trend to highlight is the adverse margin mix effect as the older, more favorable deals negotiated by the music publishers get replaced by newer, shorter deals with economics relatively more in favor of the artist.

In respect of the growth by subdivision of music publishing, we anticipate the following:

- *Mechanical* (derived from the sale of recorded music). These royalties are naturally dependent on physical sales and digital downloads, which taken together we believe are seeing a slowdown in the rate of decline and an imminent move into positive territory. Growth should be helped by new income tracking initiatives.
- *Performance* (revenues derived when a song is performed live on stage, played in a bar or other public venue, or broadcast on the radio or TV)—growth will be driven by chart success on songs, radio; by TV digital fragmentation, and commercialization (which increases the number of radio channels, which, in turn, increases the royalties receivable); by rate negotiations with cable and radio (e.g., negotiating a share in the new evolving satellite radio subscription models in the United States); and by the growth in general from ring tones and ring tunes.
- *Synchronization* (revenue generated by the use of songs in audiovisual works e.g., adverts, TV, radio, films, games, and mobile phones)—growth should be accentuated by better and more proactive marketing to advertisers, TV producers, computer games manufacturers, film makers, together with the development of Internet-enabled music catalogues to facilitate the process of buying rights and lowering its costs.
- *Other.* Higher print music sales as music tuition and instruments become more affordable, slightly offset by a move toward online purchases of single-track sheet music.

An illustration of the split of royalties by subdivision and of the growth generated in 2005-06 by royalty type for EMI is set out in Figure 19:

Figure 19: **EMI Music Publishing—Analysis of Revenue**
at constant currency, £ in millions

	FY 04/05	%	FY 05/06	%	Change
Mechanical	179.7	44.8%	185.4	45.1%	3.2%
Performance	108.0	27.0%	111.7	27.2%	3.4%
Synchronization	67.2	16.8%	70.8	17.2%	5.4%
Other	45.8	11.4%	43.2	10.5%	-5.7%
Total	400.7	100%	411.1	100%	2.6%

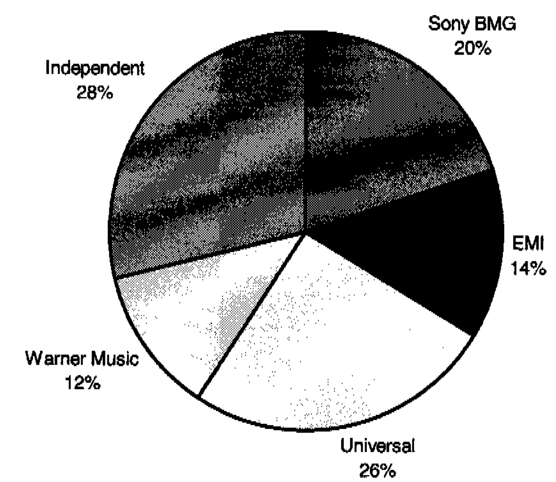
Source: EMI Group.

Market Share trends

Recorded Music

Following the formation of the Sony and BMG joint venture, the global music industry has become highly rationalized. The industry's two largest players are Universal and Sony BMG, with Warner and EMI achieving considerably smaller shares. Speculation has long abounded about a merger between EMI and Warner to create an equal-size player to Sony BMG and Universal.

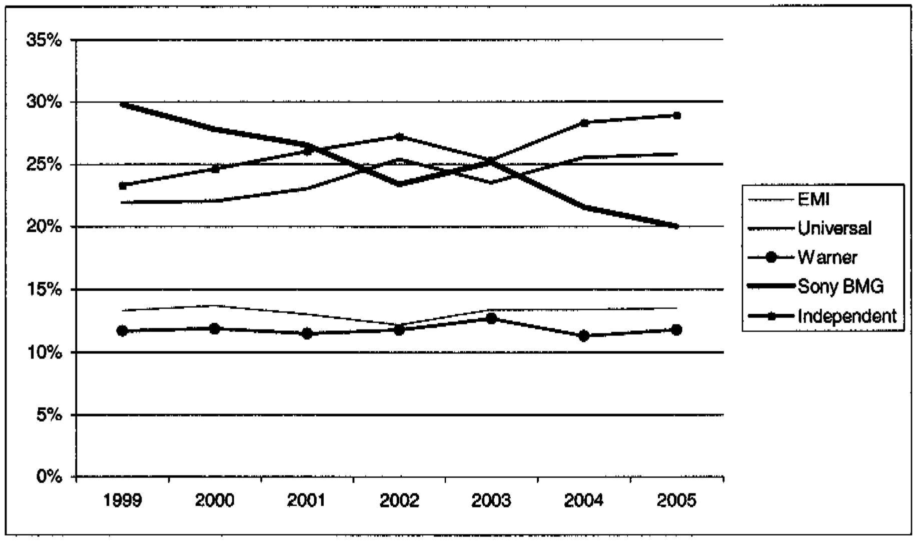
Exhibit 20: **Music Industry Market Shares**



Source: IFPI, Credit Suisse estimates

While the market shares of Warner and EMI have remained relatively constant, the combined Sony BMG (which were separate until August 2004) has recorded the most significant decline over the past five years, with Universal and Independents the major beneficiaries. Sony BMG's market share is likely falling due to issues associated with its restructuring program, and cutbacks in A&R spending, as well as from the integration of the two businesses.

Exhibit 21: **Music Industry Market Share Trends**

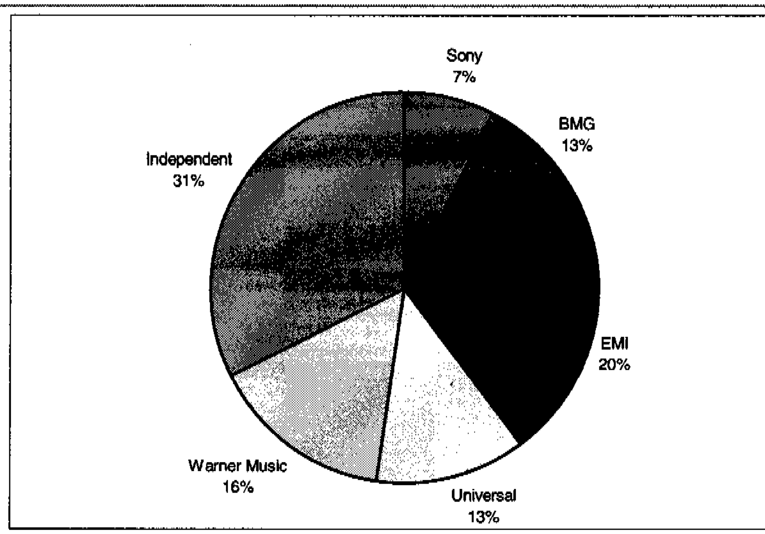


Source: IFPI, Credit Suisse estimates

Music Publishing

Market shares for the music publishing business differ markedly from the recorded music business. The industry is considerably more fragmented, reflecting a greater share of independents as well as separate music publishing businesses of Sony and BMG. EMI and Warner Music have the largest shares of the Majors, despite having smaller shares of recorded music.

Exhibit 22: **Music Publishing Market Shares**



Source: Company data.

Due to the size of the combined EMI and Warner music publishing businesses, our view is that any merger of the recorded music businesses would require divestment of a substantial part or all of one of the music publishing businesses.

Music Industry Margin Potential

While revenue trends for the industry potentially still remain challenging, the industry-wide cost restructuring has already yielded margin opportunities in the sector, with potentially more to come. As highlighted in Exhibit 23, the industry has already undertaken, or committed to very substantial cost reductions, which we expect to underpin earnings growth in the short term.

Exhibit 23: **Music Industry Annual Cost Reductions Achieved to date**

US$ in millions

Sony BMG	300
EMI	270
Universal Music	468
Warner Music	250
Industry	**1288**

Source: Company data, Credit Suisse estimates.

As evidence of the industry's concerted attack on costs, EMI has just announced a third restructuring plan, following on from its £100 million savings plan announced in 2002 and £50 million program in 2005. The latest initiative, affecting all regions (particularly Japan) and both divisions, targets £10 million of (achieved) savings in 2006-07, with the full £30 million run-rate achieved by end 2007-08. EMI stated that the £60 million cash cost of achieving these savings would be more than offset by proceeds from property disposals.

Currently the industry is experiencing very wide margin disparity (as highlighted in Exhibit 24) with Universal's industry-leading EBITDA margin of 15.5% contrasting with Sony BMG's 11.8%. We believe this is partially due to the timing of companywide restructuring being undertaken by the companies. We expect the benefits of cost restructuring to provide the most meaningful short-term support to industry margin growth. Other issues we see relevant to the longer-term margin opportunity for the industry are discussed below.

Exhibit 24: Global Music Company Margins
US$ in millions, unless otherwise stated

	YE	2003	2004	2005	2006F	2007F	2008F	2009F
Revenue (US$M)								
Bertelsmann	Dec	3,067	3,166	NA	NA	NA	NA	NA
Sony	Mar	3,826	3,897	2,317	NA	NA	NA	NA
Sony BMG	Mar	NA	NA	3,258	4,283	4,262	4,262	4304
EMI	Mar	3,361	3,581	3,693	3,712	3,774	3,840	3,930
Universal Music	Dec	5,625	6,201	6,080	6,141	6,264	6,389	6,517
Warner Music	Nov/Sept	3,376	3,437	3,502	3,532	3,633	3,740	3850
Group Total		19,255	20,283	18,850	17,668	17,933	18,231	18,600
Revenue Growth								
Bertelsmann		19.8%	3.2%	NA	NA	NA	NA	NA
Sony		-25.6%	1.9%	NA	NA	NA	NA	NA
Sony BMG		NA	NA	NA	NA	-0.5%	0.0%	1.0%
EMI		-4.1%	6.6%	3.1%	0.5%	1.7%	1.7%	2.3%
Universal Music		-5.0%	10.2%	-2.0%	1.0%	2.0%	2.0%	2.0%
Warner Music		2.6%	1.8%	1.9%	0.9%	2.9%	2.9%	2.9%
Group Total		-5.7%	5.3%	-7.1%	-6.3%	1.5%	1.7%	2.0%
EBITDA (US$M)								
Bertelsmann		295	288	NA	NA	NA	NA	NA
Sony		-68	90	170	NA	NA	NA	NA
Sony BMG		NA	NA	384	556	589	589	609
EMI		459	480	459	493	543	587	612
Universal Music		495	950	944	1,075	1,127	1,150	1,173
Warner Music		236	373	466	497	541	592	641
Group Total		1,418	2,181	2,424	2,620	2,800	2,918	3,035
EBITDA Growth								
Sony BMG		NA	NA	NA	NA	5.9%	0.0%	3.4%
EMI		32.3%	4.6%	-4.3%	7.2%	10.1%	8.2%	4.3%
Universal Music		-45.3%	91.7%	-0.6%	13.8%	4.9%	2.0%	2.0%
Warner Music		16.8%	58.1%	24.9%	6.7%	8.9%	9.4%	8.3%
Group Total		-29.6%	53.8%	11.1%	8.1%	6.9%	4.2%	4.0%
EBITDA Margin								
Bertelsmann		9.6%	9.1%	NA	NA	NA	NA	NA
Sony		-1.8%	2.3%	7.3%	NA	NA	NA	NA
Sony BMG		NA	NA	11.8%	13.0%	13.8%	13.8%	14.1%
EMI		13.7%	13.4%	12.4%	13.3%	14.4%	15.3%	15.6%
Universal Music		8.8%	15.3%	15.5%	17.5%	18.0%	18.0%	18.0%
Warner Music		7.0%	10.9%	13.3%	14.1%	14.9%	15.8%	16.6%
Group Total		7.4%	10.8%	12.9%	14.8%	15.6%	16.0%	16.3%

Source: Company data, Credit Suisse estimates. EBITDA is before restructuring charges. Sony BMG in March 2005 is for seven months only.

Recorded Music and Music Publishing

The margin disparity above is also attributable to the mix of Recorded music and music publishing businesses which operate with substantial margin differentials as highlighted in Figure 25. Music publishing averages a 23% margin compared with 12.6% for recorded music.

Figure 25: **Recorded Music versus Music Publishing Margins**
In USD millions, unless otherwise stated

USDm	YE	2003	2004	2005	2006F	2007F	2008F	2009F
RECORDED MUSIC								
Revenue								
EMI	March	2,741	2,910	2,954	2,962	3,007	3,052	3,114
Sony BMG	March	NA	NA	3,258	4,283	4,262	4,262	4,304
Universal Music	December	5,256	5,786	5,646	5,711	5,825	5,942	6,061
Warner Music	September	2,839	2,859	2,924	2,997	3,075	3,160	3,251
Total		10,836	11,555	14,783	15,954	16,169	16,415	16,730
EBITDA								
EMI		287	296	268	294	339	380	396
Sony BMG		NA	NA	384	556	589	589	609
Universal Music		403	846	836	967	1018	1038	1059
Warner Music		135	245	355	390	429	473	517
Total		825	1386	1842	2208	2375	2480	2581
EBITDA Margin								
EMI		10.5%	10.2%	9.1%	9.9%	11.3%	12.5%	12.7%
Sony BMG		NA	NA	11.8%	13.0%	13.8%	13.8%	14.1%
Universal Music		7.7%	14.6%	14.8%	16.9%	17.5%	17.5%	17.5%
Warner Music		4.7%	8.6%	12.1%	13.0%	13.9%	15.0%	15.9%
Total		7.6%	12.0%	12.5%	13.8%	14.7%	15.1%	15.4%
MUSIC PUBLISHING								
Revenue								
EMI		620	672	738	749	767	789	816
Universal Music		369	415	434	430	438	447	456
Warner Music		563	552	607	565	587	611	630
Total		1,552	1,639	1,779	1,744	1,793	1,847	1,902
EBITDA								
EMI		171	185	192	198	203	207	216
Universal Music		92	104	108	107	110	112	114
Warner Music		102	127	111	114	119	126	132
Total		365	415	411	419	432	445	461
EBITDA Margin								
EMI		27.7%	27.5%	26.0%	26.4%	26.5%	26.2%	26.5%
Universal Music		25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%
Warner Music		18.1%	22.9%	18.2%	20.1%	20.3%	20.7%	20.9%
Total		23.5%	25.3%	23.1%	24.0%	24.1%	24.1%	24.3%

Source: Company data, Credit Suisse estimates. Note: Corporate overheads allocated to each division for WMG. EMI depreciation & amortization allocated to each division in proportion to revenue. Universal recorded music revenues are disclosed; EBITDA is based on estimated margins.

Theoretically, therefore, music companies with large publishing exposure should be experiencing higher group margins than those with low publishing exposure given that this is a higher margin business. As we highlight in Exhibit 26, however, Universal has a low publishing exposure relative to Warner and EMI, and yet is achieving overall group margins that are noticeably higher. This suggests to us that economies of scale are meaningful in the business, as Universal, as the largest player is achieving the highest margins in the industry despite its low publishing exposure.

Exhibit 26: Recorded Music versus Publishing Revenue Splits (Fiscal 2005)

	Recorded	Publishing
Warner Music	85%	15%
EMI	80%	20%
Universal	93%	7%
Sony BMG	100%	0%

Source: Company data, Credit Suisse estimates.

Digital

We believe a potential margin opportunity for the industry comes from the growth in digital sales as a proportion of total music revenues. This upside has been referred to by the management teams of UMG, WMG and EMI. Despite lower wholesale margins for digital than physical sales (as discussed in the digital section of this report), we see two reasons why digital revenue can contribute to margin expansion as digital revenue increases, by our estimates, from 5% of industry sales in 2005 to 24% in 2009:

- Digital margins benefit from the absence of manufacturing and distribution costs and returns despite the higher royalties paid to artists.
- Digital sales are generated more from catalogue (two-thirds of sales) rather than physical sales which are more frontline and, therefore, requires lower marketing and advertising cost.

Conclusion

Our estimates assume that average music company EBITDA margins can expand from the 12.9% achieved in 2005 to 16.3% in 2009. The benefits of industry restructuring, together with favorable digital economics are expected to compensate for the modest revenue growth we forecast for the industry.

Merger Opportunities

Warner Music and EMI have twice previously been on the verge of merging. First in 2000 when European Union competition concerns saw a transaction fall apart, and second in 2003 when a private consortium headed by current chairman and CEO, Mr. Edgar Bronfman, purchased the business from Time Warner. Merger synergies in each case were estimated at $300-400 million. (Cost savings estimated from the combined Sony BMG were around $300 million). As indicated earlier, cost benefits from restructuring have supported margin growth across the music industry despite revenue pressures. A third attempt recently faltered when WMG rejected a $28.50 per share bid from EMI. We believe the cost benefits of a merged entity remain compelling and outline the cost opportunities as well as other issues pertinent to a merger below.

Cost Reduction Potential

We believe estimates of cost reduction potential for a potentially combined Warner-EMI need to take into account the significant cost restructuring that has been undertaken by the two companies individually over the past two years. The $300-400 million cost opportunity cited in the past is not all still available. We have compared a profile of a combined EMI-Warner group with that of Universal in Exhibit 27. It highlights that on the basis of 2005 revenues and market shares, a combined Warner-EMI would have similar shares of the recorded music market.

Exhibit 27: **Comparison of EMI-Warner with Universal**

12 months to March	2006 EMI	2006 Warner	EMI-Warner Combined	Dec 05 Universal
US$m				
Recorded Music Revenue	3,060	2,959	6,019	5,746
Operating costs	2,756	2,580	5,336	4,895
EBITDA	304	379	683	851
£M				
Recorded Music Revenue	1,660	1,605	3,265	3,117
Operating costs	1,495	1,399	2,894	2,655
EBITDA	165	206	371	461
Margin	9.9%	12.8%	11.4%	14.8%
Costs as % of revenues	90.1%	87.2%	88.6%	85.2%

Source: Company data, Credit Suisse estimates.

In assessing the cost reduction potential at EMI-Warner, we highlight the margin differential with Universal. It is difficult to quantify exactly how much of this differential is due to management ability and how much is due to the benefits of economies of scale. To the extent that it is the latter, it is conceivable that the scale of a combined EMI-Warner group could achieve a similar level of margin. We have looked at four scenarios to determine the potential benefit to that could accrue to the two companies in Exhibit 28.

- First, we have assumed that the combined group is able to achieve a margin at the level that WMG has achieved in the 12 months to March 2006. This yields annual pre-tax cost savings of $88 million/£48 million.

- Second, we have assumed that the combined group can close half the gap to the margin that Universal currently enjoys, with annual pre-tax cost savings of $108 million/£59 million.
- Third, we have assumed the combined group can achieve Universal's margin for the 12 months to December 2005. This would yield pre-tax benefits of $208 million/£113 million.
- Fourth, we have assumed that the combined group can achieve our forecast of Universal's margin for the 12 months to December 2006F. This would yield pre-tax benefits of $336 million/£182 million.

In our analysis in Figure 30 and Figure 31 we have assumed an outcome between scenarios three and four, with annual cost savings assumed of $230 million/£125 million, or approximately 4% of the combined cost base of the two companies.

Exhibit 28: **Warner-EMI Cost Restructuring Scenarios**

Recorded Music Costs	At Warner level	Halfway to Universal Margin Dec 05	At Universal Margin Dec 05	At Universal Margin Dec 06F
US$m				
Operating costs	5,248	5,228	5,128	5,000
Cost savings potential	88	108	208	336
£M				
Operating costs	2,846	2,836	2,782	2,712
Cost savings potential	48	59	113	182
Warner-EMI EBITDA margin	12.8%	13.2%	14.8%	16.9%
Cost savings as % total costs	1.7%	2.0%	3.9%	6.3%

Source: Company data, Credit Suisse estimates.

Who buys whom?

The first move in a potential EMI/Warner combination has been made by EMI and the structure of WMG's share register suggests that it is more likely to be acquired than be an acquirer should the private equity holders achieve an acceptable return. In addition, the highly leveraged nature of its balance sheet limits its financial flexibility.

Exhibit 29: **EMI and Warner Debt/Market Capitalization**

YE	Mar-06 EMI	Mar-06 Warner	EMI-Warner Combined
$M			
Market Capitalization	4,377	4,026	8,404
Net Debt	1,632	1,884	3,516
Enterprise value	6,009	5,910	11,920
£M			
Market Capitalization	2,363	2,173	4,535
Net Debt	881	1,017	1,897
Enterprise value	3,243	3,190	6,433
Debt/Market Capitalization	37.3%	46.8%	41.8%

Source: Company data, Credit Suisse estimates.

However it is not impossible that WMG becomes the motivator of any potential transaction. We have examined the two scenarios below.

EMI bid for WMG

We have modeled EMI bidding for WMG in Figure 30. We have assumed

1. A $30 purchase price;
2. $232 million (£125 million) p.a of cost savings and $377 million of restructuring costs—our savings are around 4% of the combined cost base, achievable, in our view, given the substantial cost duplication. Some industry estimates assume $371 million (£200 million) or 6% of the combined cost base. We ignore any revenue synergies that may arise;
3. The Warner Chappell music publishing business is sold to meet regulatory requirements for a price of 12.5 times EBITDA. Given the strong demand for music publishing assets from private equity and from trade players such as Universal, and the business's capability to take on significant leverage, this multiple may be too conservative;
4. Net debt/EBITDA of 3 times. Given the additional EBITDA generated by cost savings, there should be scope to take on additional debt but still remain within this threshold. The balance is financed by the issue of new EMI shares—we assume via a placing at a 10% discount, again conservative if the vendors accept EMI stock directly for their shares;
5. A combined tax rate of 30%—conservative given EMI's current 23% rate, the tax loss carryforwards at WMG, and its tax deductible amortization of intangibles.

On this conservative basis, the deal would be 18% accretive to EMI's earnings one year after the merger is completed. If debt/EBITDA could be stretched to 4 times, the positive accretion would stretch to 28%. The biggest sensitivity is our cost savings assumption—if we increased this to $370 million (£200 million) p.a., the accretion would be 46% on 3 times debt/EBITDA and 65% on 4 times. This accretion is substantial and can best be explained by :

1 The significant improvement in EBITDA from cost savings ($230 million/£125 million) is over 50% of the current EBITDA generated by WMG's recorded music business;

2 The corresponding additional debt that can be raised at a lower average cost of capital; and

3 The disposal of the publishing business for a price that is significant relative to WMG's market capitalization. In fact, the incremental EBITDA multiple payable for WMG, after disposing of its publishing business and after $230 million (£125 million) p.a. of cost savings is just 8.0 times, well below EMI's 10.5 and WMG's current 11.2 multiple.

WMG bid for EMI

We regard this as a far less likely scenario than a further EMI bid for WMG given the dominance on WMG's register of private equity interests. However, we have modeled a WMG bid for EMI with a similar set of assumptions. We have assumed a £3.41 offer price, a 25% premium to the current market price. We have made the same assumptions on cost savings and restructuring costs as in the EMI acquisition case, and assumed the sale of the EMI music publishing business for 12.5 times EBITDA. We have also assumed that equity would be raised at a 10% discount to the current market price. At a 3 times debt/EBITDA multiple, such a transaction would be 25% accretive to WMG, and at 4 times debt/EBITDA, 32% accretive one year from acquisition.

Figure 30: **EMI Bids for Warner**

	US$	US$	£	£
BALANCE SHEET ANALYSIS				
WMG share price - assumed offer		$30.00		
WMG outstanding shares fully diluted		150.7		
Market Cap at offer price		4,522		2,441
WMG Net Debt (March 2006)		1,884		1,017
WMG Enterprise Value		6,406		3,457
EMI share price				£2.73
EMI outstanding shares fully diluted				873
Market Cap		4,416		2,383
EMI Net Debt (March 2006)		1,632		881
EMI Enterprise Value		6,048		3,264
WMG & EMI Combined Debt		3,516		1,898
Less : Sale of Warner Chappell		-1,792		-967
Plus : Restructuring costs		371		200
WMG acquisition cost (debt financed)		4,522		2,441
Group debt fully debt financed		6,617		3,571
WMG/EMI Group EBITDA		1,229		663
Net debt/EBITDA (full debt financing)		5.4x		5.4x
Target Net Debt/EBITDA multiple	3x	4x	3x	4x
Target Net Debt	3,688	4,917	1,990	2,654
Additional Net Debt	2,055	3,285	1,109	1,773
Incremental Interest Expense	164	263	89	142
Equity required	2929	1700	1581	917
No. of new EMI shares (10% discount to market)			643	373
WARNER CHAPPELL VALUATION				
YE Sept 2006 EBITDA	143		77	
@ 12.5x multiple	1,792		967	
EARNINGS ANALYSIS	**2006**	**2007**	**2006**	**2007**
WMG Revenue	3532	3633	1,906	1,961
Less : Publishing	-535	-558	-289	-301
Adj WMG Revenue	2,997	3,075	1,617	1,659
EMI Revenue	3,919	3,987	2,115	2,152
WMG/EMI Revenue	6,915	7,062	3,732	3,811
WMG EBITDA	497	541	268	292
Less : Publishing	-143	-149	-77	-81
Adj WMG EBITDA	354	392	191	211
EMI EBITDA	560	606	302	327
Savings		232		125
WMG/EMI EBITDA	913	1,229	493	663
EBITDA Margin	13.2%	17.4%	13.2%	17.4%
ACCRETION				
Target Debt Levels	3x	4x	3x	4x
Adj WMG EBITDA	392	392	211	211
Cost savings	232	232	125	125
Less : Interest expense	-164	-263	-89	-142
Less tax @ 30%	-138	-108	-74	-58
Incremental Net Income	321	252	173	136
EMI Old Net Income	304	304	164	164
New EMI Net Income	625	556	337	300
New shares to be issued			643	373
Total shares			1516	1246
New EMI EPS			£0.22	£0.24
Previous EMI EPS			£0.19	£0.19
Increase in EPS			£0.03	£0.05
Increase in EPS %			18.3%	28.1%
Net Cost of WMG RM		4,614		2,490
Restructuring Costs		371		200
Total Cost		4,984		2,690
WMG RM EBITDA		392		211
Cost Savings		232		125
Total EBITDA		623		336
EV/EBITDA WMG RM		8.0x		8.0x

Source: Company data, Credit Suisse estimates.

Figure 31: WMG Bids for EMI

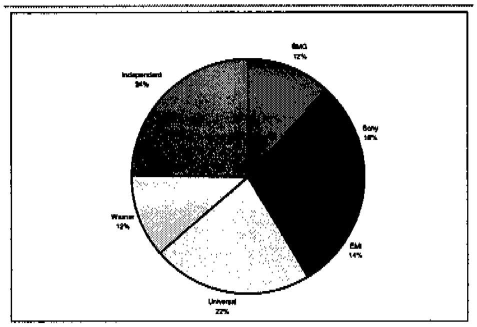
	US$	US$	£	£
BALANCE SHEET ANALYSIS				
WMG share price		$26.71		
WMG outstanding shares fully diluted		150.7		
Market Cap at offer price		4,026		2,173
WMG Net Debt (March 2006)		1,884		1,017
WMG Enterprise Value		5,910		3,190
EMI share price - assumed offer				£3.41
EMI outstanding shares fully diluted				873
Market Cap		5,520		2,979
EMI Net Debt (March 2006)		1,632		881
EMI Enterprise Value		7,152		3,860
WMG & EMI Combined Debt		3,516		1,898
Less : Sale of EMI Publishing		-2,426		-1,309
Plus : Restructuring costs		371		200
EMI acquisition cost (debt financed)		5,520		2,979
Group debt fully debt financed		6,981		3,768
WMG/EMI Group EBITDA		1,181		637
Net debt/EBITDA (full debt financing)		5.9x		5.9x
Target Net Debt/EBITDA multiple	3x	4x	3x	4x
Target Net Debt	3,542	4,723	1,912	2,549
Additional Net Debt	1,658	2,839	895	1,532
Incremental Interest Expense	133	227	72	123
Equity required	3439	2258	1856	1219
No. of new WMG shares (10% discount to market)	143	94		
EMI PUBLISHING VALUATION				
YE Sept 2006 EBITDA	194		105	
@ 12.5x multiple	2,426		1,309	
EARNINGS ANALYSIS	**2006**	**2007**	**2006**	**2007**
WMG Revenue	3532	3633	1,906	1,961
EMI Revenue	3,919	3,987	2,115	2,152
Less : Publishing	-773	-794	-417	-429
Adj EMI Revenue	3,146	3,193	1,698	1,723
WMG/EMI Revenue	6,678	6,826	3,604	3,684
WMG EBITDA	497	541	268	292
EMI EBITDA	560	606	302	327
Less : Publishing	-194	-198	-105	-107
Adj EMI EBITDA	366	408	197	220
Savings		232		125
WMG/EMI EBITDA	863	1181	466	637
EBITDA Margin	12.9%	17.3%	12.9%	17.3%
ACCRETION				
Target Debt Levels	3x	4x	3x	4x
Adj EMI EBITDA	366	366	197	197
Cost savings	232	232	125	125
Less : Interest expense	-133	-227	-72	-123
Less tax @ 30%	-139	-111	-75	-60
Incremental Net Income	325	259	175	140
WMG Old Net Income	228	228	123	123
New WMG Net Income	553	487	299	263
New shares to be issued	143	94		
Total shares	294	245		
New WMG EPS	$1.88	$1.99		
Previous WMG EPS	$1.51	$1.51		
Increase in EPS	$0.37	$0.48		
Increase in EPS %	24.6%	31.8%		
Net Cost of EMI RM		4,727		2,551
Restructuring Costs		371		200
Total Cost		5,097		2,751
EMI RM EBITDA		408		220
Cost Savings		232		125
Total EBITDA		640		345
EV/EBITDA EMI RM		8.0x		8.0x

Source: Company data, Credit Suisse estimates.

Regulatory Issues

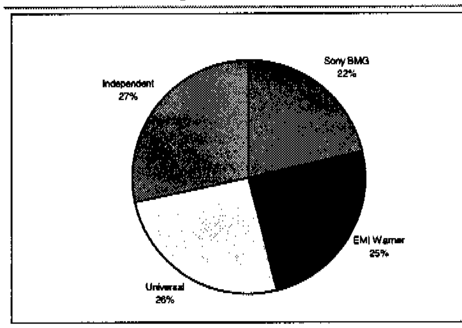
The fact that the European Union allowed the Sony BMG 50/50 joint venture to proceed without any particularly onerous conditions may suggest the regulatory concerns, which prevented the EMI-Warner merger in 2000 have dissipated. Our discussions with an expert in competition law indicate that the authorities do not have to show the resulting combination would be dominant, just that it would lessen competition. First, although reducing the number of players from four to three may seem like it is decreasing competition, in fact, it may actually have the opposite effect by creating three giants to battle each other in the industry. The anticompetition argument may lose some validity as the market share of independents has actually increased over the five-year period, suggesting that consolidation has not had a negative effect on their competitive standing.

Exhibit 32: **Music Industry Shares—2000**



Source: IFPI.

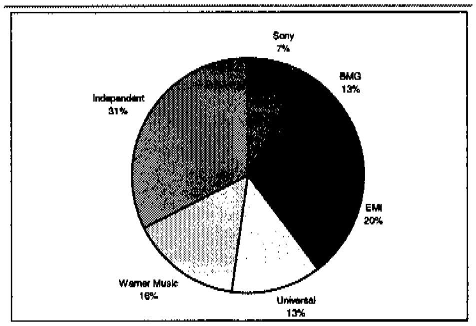
Exhibit 33: **Music Industry Shares post EMI/Warner Merger—2005**



Source: IFPI.

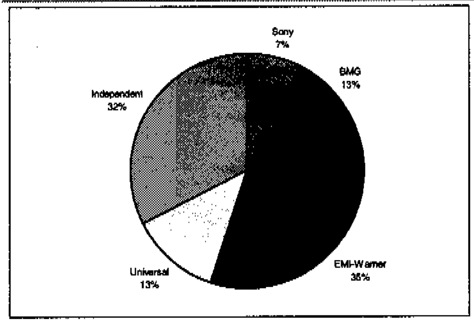
Second, to disallow an EMI/Warner merger after allowing a Sony BMG combination would appear inconsistent. Finally, the European Union seems less likely to block deals than before, given its recent history. We do, however, believe that only the recorded music businesses could be merged and not the music publishing businesses, given the potential dominance of an EMI/Warner combination, representing the number 1 and 2 players in the industry. We do not see a required sale of WMG's publishing business as a barrier to a merger given the publicly stated desire of Universal to expand in that area and the appetite of private equity investors.

Exhibit 34: **Music Publishing Shares—2004**



Source: Universal Music.

Exhibit 35: **Music Industry Shares post EMI/Warner merger—2005**



Source: Universal Music.

Management Issues

We believe management a key issue in assessing a combination of WMG and EMI. As highlighted in Exhibit 36, the WMG register is dominated by private equity investors, presumably willing to crystallize a profit on their investment.

Exhibit 36: **WMG Share Register**

	Shares (M)	%
Thomas H Lee	55.6	37.4%
Bain Capital Investors	24.1	16.2%
Music Capital (Bronfman)	14.2	9.6%
Providence Group	12.9	8.7%
Total	**106.7**	**71.9%**

Source: Company data, Credit Suisse estimates.

However, it does not necessarily follow that WMG management has the same short-term agenda. Without a desire by management to cash out of the business rather than manage it, the combined Warner-EMI would be at risk of significant management disruption and a negative impact on the business as has arguably been the case with Sony BMG.

Valuation Comparison

EBITDA Multiple

We have compared the four major music companies in terms of valuation. Warner Music and EMI are the only two pure listed plays, with Universal contributing approximately 20% of the value of Vivendi Universal and Sony BMG contributing less than 5% to the value of Sony. The latter two have been included for comparative purposes.

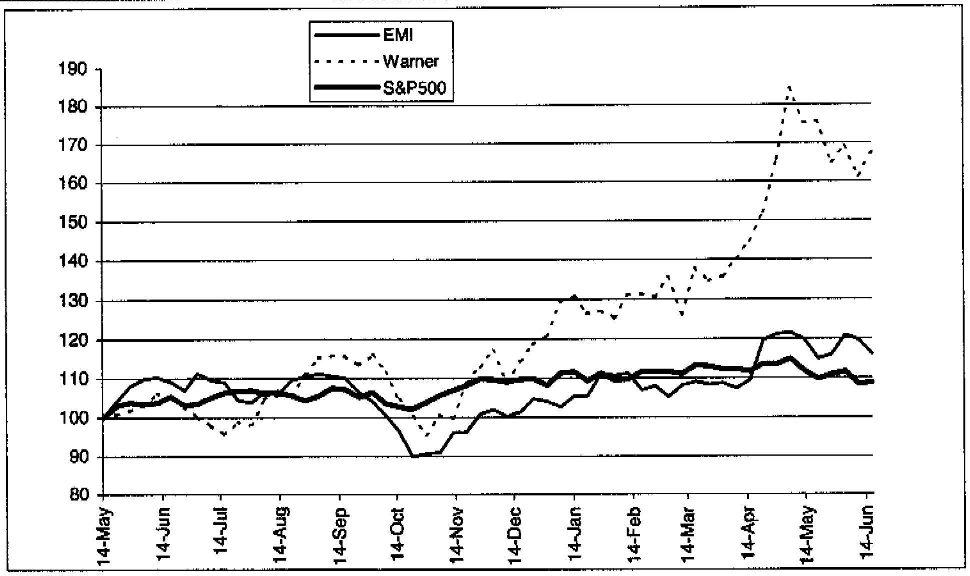
Exhibit 37: **Music Company EBITDA Multiple and PE multiple Comparison**

Stock	EMI	Warner	Vivendi	Sony
Fiscal Year End	**March**	**Sept**	**Dec**	**March**
Currency	**£M**	**US$M**	**€M**	**¥ Billions**
Music exposure	**100%**	**100%**	**20% of valuation**	**> 5% of valuation**
Share price	£2.73	$26.71	€ 26.80	¥4.840
Shares outstanding (M)	874	151	1154	1046
Market Capitalization	2,386	4,025	30,914	5,063
Latest Net Debt	880	1,952	3,869	-102
Adjustments	-150	-281	-8899	0
Adjusted Enterprise Value (local)	3,116	5,696	25,884	4,961
Adjusted Enterprise Value (US$m)	5,774	5,696	32,731	43,256
EBITDA (calendarized)				
2005	269	472	3,321	487
2006E	297	507	3,642	560
2007E	323	553	3,844	614
EV/EBITDA Multiple (x)				
2005	11.6	12.1	7.8	10.2
2006E	10.5	11.2	7.1	8.9
2007E	9.6	10.3	6.7	8.1
EPS (calendarized)				
2005	0.15	1.30	1.36	158.0
2006E	0.17	1.37	1.55	47.0
2007E	0.19	1.54	1.70	204.0
PE (x)				
2005	18.2	20.6	19.7	30.6
2006E	16.3	19.5	17.3	103.0
2007E	14.4	17.4	15.8	23.7

Source: Company data, Credit Suisse estimates, Bloomberg. Earnings data are calendarized for EMI, WMG, and Vivendi. Sony is March year-end and has limited comparability due to limited music exposure.

The multiples of EMI and Warner have both expanded, reflecting some elements of takeover speculation.

Exhibit 38: **EMI and Warner Share Price Performance**



Source: Bloomberg.

Tax assets and other adjustments to Enterprise Value

EMI enjoys a lower-than-average tax rate because of losses brought forward in certain tax jurisdictions. For example, in 2005-06 its rate was just 17.6%, helped by a better use of tax losses and a lower tax liability settlement. Management confirmed this rate would revert to 22% in 2006-07, with a 25% rate in the medium term. Simplistically, we value EMI's tax asset as being the NPV of the differential between our forecast rate and a normalized blended rate of, about 33% over the next five years. This equates to £81 million.

We make two other adjustments to derive EMI's Enterprise Value. First, we deduct £70m in respect of our estimate of the capitalised value of the minority interests, namely the 45% interest held by Toshiba in Toshiba-EMI Ltd (Japan). In addition, we add back £139m in respect of EMI's convertible bond, to be consistent with our hypothetically assumption that the options to convert into 78.9m shares are exercised and included within our 874m share base. The total adjustment amounts to £150m.

WMG enjoys a tax benefit on its deductible amortization in the order of $100 million per annum over 15 years. On a NPV basis we value this asset at $275 million.

We incorporate these as adjustments in our EV/EBITDA multiples analysis above. For the P/E ratio analysis we simply take as our denominator for EMI after actual cash tax paid, on the grounds that this is reflective of sustainable earnings for some time to come. For WMG, we normalize earnings by adding back the after-tax amortization expense.

DCF Valuation

We have undertaken a discounted cash flow analysis of WMG, outlined in Exhibit 39. We have assumed a terminal growth rate of 2.5% for WMG in-line with our cautious view of longer-term overall industry growth. This delivers a valuation outcome modestly below the current share price. The sensitivity of this valuation approach to assumptions on terminal growth are considerable, with an incremental 1% increase in the terminal growth rate delivering valuation upside of close to 12%.

Exhibit 39: WMG DCF Valuation

Effective Tax Rate	35%	Current Share Price	$	26.71
Risk Free Rate (10Y)	5.0%	Market Value of Equity ($m)		4,026
Borrowing Margin	3.0%	Book Value of Debt ($m)		1,958
Equity Risk Premium	5.2%	After Tax Cost of Debt		5.2%
Equity Beta	1.30	Required Equity Return		11.8%
Terminal Growth Rate	2.5%	WACC		9.6%
Terminal EBITDA multiple	9.1	Weighted Average Equivalent Shares		150.7

Year ending 30 September	2006F	2007F	2008F	2009F	2010F	2011F	2012F	2013F	2014F	2015F	2016F		Terminal
EBITDA	497.3	541.0	592.2	641.0	677.0	707.0	732.5	754.0	780.7	812.8	832.2		
Taxation	174.0	189.3	207.3	224.4	236.9	247.4	256.4	263.9	273.3	284.5	291.3		
Increase in Working Capital	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Operating Cash Flow	323.2	351.6	384.9	416.7	440.0	459.5	476.1	490.1	507.5	528.4	541.0		
Capital Expenditure	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0		
Free Cash Flow	295.2	323.6	356.9	388.7	412.0	431.5	448.1	462.1	479.5	500.4	513.0		525.8
Discount Factor	0.97	0.89	0.81	0.74	0.67	0.62	0.56	0.51	0.47	0.43	0.39		0.35
PV of Cash Flows	287.5	287.5	289.3	287.4	277.9	265.6	251.6	236.7	224.0	213.3	199.6		186.5
PV of Cash Flows FY06 - FY16													2,820.4
PV of Terminal Cash Flow													2,622.4
Total PV													5,442.7
Less : Net debt													-1,958
Add : PV of tax assets													281
Net Asset Value													3,766
[illegible]													[illegible]
Current share price												$	26.71
Discount													-6.9%

Source: Company data, Credit Suisse estimates, Bloomberg.

Conclusion

The valuation of EMI and WMG is not compelling on current earnings forecasts with EBITDA multiples at a premium to entertainment companies. WMG's valuation on a DCF basis is largely in-line with its current share price. However, as outlined in the merger economics section of this report, earnings, and, therefore valuation prospects would be significantly enhanced by a merger of the two companies.

Companies

EMI

SWOT analysis

Strengths

- *Strong and disciplined management.* EMI was the first music Major to initiate a major restructuring program back in 2002 when it undertook to cut costs by over £100 million per annum. This was followed in 2004 by a second wave of restructuring, cutting a further £50 million p.a. from the cost base, and augmented by the more recent £30m cost reduction programme.
- *Leading music publishing business.* EMI has the biggest music publishing catalogue in the world, representing 20% of its group sales. Rival catalogues constitute a much smaller proportion of sales. We prefer publishing to recorded music because of its higher margins (about 25% versus 10%), lower volatility (owing to the diversification of royalty sources), and higher growth potential (boosted by structural growth in synchronization and performance royalties).
- Market share gain momentum: 2005/06 H1 saw EMI's market share increase from 12.5% to 13.1%, boosted by the success of Coldplay and Gorillaz new releases. This 13.1% share was sustained for the full year.
- Relative strength in UK and Ireland with around 19% market share.

Weakness

- Relative weakness in United States. (11% market share in 2005/06 H1 and in Japan (just 8% market share in 2005/06 H1).
- Use of exceptional items: in the past four years EMI processed an average operational exceptional charge of £108 million p.a. Although we witnessed unprecedented changes in the industry during this period, some investors might argue a substantial "exceptional" charge (e.g., £100 million p.a.) should be built into the underlying profit base.
- Below investment grade debt rating results in high cost of debt and reduces strategic flexibility.

Opportunities

- Possible merger of recorded music business with Warner, with the resultant scale benefits from increasing individual market shares from 12-13% to a combined 25%, together with cost savings from the elimination of duplication of activities. We estimate annual cost savings to be around £125 million p.a.
- Reduction of cost of debt from an underlying 8-9% (we estimate a fiscal 2006-07 interest charge of £87 million). The £5 million exceptional refinancing cost taken at the interims heralded the start of this process, with management already forecasting better rates for 2006/07.

Threats

- Possible weakening of front list and artists' roster from cost reduction (although management argues strongly that A&R has become more efficient, rather than cut back).

Assumptions underpinning earnings forecasts

We forecast EMI's Recorded Music revenue will grow by 1.5% this year (in 2005-06 growth was 3.7%, or 1.9% in constant currency), in-line with consensus expectations. In its full-year results press release, EMI suggested, "the global recorded music industry will return to growth in due course." It expects "declining physical sales" and strong consumer demand for digital music. At its results presentation in May management said the return to growth would happen "soon." In fact, Recorded Music CEO Alain Levy suggested EMI's sales growth would be positive this year through a combination of overall market growth and/or market share growth.

In support of this positive outlook, EMI's release schedule for this year looks quite strong, with expected releases from Janet Jackson, Norah Jones, The Beatles, Joss Stone, KT Tunstall, Hikaru Utada (important for Japan), Robbie Williams, and Chingy. This may help to offset concerns that the revenue growth experienced of 1.9% (against a market down 0.9%) in 2005-06 was a one-off, boosted by the Coldplay and Gorillaz successes, and that EMI's share gain from 12.9% to 13.1% could not be sustained. However, management does acknowledge that the year's sales should be more second-half weighted given the difficult prior-year comparison with the Coldplay and Gorillaz effect.

We forecast EMI's Music Publishing revenue will grow by 2.6% this year (in 2005-06 growth was 4.7%, or 2.6% in constant currency), broadly in-line with consensus expectations. Our growth estimate reflects the fact that 45% of EMI's Music Publishing revenues are linked to recorded music sales through mechanical royalties, with some outperformance against our recorded music growth once more coming from synchronization (which grew 5.4% in constant currency in 2005-06). EMI Music Publishing expects to benefit from releases from artists such as Pharrell Williams, Pink, Scissor Sisters, The Zutons, and Diddy.

Overall we forecast 1.7% revenue growth for the group. Given the operational leverage of EMI, this translates into Group EBITA of £277 million, up 11%, again in-line with consensus. Our forecasts also reflect EMI's £30 million cost-savings plan. This new initiative, affecting all regions (particularly Japan) and both divisions, targets £10 million of (achieved) savings in 2006-07, with the full £30 million run-rate achieved by end 2007-08. EMI has stated that the £60 million cash cost of achieving these savings would be more than offset by proceeds from property disposals.

We forecast "Adjusted Profit Before Tax" (ABT) of £190 million, up 19% on 2005-06. This is after deducting a £87 million interest charge (under £90 million, according to management), an underlying rate of interest of over 8%.

Exhibit 40: EMI Earnings Model

US$ in millions, unless otherwise stated

Y/e 31st March	2004A	2005A	2006A	2007E	2008E	2009E
REVENUE						
Recorded music	**1,723**	**1,601**	**1,660**	**1,685**	**1,710**	**1,745**
% growth	-2.9%	-7.1%	3.7%	1.5%	1.5%	2.0%
digital sales	*8*	*34*	*92*	*169*	*231*	*297*
% growth		*340%*	*173%*	*82%*	*37%*	*28%*
% of total recorded music revenues	*0.4%*	*2.1%*	*5.6%*	*10.0%*	*13.5%*	*17.0%*
Music publishing	**398**	**401**	**420**	**430**	**441**	**457**
% growth	-0.8%	0.7%	4.7%	2.6%	2.6%	3.5%
digital sales	*7*	*13*	*20*	*32*	*51*	*69*
% growth		*75.7%*	*51.5%*	*63.8%*	*57.2%*	*35.1%*
% total music publishing revenues		*3.2%*	*4.7%*	*7.5%*	*11.5%*	*15.0%*
Total Group Revenues	**2,121**	**2,001**	**2,079.9**	**2,115**	**2,152**	**2,202**
OPERATING PROFIT						
Total recorded music	**147**	**126**	**145**	**170**	**193**	**202**
% margin	8.6%	7.8%	8.7%	10.1%	11.3%	11.6%
% growth	-2.1%	-14.9%	15.6%	17.2%	13.2%	5.1%
Total music publishing	**102**	**100**	**105**	**107**	**109**	**112**
% margin	25.6%	24.9%	25.1%	24.9%	24.7%	24.5%
% growth	-1.5%	-2.3%	5.8%	1.7%	1.7%	2.7%
Group Operating Profit (reported EBITA)	**249**	**225**	**250**	**277**	**301**	**314**
% margin	11.8%	11.2%	12.0%	13.1%	14.0%	14.3%
% growth	-1.9%	-9.7%	11.3%	10.7%	8.7%	4.2%
Goodwill	(4)	-	-	-	-	-
Amortisation music copyrights	(47)	(48)	(50)	(51)	(52)	(53)
% change	20%	2%	4%	2%	2%	2%
Amortisation	(51)	(48)	(50)	(51)	(52)	(53)
Operating exceptional items	(138)	-	4.0	-	-	-
Total deductions	(189)	(48)	(45.9)	(51)	(52)	(53)
Group operating profit (EBIT)	**60**	**177**	**205**	**226**	**250**	**261**
% margin	2.8%	8.8%	9.8%	10.7%	11.6%	11.9%
% growth	-67.8%	194.7%	15.5%	10.6%	10.2%	4.7%
EBITDA (excluding copyright am.)	***284***	***249***	276	***304***	***329***	***343***
% change	*-4.3%*	*-12.4%*	*10.8%*	*10.1%*	*8.3%*	*4.2%*
Share of operating profit	-	-	-	-	-	-
Associates	(0.3)	1.1	1.0	-	-	-
Total operating profit	**60**	**178**	**205.6**	**226**	**250**	**261**
Losses on businesses disposed						
Profit on disposal of fixed asset invest / Other	(17)	(17.5)	-			
Non-operating exceptional items	(17)	(17.5)	4.7	-	-	-
Profit before finance charges	43	161	210	226	250	261
Net interest paid	(96)	(62)	(92)	(87)	(81)	(67)
Joint venture - all HMV interest	-	-	-	-	-	-
Finance charges	(96)	(62)	(92)	(87)	(81)	(67)
Profit before Tax (PBT)	**(53)**	**99**	**118.1**	**139**	**168**	**194**
% growth	-117%	-288%	19%	18%	21%	16%
Adjusted PBT	**163**	**141**	**159.4**	**190**	**220**	**247**
% growth		-14%	13%	19%	16%	12%
Tax	(20)	(24)	(28)	(44)	(53)	(62)
Effective rate	-37%	24%	24%	23.3%	24%	25%
Profit before minorities	(73)	75	90	95	115	132
Minority interests	1	1	(4)	(5)	(6)	(7)
Net profit attributable to group	**(72)**	**76**	**86**	**90**	**109**	**125**

Source: Company data, Credit Suisse estimates.

Exhibit 41: **EMI Valuation Data and Summary**

US$ in millions, unless otherwise stated

YE March			2005A	2006A	2007E	2008E
Current Stock Price	**£2.73**	**Rating**		**OUTPERFORM**		
Market cap (millions)	**2,382.7**	**Target Price**		**£3.10**		
Recorded Music			1,601	1,660	1,685	1,710
Music Publishing			401	420	430	441
Total Consolidated Revenues			**2,001**	**2,080**	**2,115**	**2,152**
% Growth			*-5.6%*	*3.9%*	*1.7%*	*1.7%*
Total Consolidated EBITDA			**249**	**276**	**304**	**329**
Growth			(12.4%)	10.8%	10.1%	8.3%
Margin			12%	13%	14%	15%
EBITDA per share			**£0.29**	**£0.32**	**£0.35**	**£0.38**
Operating Income			**177**	**205**	**226**	**250**
Growth			194.7%	15.5%	10.6%	10.2%
Margin			8.8%	9.8%	10.7%	11.6%
After tax cash flow (net inc. + D&A)			**177**	**203**	**218**	**240**
Growth			(29.0%)	14.5%	7.6%	10.2%
ATCF Per share			**£0.20**	**£0.23**	**£0.25**	**£0.27**
Growth			(32.7%)	14.3%	7.6%	10.2%
Free cash flow			**42**	**50**	**128**	**152**
Growth			(67.2%)	19.2%	158.0%	18.3%
FCF per share			**£0.05**	**£0.06**	**£0.15**	**£0.17**
Growth			(68.9%)	19.0%	158.0%	18.3%
Cash			243	193	193	193
Debt			1,080	1,072	1,007	918
Minority interest			-8	59	74	89
Net Debt			**830**	**938**	**888**	**814**
Earnings per share (pence)			**£0.131**	**£0.157**	**£0.171**	**£0.194**
Growth			-15.5%	19.9%	9.4%	13.4%
Shares outstanding			872.8	874.2	874.2	874.2
Current Multiples						
Price/Earnings			**20.9**	**17.4**	**15.9**	**14.1**
Total Enterprise Value/EBITDA			**12.3**	**11.5**	**10.3**	**9.3**
Price/After tax cash flow			**13.5**	**11.8**	**10.9**	**9.9**
Price/Free cash flow			**57.1**	**48.0**	**18.6**	**15.7**

Source: Company data, Credit Suisse estimates.

Sony BMG

SWOT Analysis

Strengths

- *Scale.* Sony BMG is the second largest of the music majors after Universal, providing the joint venture with significant benefits of scale.
- *Strong artist roster.* Sony BMG artists produced 20 of the top 50 albums of 2004
- *Cost reductions* as a result of the merger are supporting better-than-expected profit growth.

Weaknesses

- Declining market share. It is not clear at this stage how much this is a function of a deliberate reduction in the artist roster following the merger and how much a function of a less successful release slate.
- Separation of publishing and recorded music. Sony and Bertelsmann have retained the individual music publishing businesses. The separation from the recorded music business reduces the opportunity for cross selling between business units in our view.
- The business has experienced considerable management upheaval as a result of the merger.

Opportunities

- Cost restructuring. The newly merged company is towards the end of a significant restructuring program, which was initiated following the merger. The joint venture likely has the largest margin upside opportunity of the music majors. However, margins on a relative basis may continue to underperform the peer group due to the separation of the higher margin publishing business.
- Bertelsmann appears to be exploring strategic options for its music business. This may bring the recorded music business under Sony control; it may also provide the opportunity for Sony to acquire BMG's music publishing business.

Threats

- *Management instability.* Tensions between the joint venture partners concerning management direction risk affecting the operational momentum of the business.
- *Fallout from copyright protection scandal.* Sony BMG may experience an ongoing impact on its business due to consumer concern about vulnerabilities arising from its copyright protection software.

Assumptions underpinning earnings forecasts

Our forecasts assume that Sony BMG completed its restructuring plan in the year to March fiscal 2006. For the year to March fiscal 2007, we assume Sony BMG will continue to underperform market growth following the cuts in the artist roster undertaken in the previous year. However, cost cutting benefits are expected to underpin further margin expansion in the year to March 2007.

Exhibit 42: **Sony BMG Earnings Model**

US$ in millions, unless otherwise stated

YE March	2005	2006	2007F	2008F	2009F	2010F
Sales	3,258	4,283	4,262	4,262	4,304	4,304
% change	*NA*	*NA*	*-0.5%*	*0.0%*	*1.0%*	*0.0%*
COSTS						
Product	640	835	837	837	846	846
Royalties	768	1,010	1,005	1,005	1,015	1,015
A&R	231	304	302	302	305	305
Other	89	117	117	117	118	118
Cost of Goods Sold	1,728	2,266	2,261	2,261	2,284	2,284
Gross Profit	1,529	2,017	2,001	2,001	2,021	2,021
Distribution	92	127	127	127	127	127
Variable Marketing	415	480	466	466	466	466
Selling Overhead	103	135	131	131	131	131
Marketing Overhead	172	239	232	232	232	232
G&A Overhead	364	480	456	456	456	456
Total SG&A	1,146	1,461	1,411	1,411	1,411	1,411
Total Costs	2,874	3,727	3,672	3,672	3,695	3,695
% change		*NA*	*-1.5%*	*0.0%*	*0.6%*	*0.0%*
EBITDA	**383**	**556**	**589**	**589**	**609**	**609**
% change						
Depreciation & amortiz:	147	220	220	220	220	220
EBIT	237	336	369	369	389	389
Restructuring charges	-290	-186	0	0	0	0
Pre-tax profit reported	-53	150	369	369	389	389
Tax	-13	-55	-74	-74	-78	-78
Net income	**-66**	**95**	**295**	**295**	**311**	**311**
Sony 50% in USD	-33	48	148	148	156	156
Sony 50% in JPY	**-3.6**	**5.4**	**16.2**	**16.2**	**17.1**	**17.1**
EBITDA Margin pre-re:	11.8%	13.0%	13.8%	13.8%	14.2%	14.2%
EBITDA Margin post-re	2.9%	8.6%	13.8%	13.8%	14.2%	14.2%
EBIT Margin %	7.3%	7.8%	8.7%	8.7%	9.0%	9.0%

Source: Company data, Credit Suisse estimates.

Exhibit 43: Sony Valuation Data and Summary

US$ in millions, unless otherwise stated

YE March	2004	2005	2006	2007E	2008E
Current Stock Price ¥4,720.00	**Rating**	OUTPERFORM			
Market cap (millions) ¥4,707	**Target Price**	¥7,500.00			
Electronics	5,042	5,022	5,150	5,361	5,580
Games	780	730	959	1,163	1,847
Pictures	756	734	746	783	815
Financial Services	594	561	743	743	743
Other	709	504	409	421	434
Eliminations	(385)	(390)	(532)	(520)	(502)
Total operating revenues	**7,496**	**7,160**	**7,475**	**7,951**	**8,917**
% change	*10.5%*	*-5.6%*	*6.2%*	*0.0%*	*0.0%*
Electronics	204	241	245	429	563
Games	125	60	25	-14	75
Pictures	43	69	34	60	62
Financial Services	112	108	241	108	108
Other	12	23	33	32	32
Corporate/Eliminations	-30	-15	-18	-1	-1
Total Consolidated EBITDA	**465**	**487**	**560**	**614**	**842**
Growth	(13.4%)	4.6%	15.0%	9.7%	37.1%
Margin	6%	7%	7%	8%	9%
EBITDA per share	**¥445.22**	**¥466.37**	**¥535.26**	**¥587.21**	**¥805.08**
Operating income	**99**	**114**	**191**	**206**	**415**
Growth	(46.7%)	15.2%	67.9%	7.6%	101.9%
Margin	1.3%	1.6%	2.6%	2.6%	4.7%
Net Income	89	164	124	213	360
D&A	366	373	382	408	426
After tax cash flow (net inc. + D&A)	**455**	**537**	**505**	**621**	**787**
Growth	(3%)	18%	(6%)	23%	27%
ATCF Per share	**¥435.27**	**¥514.19**	**¥483.15**	**¥594.12**	**¥752.51**
Growth	7%	(18%)	6%	(23%)	(27%)
Free cash flow	**-147**	**-73**	**-440**	**-9**	**22**
Growth		(50.2%)	502.4%	(98.0%)	(354.2%)
FCF per share	**-¥140.38**	**-¥70.02**	**-¥420.82**	**-¥8.25**	**¥20.97**
Growth		(50.1%)	501.0%	(98.0%)	(354.2%)
Cash	1,129	1,241	1,240	1,242	1,275
Debt	1,253	909	1,101	1,101	1,101
Minority interest	23	24	37	37	37
Net Debt	**147**	**-308**	**-102**	**-104**	**-137**
Earnings per share (adjusted)	**¥85**	**¥158**	**¥47**	**¥204**	**¥345**
Growth	(27%)	86%	(71%)	337%	69%
Shares outstanding (bn)	1.045	1.044	1.046	1.046	1.046
Current Multiples					
Price/Earnings	**55.6**	**29.9**	**101.3**	**23.2**	**13.7**
Total Enterprise Value/EBITDA	**10.4**	**9.0**	**8.2**	**7.5**	**5.4**
Price/After tax cash flow	**10.8**	**9.2**	**9.8**	**7.9**	**6.3**
Price/Free cash flow	**-34**	**-67**	**-11**	**-572**	**225**

Source: Company data, Credit Suisse estimates.

Vivendi (Universal Music Group)

SWOT Analysis

Strengths

- Scale and portfolio diversification. In a hit or miss business like music, scale helps reducing volatility and limiting the negotiation power of each of the artists taken individually. UMG is the largest group with over 25% market share of the global recorded music.
- *Sound financial position.* Lack of financial constraints may represent a strength given the uncertainty of future revenue growth and it may allow a smoother management of the operations together with small acquisitions. UMG is 92% owned by Vivendi Universal, which could increase its firepower by about €1 billion.

Weaknesses

- Limited exposure to publishing. With the development of new media to distribute music, publishing becomes a key link to value creation that UMG may not take full advantage of. UMG has only about 13% market share of the global music publishing, same as Sony BMG, but well behind Warner (16%) and EMI (20%).

Opportunities

- Expansion in publishing. Management has announced plans to boost its presence in music publishing from the current 9% of total revs to about 20%. The potential merger of Warner EMI could represent an opportunity, as we would expect the newco to be forced to dispose of some publishing assets (Warner Chapell).
- *Cross selling within the conglomerate.* Being part of Vivendi Universal UMG could take advantage of in-house knowledge to cross sell its content into telecom, games, or movies, although we would expect very limited revenue synergies.

Threats

- *Further distribution consolidation.* In the move from physical to digital distribution music Majors had to cope with increased price pressure from iTunes enjoying around 70% market share. High concentration of distribution also limits music Majors' ability to price digital downloads at different levels.

Assumptions underpinning earnings forecasts

We forecast UMG's revenues to increase by 1% in 2006, broadly in-line with consensus. Thanks to the end of the restructuring plan, flow-through from a strong schedule release last year, and the disposal of zero-margin music clubs, we expect EBITA margin to increase from 9.8% in 2005 to 11% in 2006. Our forecasts assume relatively stable market share from 2006 onward.

Exhibit 44: **Universal Music Earnings Model**

€ in millions, unless otherwise stated

	2004A	2005A	2006E	2007E	2008E
Sales	**4,989**	**4,893**	**4,942**	**5,041**	**5,142**
of which: digital	95	259			
operating costs	-4,225	-4,133	-4,077	-4,133	-4,216
EBITDA	**764**	**760**	**865**	**907**	**925**
D&A	-342	-261	-321	-353	-360
other (restructuring, etc.)	-63	-19			
EBITA	**359**	**480**	**544**	**554**	**566**
growth / margins					
Revenue growth	***0.3%***	***-1.9%***	***1.0%***	***2.0%***	***2.0%***
% of costs	*-84.7%*	*-84.5%*	*-82.5%*	*-82.0%*	*-82.0%*
EBITDA margin	***15.3%***	***15.5%***	***17.5%***	***18.0%***	***18.0%***
D&A as % of revs	*-6.9%*	*-5.3%*	*-6.5%*	*-7.0%*	*-7.0%*
EBITA margin	***7.2%***	***9.8%***	***11.0%***	***11.0%***	***11.0%***

Source: Company data, Credit Suisse estimates.

Exhibit 45: **Vivendi Valuation Data and Summary**

€ in millions, unless otherwise stated

YE Dec			2005	2006E	2007E	2008E
Current Stock Price	**€26.80**	**Rating**		**Neutral**		
Market cap (millions)	**30,913.2**	**Target Price**		**€24.00**		
Canal+			3,452	3,612	3,792	3,963
Music (UMG)			4,893	4,942	5,041	5,142
Games			641	737	767	798
SFR			8,687	8,861	9,127	9,400
Maroc Telecom			1,860	2,046	2,189	2,299
Other			-49	63	64	66
Total Consolidated Revenues			**19,484**	**20,260**	**20,980**	**21,667**
% Growth			*9.0%*	*4.0%*	*3.6%*	*3.3%*
Canal+			369	340	406	635
Music (UMG)			760	865	907	925
Games			86	97	109	113
SFR			3,209	3,551	3,658	3,768
Maroc Telecom			1,056	1,186	1,269	1,323
Other			-149	-179	-186	-192
Total Consolidated EBITDA			**5,331**	**5,861**	**6,164**	**6,573**
Growth			*8.0%*	*9.9%*	*5.2%*	*6.6%*
Margin			27%	29%	29%	30%
EBITDA per share			**$4.60**	**$5.04**	**$5.30**	**$5.65**
Operating income			**3,977**	**4,597**	**4,900**	**5,287**
Growth			*13.0%*	*15.6%*	*6.6%*	*7.9%*
Margin			20.4%	22.7%	23.4%	24.4%
Net Income			3,154	2,378	2,632	2,922
D&A			1,525	1,711	1,807	1,859
After tax cash flow (net inc. + D&A)			**4,679**	**4,089**	**4,439**	**4,781**
Growth			*(13.7%)*	*(12.6%)*	*8.6%*	*7.7%*
ATCF Per share			**€4.04**	**€3.51**	**€3.82**	**€4.11**
Growth			*(14.2%)*	*(13.0%)*	*8.6%*	*7.7%*
Free cash flow			**1,296**	**1,294**	**1,428**	**1,643**
Growth			*14.7%*	*(0.1%)*	*10.3%*	*15.1%*
FCF per share			**€1.12**	**€1.11**	**€1.23**	**€1.41**
Growth			*13.9%*	*(0.5%)*	*10.3%*	*15.1%*
Cash			2,902	2,902	2,902	2,902
Debt			6,760	6,771	5,692	4,471
Minority interest						
Net Debt			**3,858**	**3,869**	**2,790**	**1,569**
Earnings per share			**€1.36**	**€1.55**	**€1.70**	**€1.88**
Growth			*78.6%*	*14.2%*	*9.8%*	*10.7%*
Shares outstanding			1,158.5	1,163.5	1,163.5	1,163.5
Current Multiples						
Price/Earnings			19.7	17.2	15.6	14.1
Total Enterprise Value/EBITDA			7.8	7.1	6.5	5.8
Price/After tax cash flow			6.6	7.6	7.0	6.5
Price/Free cash flow			23.9	23.9	21.6	18.8

Source: Company data, Credit Suisse estimates.

Warner Music

SWOT Analysis

Strengths

- Strong artist roster. This is driving an expansion in WMG's recorded music market share, particularly in the United States.
- Management depth. CEO Edgar Bronfman has experience at two major music companies (WMG and Universal) and the ability to attract talent such as Lyor Cohen who joined WMG from Universal.
- *Cost cutting program.* WMG has removed $250 million from its cost base since the separation from Time Warner. Group EBITDA margins are forecast to reach 14.1% in fiscal 2006, more than double the 7% margins reported for fiscal 2003.
- *Aggressive digital business development.* WMG has been aggressive in developing its digital business and is the leading music company with respect to digital revenues as a proportion of total In the March 2006 quarter, WMG's digital revenues made up 11.3% of group revenue compared with 10% for Universal and 7.2% for EMI.
- Strong music publishing business. Music publishing market share is second only to EMI.

Weaknesses

- Financial transparency is limited. The company has a relatively short listed history, and has experienced changes in financial reporting periods. In addition, it provides low levels of information on its release roster. As a "controlled company," WMG is exempt from certain corporate governance requirements of the New York Stock Exchange.
- *Lowest market share of the major music companies.* This may limit its margin upside due to absence of economies of scale.
- *Highly geared balance sheet.* This limits WMG's strategic options.
- *The company's register is dominated by private equity investors.* There is a small free float (approximately 28%). While greater liquidity would arguably have favorable consequences for share price performance, a move by private equity holders to monetize their investments would likely raise fears of a share overhang.

Opportunities

- The economic rationale for a merger with EMI is strong, and would place the merged group in close to top position in terms of market share. As highlighted in our detailed analysis of the merger opportunity, overall cost savings opportunities could amount to $230 million, providing meaningful margin upside to a combined group.
- There may be opportunities for the recorded music and music publishing businesses to work more closely together and facilitate greater exploitation of digital opportunities.

Threats

- Takeover premium? Arguably the market has awarded a valuation premium to WMG for a potential merger or takeover by EMI. There is, therefore, a risk of share price downside were this not to occur.
- *Warner Music is not in compliance with Sarbanes-Oxley.* The company needs to implement appropriate internal controls to achieve this. Two of three material weaknesses have been addressed. The remaining weakness relates to accounting for royalty payments.
- It is unclear whether WMG has been overly aggressive in reducing its A&R investment, which may affect its future release schedule. Since its separation from Time Warner, the company has reduced its artist roster by approximately 30%.

Assumptions underpinning earnings forecasts

Recorded music. We have assumed that WMG's trends in its physical business will be broadly in-line with the market. However, we expect the digital business to considerably outperform the market, reflecting the trends evident in the first two quarters of fiscal 2006. For the full year, we expect digital revenue growth of 131% compared with our estimates for the total market of 87%. Recorded music revenue growth of 2.5% is in-line with that achieved in fiscal 2005. We expect continued margin expansion, reflecting a continued cost focus, and the growing proportion of higher margin digital revenues. Full-year EBITDA margins are forecast to achieve 16% compared with the 15.3% achieved in fiscal 2005. (These margins are before the impact of corporate overheads). Longer term, we have assumed that WMG's physical recorded music business continues to perform in-line with the broader market given the difficulty of forecasting release slates. However, we have continued to assume above-average growth in digital given WMG's success in positioning itself in that business.

Music publishing: We expect a modest decline in the contribution of the business reflecting asset sale impacts and the weaker trends of the first two quarters. We expect divisional margins to expand, reflecting the sale of lower-margin businesses and strong growth forecast for digital revenue growth. Longer term we have forecast modest declines in the traditional business, but continued strong growth in digital, for overall revenue growth around 2%.

Exhibit 46: **Warner Music Valuation Data and Summary**

US$ in millions, unless otherwise stated

YE September		2005	2006E	2007E	2008E
Current Stock Price	$26.71	Rating	OUTPERFORM		
Market cap (millions)	4,026.2	Target Price	$30.00		
Recorded Music		2,924	2,997	3,075	3,160
Music Publishing		607	565	587	611
Total Consolidated Revenues (excl. eliminations)		**3,502**	**3,532**	**3,633**	**3,740**
% Growth		*1.9%*	*0.9%*	*2.8%*	*3.0%*
Total Consolidated EBITDA		**466**	**497**	**541**	**592**
Growth		*24.6%*	*6.7%*	*8.8%*	*9.5%*
Margin		13.3%	14.1%	14.9%	15.8%
EBITDA per share		**$3.60**	**$3.30**	**$3.58**	**$3.92**
Operating Income		**228**	**265**	**313**	**357**
Growth		*117.1%*	*16.2%*	*18.0%*	*17.3%*
Margin		6.5%	7.5%	8.6%	9.8%
After tax cash flow (net inc. + D&A)		**245**	**281**	**304**	**330**
Growth		*NM*	*14.6%*	*8.2%*	*8.8%*
ATCF Per share		**$1.89**	**$1.86**	**$2.01**	**$2.19**
Growth		*(391.6%)*	*(1.7%)*	*8.0%*	*8.8%*
Free cash flow		**-267**	**-25**	**275**	**277**
Growth		*NM*	*NM*	*NM*	*0.8%*
FCF per share		($2.06)	($0.16)	**$1.82**	**$1.84**
Growth		*NM*	*NM*	*NM*	*0.8%*
Cash		288	263	538	815
Debt		2,246	2,269	2,319	2,369
Minority interest		0	0	0	0
Net Debt		**1,958**	**2,006**	**1,781**	**1,554**
Earnings per share (normalized)		**$1.23**	**$1.34**	**$1.51**	**$1.71**
Growth		*NM*	*8.6%*	*13.2%*	*13.0%*
Shares outstanding		129.4	150.7	151.0	151.0
Current Multiples					
Price/Earnings		**21.7**	**20.0**	**17.7**	**15.6**
Total Enterprise Value/EBITDA		**12.2**	**11.6**	**10.3**	**9.1**
Price/After tax cash flow		**14.1**	**14.3**	**13.3**	**12.2**
Price/Free cash flow		**-12.9**	**-162.6**	**14.7**	**14.5**

Source: Company data, Credit Suisse estimates.

Board

WMG's board consists of 13 directors, including two independent directors (Mr. Shelby W. Bonnie and Ms. Michele Hooper). The company is not in compliance with New York Stock Exchange rules and is in the process of finding one additional independent candidate to join its board and serve as a member of its audit committee.

Management

Edgar Bronfman, Jr.—Chairman of Board and CEO

Mr. Bronfman has served as chairman of the board and CEO since March 2004. Previously he served as chairman and CEO of Lexa Partners LLC, a management venture capital group. Prior to that his roles included executive vice chairman of Vivendi Universal from December 2000 to December 2003, and president and CEO of The Seagram Company from June 1994 to December 2000.

Lyor Cohen—Chairman and CEO of U.S. Recorded Music

Mr. Cohen has served as chairman and CEO of WMG's U.S. Recorded Music division since March 2004. Previously he served as chairman and CEO of Universal Music Group's Def Jam Music Group, and was president of Def Jam from 1988 to 2002.

Patrick Vien—Chairman and CEO of Warner Music International

Mr. Vien joined WMI in February 2006 from NBC Universal's Global Networks division.

Richard Blackstone—Chairman and CEO of Warner/Chappel Music

Mr. Blackstone has served as chairman and CEO of Warner/Chappell Music since May 2005. He joined WMG from Zomba Music Publishing where he served as president and in other capacities since 1989.

Michael D. Fleisher—Executive Vice President and Chief Financial Officer

Mr. Fleisher joined WMG as executive vice president and chief financial officer in January 2005. Previously he was chairman and CEO of Gartner Inc. and served in various capacities from 1993.

Accounting Issues

WMG's balance sheet has a value of $1.7 billion of assets, which are subject to amortization (recorded music catalog, music publishing copyrights, and trademarks). The annual amortization charge of $188 million is effective in reducing WMG's tax rate due the tax deductibility of $100 million of the amortization charge. Our EPS estimates are "normalized" by adding back the after-tax amortization charge.

Exhibit 47: Warner Music Income Statement

FYE September 30 *($ in millions)* **INCOME STATEMENT ANALYSIS**	Dec-04 Q1 05A	Mar 05 Q2 05A	Jun-05 Q3 05A	Sep-05 Q4 05A	Dec-05 Q1 06A	Mar-06 Q2 06A	Jun-06 Q3 06E	Sep-06 Q4 06E	FY 05A	FY 06E	FY 07E	FY 08E
Revenue	1086	767	742	905	1044	796	758	934	3502	3532	3633	3740
Costs and Expenses	-893	-679	-672	-793	-842	-692	-682	-819	-3036	-3035	-3092	-3148
Cost of Revenue	-581	-400	-396	-473	-530	-398	-402	-495	-1850	-1872	-1925	-1982
Selling, General, & Administrative	-312	-279	-276	-320	-312	-294	-280	-324	-1186	-1163	-1166	-1166
OIBDA	195	88	70	112	202	104	76	115	466	497	541	592
FAS 123 Expense	2	7	9	7	6	2	6	6	25	20	20	20
OIBDA excl. FAS 123 Expense	197	95	79	119	208	106	82	121	491	517	561	612
Depreciation	-14	-14	-12	-11	-11	-11	-11	-11	-51	-44	-40	-37
Amortization	-46	-47	-47	-47	-47	-48	-46	-47	-187	-188	-188	-188
Operating Income	135	27	11	54	144	45	19	57	228	265	313	367
Non-operating Income (expense)												
Net Interest Expense	-38	-52	-50	-42	-45	-45	-40	-38	-182	-168	-162	-157
Equity in Investees	-1	0	0	0	0	1	0	-1	-1	0	0	0
Other	4	0	2	2	0	2	0	-2	8	0	0	0
Unrealized Gain on Warrants	-22	39	0	0	0	0	0	0	17	0	0	0
Minority Interest	-5	0	0	0	0	0	0	0	-5	0	0	0
Total Non-operating Income	-62	-13	-48	-40	-45	-42	-40	-41	-163	-168	-162	-157
Pre-tax Income	73	14	-37	14	99	3	-21	16	65	97	150	209
Income Taxes	-32	-10	-7	-9	-30	-10	-4	-4	-58	-48	-75	-105
Tax Rate (%)	*44%*	*71%*	*-19%*	*64%*	*30%*	*333%*	*-20%*	*25%*	*89%*	*50%*	*50%*	*50%*
Net Income before non-recurring	41	4	-44	5	69	-7	-26	12	7	48	75	105
Addback : Tax effected amortization	37	38	38	38	38	39	37	38	152	153	153	153
Normalized Net Income	**78**	**42**	**-6**	**43**	**107**	**32**	**12**	**50**	**159**	**201**	**228**	**258**
Non-recurring items												
Impairment Charges			-73	0					-73			
Restructuring charges (net)				-7					-7			
Loss on sale									0			
IPO-related cash bonus			-10						-10			
Bonus related to stock awards			-19						-19			
Management fees	-5		-1						-6			
Loss on repayment of debt			-35						-35			
Other				-28					-29			
Cumulative effect of a/c change									0			
Total non-recurring items	-5	0	-138	-35	0	0	0	0	-179			
Tax effect on non-recurring items			3						3			
Reported Net Income	**36**	**4**	**-179**	**-30**	**69**	**-7**	**-26**	**12**	**-169**	**48**	**75**	**105**
Reported Basic EPS	$0.33	$0.04	($1.41)	($0.21)	$0.49	($0.05)	($0.18)	$0.08	($1.40)	$0.34	$0.53	$0.74
Reported Diluted EPS	$0.31	$0.03	($1.41)	($0.21)	$0.46	($0.05)	($0.17)	$0.08	-$1.31	$0.32	$0.50	$0.69
Normalized Diluted EPS	**$0.68**	**$0.34**	**($0.05)**	**$0.29**	**$0.71**	**$0.21**	**$0.08**	**$0.33**	**$1.23**	**$1.34**	**$1.51**	**$1.71**
% Growth	*NM*	*NM*	*NM*	*NM*	*5.0%*	*-37.5%*	*NM*	*15.2%*	*NM*	*8.6%*	*13.2%*	*13.0%*
Shares Outstanding (Basic)	107.5	107.7	127.0	141.2	141.4	141.9	141.9	141.9	120.9	141.9	141.9	141.9
Shares Outstanding (Diluted)	115.3	123.5	127.0	150.2	150.5	150.8	150.8	150.8	129.4	150.7	151.0	151.0

Source: Company data, Credit Suisse estimates.

Figure 48: WMG Divisional Analysis

($ in millions)	Q1 05A	Q2 05A	Q3 05A	Q4 05A	Q1 06A	Q2 06A	Q3 06E	Q4 06E	FY 05A	FY 06E	FY 07E	FY 08E
SEGMENT ANALYSIS												
Revenue												
Recorded Music	940	621	588	775	920	676	612	789	2,924	2,997	3,075	3,160
Music Publishing	155	154	161	137	131	129	153	152	607	565	587	611
Intersegment Elimination	-7	-8	-7	-7	-7	-9	-6	-8	-29	-30	-29	-30
Total Revenue	1,088	767	742	905	1,044	796	758	934	3,502	3,532	3,633	3,740
Digital Revenues	25	35	44	53	69	90	95	108	157	362	579	802
% total	*2.3%*	*4.6%*	*5.9%*	*5.9%*	*6.6%*	*11.3%*	*12.5%*	*11.6%*	*4.5%*	*10.2%*	*15.9%*	*21.4%*
Cash Costs												
Recorded Music	744	543	515	672	711	594	533	680	2,476	2,518	2,555	2,594
Music Publishing	131	106	131	94	109	82	126	105	462	422	438	454
Corporate	16	23	17	20	16	14	18	28	73	75	78	81
Total Cash Costs	891	672	663	786	836	690	676	813	3,011	3,015	3,072	3,128
OIBDA (before options expense)												
Recorded Music	196	78	73	103	209	82	78	109	448	479	519	566
Music Publishing	24	48	30	43	22	47	27	47	145	143	149	157
Corporate	-23	-31	-24	-27	-23	-23	-24	-35	-102	-105	-107	-111
Total OIBDA	197	95	79	119	208	106	82	121	491	517	561	612
Options expense												
Recorded Music	2	4	6	5	3	1	3	3	17	10	10	10
Music Publishing	0	1	1	1	1	0	1	1	3	3	3	3
Corporate	0	2	2	1	2	1	2	2	5	7	7	7
Total options expense	2	7	9	7	6	2	6	6	25	20	20	20
D&A												
Recorded Music	42	42	41	40	40	41	39	40	165	160	160	155
Music Publishing	14	15	15	15	15	15	15	15	59	60	60	60
Corporate	4	4	3	3	3	3	3	3	14	12	8	10
Total Dep & Amortization	60	61	59	58	58	59	57	58	238	232	228	225
Operating Income												
Recorded Music	152	32	26	58	166	40	36	66	266	309	349	401
Music Publishing	10	32	14	27	6	32	11	31	83	80	86	94
Corporate	-27	-37	-29	-31	-28	-27	-29	-40	-121	-124	-123	-128
Total Operating Income	135	27	11	54	144	45	19	57	228	265	313	367
OIBDA Margin												
Recorded Music	20.9%	12.6%	12.4%	13.3%	22.7%	12.1%	12.8%	13.8%	15.3%	16.0%	16.9%	17.9%
Music Publishing	15.5%	31.2%	18.6%	31.4%	16.8%	36.4%	17.8%	31.0%	23.9%	25.4%	25.4%	25.7%
Total Margin	18.1%	12.4%	10.6%	13.1%	19.9%	13.3%	10.8%	13.0%	14.0%	14.6%	15.4%	16.4%
SEGMENT GROWTH ANALYSIS												
Revenue												
Recorded Music	-8.6%	4.9%	1.9%	17.1%	-2.1%	8.9%	4.0%	1.9%	2.3%	2.5%	2.6%	2.8%
Music Publishing	-2.5%	3.4%	0.0%	-2.1%	-15.5%	-16.2%	-5.0%	11.0%	-0.3%	-6.9%	4.0%	4.0%
Intersegment Elimination	-22.2%	33.3%	-41.7%	75.0%	0.0%	12.5%	-12.6%	7.6%	-6.5%	2.2%	-1.2%	3.0%
Total Revenue	-7.6%	4.4%	2.2%	13.4%	-4.0%	3.8%	2.2%	3.2%	1.9%	0.9%	2.8%	3.0%
Cash Costs												
Recorded Music	-15.5%	-4.9%	0.8%	11.6%	-4.4%	9.4%	3.5%	1.2%	-3.6%	1.7%	1.5%	1.5%
Music Publishing	-0.8%	1.9%	-1.5%	-1.1%	-16.8%	-22.6%	-4.0%	11.5%	-0.4%	-8.7%	3.9%	3.5%
Corporate	128.6%	91.7%	142.9%	122.2%	0.0%	-39.1%	3.0%	38.4%	135.5%	3.0%	4.0%	3.0%
Total Cash Costs	-12.6%	-2.2%	1.8%	11.3%	-6.2%	2.7%	2.0%	3.4%	-1.7%	0.1%	1.9%	1.8%
OIBDA												
Recorded Music	32.4%	271.4%	10.6%	71.7%	6.6%	5.1%	7.5%	6.0%	54.0%	6.9%	8.5%	9.0%
Music Publishing	-11.1%	6.7%	7.1%	-4.4%	-8.3%	-2.1%	-9.4%	9.8%	0.0%	-1.1%	4.1%	5.2%
Corporate	43.8%	72.2%	26.3%	107.7%	0.0%	-25.8%	-1.6%	30.4%	64.5%	2.8%	2.5%	3.0%
Total OIBDA	23.9%	97.9%	5.3%	29.3%	5.6%	11.6%	3.9%	1.9%	31.3%	5.3%	8.5%	9.1%
Operating Income												
Recorded Music	63.4%	NM	8.3%	205.3%	9.2%	25.0%	40.4%	14.2%	141.8%	16.1%	13.1%	14.8%
Music Publishing	66.7%	33.3%	7.7%	-15.6%	-40.0%	0.0%	-20.1%	15.5%	10.7%	-3.1%	7.3%	9.1%
Corporate	35.0%	68.2%	31.8%	63.2%	3.7%	-27.0%	-0.2%	30.0%	53.2%	2.7%	-1.0%	4.2%
Total Operating Income	70.9%	NM	-26.7%	68.8%	6.7%	66.7%	70.4%	5.8%	115.1%	16.2%	18.0%	17.3%

Source: Company data, Credit Suisse estimates.

Exhibit 49: **Warner Music Recorded Music Model**

YE Sept	**FY03A**	**FY 04A**	**FY 05A**	**FY 06E**	**FY 07E**	**FY 08E**
Sales (net of returns)	2,699	2,691	2,646	2,540	2,428	2,319
Digital Sales	0	28	137	316	505	700
Licencing Revenues	140	140	141	141	141	141
Total Recorded Music Sales	**2,839**	**2,859**	**2,924**	**2,997**	**3,075**	**3,160**
% change						
Sales (net of returns)		*-0.3%*	*-1.7%*	*-4.0%*	*-4%*	*-5%*
Digital Sales		*NM*	*389.3%*	*131%*	*60%*	*39%*
Licensing Revenues		*0.0%*	*0.7%*	*0%*	*0%*	*0%*
Total Recorded Music Sales		*0.7%*	*2.3%*	*2.5%*	*2.6%*	*2.8%*
% of total						
Digital as % of total music sales	*0.0%*	*1.7%*	*5.7%*	*11.0%*	*16.6%*	*22.0%*
COSTS						
Product	567	560	556	533	510	487
Royalties	636	640	658	674	692	711
A&R	243	202	146	150	154	158
Other	80	73	70	72	74	76
Cost of Goods Sold	1526	1475	1430	1430	1429	1432
Gross Profit	**1,313**	**1,384**	**1,494**	**1,567**	**1,645**	**1,728**
Distribution	95	95	70	72	74	76
Variable Marketing	430	418	356	365	374	385
Selling Overhead	110	89	87	90	94	97
Marketing Overhead	180	130	110	114	119	123
G&A Overhead	382	387	430	447	465	481
Restructuring Costs	-43	-26	-7	0	0	0
Total SG&A	1154	1093	1046	1089	1126	1162
Total Costs	**2680**	**2568**	**2476**	**2518**	**2555**	**2594**
% change		*-4.2%*	*-3.6%*	*1.7%*	*1.5%*	*1.5%*
EBITDA	**159**	**291**	**448**	**479**	**519**	**566**
% change		*82.7%*	*54.0%*	*6.9%*	*8.5%*	*9.0%*
Margin	*5.6%*	*10.2%*	*15.3%*	*16.0%*	*16.9%*	*17.9%*

Source: Company data, Credit Suisse estimates.

Exhibit 50: Warner Music—Music Publishing Model

YE Sept	FY03A	FY 04A	FY 05A	FY 06E	FY 07E	FY 08E
SALES						
Sales	563	499	552	519	514	509
Sheet Music - divested		49	35			
Digital	0	4	20	46	74	102
Total	**563**	**552**	**607**	**565**	**587**	**611**
% change						
Sales		*-11.4%*	*10.6%*	*-6.0%*	*-1.0%*	*-1.0%*
Digital		*NM*	*400.0%*	*131%*	*60%*	*39%*
Total		*-2.0%*	*10.0%*	*-6.9%*	*4.0%*	*4.0%*
Digital % total		*0.7%*	*3.3%*	*8.2%*	*12.6%*	*16.7%*
OPERATING COSTS						
Royalties	328	322	354	328	342	356
A&R	30	29	30	30	31	32
Cost of Goods Sold	**358**	**351**	**384**	**358**	**374**	**388**
Gross Profit	**205**	**201**	**223**	**207**	**214**	**222**
Margin	*36.4%*	*36.4%*	*36.7%*	*36.7%*	*36.4%*	*36.4%*
G&A Overhead	95	56	78	64	65	65
Total costs	453	407	462	422	438	454
% change		*-10.2%*	*13.5%*	*-8.7%*	*3.9%*	*3.5%*
EBITDA	**110**	**145**	**145**	**143**	**149**	**157**
% change		*31.9%*	*0.0%*	*-1.1%*	*4.1%*	*5.2%*
Margin	*19.5%*	*26.3%*	*23.9%*	*25.4%*	*25.4%*	*25.7%*

Source: Company data, Credit Suisse estimates.

Exhibit 51: Warner Music Cash Flow Estimates

YE Sept	Q1 05A	FY 05A	FY 06E	FY 07E	FY 08E
Cash flows from operating activities					
Net income (loss)	36	-169	48	75	105
Adjustments:					
Cumulative effect of a/c change					
Impairment of goodwill and other intangible assets	0	0	0	0	0
Depreciation and amortization	60	239	232	228	225
Deferred taxes	-3	0	-2	0	0
Non-cash interest expense	10	68	52	50	50
Loss on debt repayment		35	0	0	0
Net investment-related losses (gains)	0	-1	0	0	0
Equity in the losses of equity-method investees	1	1	-1	0	0
Non-cash, stock-based compensation expense	2	25	20	20	20
Unrealized gains on warrants	22	-17	0	0	0
Minority interest expense	5	5	0	0	0
Changes in operating assets and liabilities:					
Accounts receivable	-220	-58	6	-29	-20
Inventories	2	-3	3	-5	-2
Royalty advances	15	0	-29	0	0
Accounts payable and accrued liabilities	115	10	-58	38	8
Other balance sheet changes	18	70	-19	1	-6
Net cash provided by (used in) operating activities	**63**	**205**	**253**	**379**	**381**
Cash flows from investing activities					
Acquisition of Old WMG	0	0	0	0	0
Investments and acquisitions	-20	-78	-86	0	0
Investment in short term investments	0	0	-61	0	0
Investment proceeds	1	54	0	0	0
Capital expenditures	-6	-30	-28	-28	-28
Net cash (used in) provided by investing activities	**-25**	**-54**	**-175**	**-28**	**-28**
Cash flows from financing activities					
Borrowings	696	946	0	0	0
Financing costs of borrowings	-17	-20	0	0	0
Debt repayments	-3	-588	-8	0	0
Capital contributions	0	0	0	0	0
Proceeds from the issuance of common stock	1	522	0	0	0
Proceeds from the issuance of subsidiary preferred stock	0	0	0	0	0
Proceeds from the issuance of restricted shares	0	1	0	0	0
Cash paid to repurchase warrant		-138	0	0	0
Repurchase of subsidiary preferred stock	-209	-200	0	0	0
Dividends paid on subsidiary preferred stock	0	-9	0	0	0
Returns of capital and dividends paid	-764	-917	-97	-76	-76
Decrease in amounts due from TWX-affiliated companies	0	0	0	0	0
Other	0	-13	0	0	0
Net cash (used in) provided by financing activities	**-296**	**-416**	**-105**	**-76**	**-76**
Effect of foreign currency exchange rate changes on cash	9	-2	2	0	0
Net (decrease) increase in cash and equivalents	**-249**	**-267**	**-25**	**275**	**277**
Cash and equivalents at beginning of period	555	555	288	263	538
Cash and equivalents at end of period	**306**	**288**	**263**	**538**	**815**

Source: Company data, Credit Suisse estimates.

Exhibit 52: **Warner Music Balance Sheet**

YE Sept	Q1 05A	FY 05A	FY 06E	FY 07E	FY 08E
ASSETS					
Current assets:					
Cash and equivalents	306	288	263	538	815
Short term investments		0	61	61	61
Accounts receivable	821	637	632	661	680
Inventories	65	52	49	54	56
Royalty advances	204	190	196	196	196
Deferred tax assets	48	36	35	37	38
Other current assets	74	39	45	40	42
Total current assets	**1,518**	**1242**	**1,282**	**1,588**	**1,889**
Royalty advances	204	190	196	196	196
Investments	9	21	24	24	24
Net PPE	180	157	141	128	119
Goodwill	966	869	944	944	944
Net intangible assets subject to amortization	1,925	1,815	1,644	1,456	1,268
Intangible assets not subject to amortization	100	100	100	100	100
Other assets	121	104	107	108	111
Total assets	**5,023**	**4,498**	**4,437**	**4,544**	**4,650**
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current liabilities:					
Accounts payable	223	247	219	257	265
Accrued royalties	1,166	1,057	1,088	1,088	1,088
Taxes and other withholdings	32	23	43	43	43
Current portion of long-term debt	12	17	17	17	17
Note payable to shareholders	0	0	0	0	0
Dividend payable	0	0	20	20	20
Other current liabilities	622	404	327	327	327
Total current liabilities	**2,055**	**1,748**	**1,714**	**1,752**	**1,760**
Long-term debt	2,534	2,229	2,252	2,302	2,352
Deferred tax liabilities, net	272	201	192	192	192
Other noncurrent liabilities	287	226	225	225	225
Minority interest in preferred stock of subsidiary	0	0	0	0	0
Dividends payable		5	6	6	6
Total liabilities	**5,148**	**4,409**	**4,389**	**4,477**	**4,535**
Shareholders' equity (deficit):					
Common Stock	0	0	0	0	0
Additional paid-in capital	93	548	568	588	608
Retained deficit	-202	-480	-549	-550	-521
Accumulated other comprehensive income, net	-16	21	28	28	28
Group equity			0		
Due from Time Warner					
Total shareholders' equity (deficit)	**-125**	**89**	**47**	**66**	**115**
Total liabilities and shareholders' equity	**5,023**	**4,498**	**4,437**	**4,544**	**4,650**

Source: Company data, Credit Suisse estimates.

Appendix 2—Music Industry Fundamentals

As highlighted earlier in the report, the music industry is structured with little overlap between recorded music and music publishing businesses. Sony BMG has left the publishing businesses with the partners; and Universal, the largest player, has a small exposure to the businesses. Historically, EMI and Warner have operated these two businesses separately, with little overlap in terms of artists. This may well have been driven by a risk reduction strategy. However, we believe the motivation in the digital environment may be to see a greater overlap in artists given the importance of rights management over several distribution platforms. EMI has talked of delays experienced in clearing digital rights for some of its recorded music artists, which cause a lag in its receipts.

Recorded Music

Approximately one-third of physical recorded music sales are generated from catalogue and two-thirds from front-line releases of both new and established artists. Less than 10% of group revenues are generated from new artists. Digital sales are the reverse of physical, with two-thirds generated by catalogue and one-third from frontline. Music companies expense the cost of new artists through A&R (artists and repertoire). Cost associated with established artists are capitalized and offset through royalties.

Recorded Music Statistics

Soundscan data are the most up-to-date source of U.S. industry sales, with both physical and digital sales published weekly. Some of the music companies have raised questions as to the accuracy of Soundscan data as they measure only a select group of retailers in the United States, and do not capture growing parts of the market, e.g., Starbucks outlets. However, we believe there is a strong indication of underlying trend from the Soundscan data. Soundscan also tracks digital downloads, although these data are freely available on single-track downloads rather than on digital albums.

Figure 53: **U.S. Weekly Music Sales**

Week	% ch Albums week 2004	% ch Albums week 2005 Adj	% ch Albums week 2006	% ch Albums YTD 2004	% ch Albums YTD 2005 Adj	% ch Albums YTD 2006
1	18.2%	1.0%	7.3%	102.9%	1.0%	7.3%
2	7.7%	-6.2%	-2.4%	59.7%	-2.6%	2.7%
3	3.8%	-8.4%	-0.8%	43.0%	-4.5%	1.6%
4	10.3%	-2.3%	-4.7%	36.1%	-4.0%	-0.1%
5	10.0%	-10.0%	-4.0%	35.1%	-5.4%	-0.9%
6	10.7%	-24.5%	-7.4%	37.9%	-10.0%	-2.2%
7	24.6%	1.2%	-2.9%	29.4%	-8.3%	-2.3%
8	8.2%	-5.9%	-0.9%	25.9%	-8.0%	-2.1%
9	-2.2%	4.4%	-9.4%	22.2%	-6.7%	-3.0%
10	-0.3%	-4.4%	-0.6%	19.5%	-6.5%	-2.8%
11	1.1%	-2.7%	-4.1%	17.8%	-6.1%	-2.9%
12	13.0%	-3.6%	-13.3%	18.6%	-5.9%	-3.9%
13	11.2%	-17.4%	4.1%	17.9%	-6.8%	-3.3%
14	18.4%	-26.5%	15.1%	18.3%	-8.4%	-2.1%
15	20.8%	-5.0%	20.0%	16.8%	-8.2%	-0.8%
16	-21.5%	-3.9%	-10.5%	14.1%	-7.9%	-1.4%
17	-1.5%	-4.5%	-10.0%	13.5%	-7.7%	-1.9%
18	11.6%	-5.6%	-9.5%	13.7%	-7.6%	-2.3%
19	7.1%	-1.0%	7.9%	12.7%	-7.3%	-1.8%
20	7.3%	0.7%	-13.3%	12.6%	-7.0%	-2.4%
21	1.6%	-7.3%		12.5%	-7.0%	
22	11.2%	-6.5%		12.2%	-7.0%	
23	5.4%	1.7%		11.9%	-6.6%	
24	-14.8%	-5.2%		11.2%	-6.5%	
25	18.6%	-8.7%		11.0%	-6.6%	
26	6.4%	-9.5%		11.1%	-6.7%	
27	12.4%	-5.3%		10.9%	-6.7%	
28	10.9%	-9.7%		11.0%	-6.8%	
29	6.8%	-11.4%		10.9%	-6.9%	
30	6.1%	-15.2%		10.9%	-7.2%	
31	15.2%	-7.7%		10.8%	-7.2%	
32	8.5%	-11.2%		10.8%	-7.4%	
33	7.2%	-5.6%		10.5%	-7.3%	
34	-2.3%	-19.8%		10.4%	-7.7%	
35	9.2%	-7.7%		10.2%	-7.7%	
36	12.4%	-7.7%		10.0%	-7.7%	
37	0.5%	-5.0%		9.8%	-7.6%	
38	-3.2%	-4.1%		9.4%	-7.5%	
39	-17.7%	-4.5%		8.7%	-9.8%	
40	-7.5%	-0.4%		8.4%	-9.7%	
41	-5.1%	-2.5%		7.9%	-9.4%	
42	-12.6%	0.8%		7.4%	-7.0%	
43	-6.0%	-8.7%		7.0%	-7.1%	
44	-5.3%	-0.1%		6.8%	-6.9%	
45	-20.8%	-13.7%		6.7%	-7.1%	
46	-7.8%	-14.1%		6.5%	-7.3%	
47	-8.1%	-12.7%		6.9%	-7.5%	
48	-5.1%	-12.9%		6.1%	-7.7%	
49	-5.3%	-11.9%		6.4%	-7.8%	
50	-10.7%	-11.0%		6.7%	-8.0%	
51	-13.4%	1.6%		6.5%	-7.5%	
52	4.5%	5.2%		3.8%	-7.2%	

Week	% ch Digital week 2004	% ch Digital week 2005	% ch Digital week 2006	% ch Digital YTD 2004	% ch Digital YTD 2005	% ch Digital YTD 2006
1		229.8%	146.0%		229.8%	146.0%
2		208.3%	89.7%		218.9%	118.4%
3		195.1%	122.0%		210.6%	119.6%
4		138.0%	137.0%		190.4%	123.5%
5		180.4%	98.1%		188.3%	118.2%
6		167.2%	92.1%		184.3%	113.5%
7		198.9%	88.5%		186.5%	109.5%
8		193.7%	92.9%		187.5%	107.2%
9		206.0%	70.9%		189.6%	102.8%
10		211.3%	74.9%		191.9%	99.7%
11		196.3%	65.7%		192.3%	96.3%
12		197.9%	66.7%		192.8%	93.5%
13		235.3%	45.4%		196.3%	89.0%
14		213.7%	61.1%		197.6%	86.9%
15		233.7%	52.3%		200.0%	84.3%
16		218.8%	66.3%		201.2%	83.1%
17		169.5%	75.1%		199.2%	82.6%
18		195.7%	56.3%		199.0%	81.1%
19		210.7%	46.2%		199.6%	79.1%
20		188.8%	61.6%		199.0%	78.1%
21		175.0%			197.6%	
22		160.0%			195.7%	
23		191.1%			195.5%	
24		144.7%			192.9%	
25		133.2%			189.9%	
26		154.0%			188.2%	
27	797.4%	142.2%			186.1%	
28	810.1%	134.1%			183.8%	
29	772.5%	136.8%			181.8%	
30	855.7%	115.4%			178.9%	
31	785.5%	147.6%			177.7%	
32	691.4%	156.4%			176.9%	
33	800.0%	127.9%			175.0%	
34	1032.3%	97.8%			171.9%	
35	824.0%	131.9%			170.4%	
36	688.7%	111.0%			168.2%	
37	610.2%	111.8%			166.1%	
38	552.2%	142.4%			165.4%	
39	490.8%	144.9%			164.8%	
40	530.3%	140.0%			164.0%	
41	581.0%	113.5%			162.5%	
42	666.5%	114.9%			161.0%	
43	368.9%	112.5%			159.5%	
44	266.0%	105.1%			157.9%	
45	308.8%	140.0%			157.4%	
46	246.9%	107.1%			155.9%	
47	211.4%	114.7%			154.8%	
48	131.7%	106.0%			153.2%	
49	203.5%	92.7%			151.3%	
50	198.2%	111.8%			150.2%	
51	283.1%	89.5%			147.9%	
52	283.4%	197.5%		392.3%	150.3%	

Week	% ch Albums/ Digital equiv week 2004	% ch Albums/ Digital equiv week 2005	% ch Albums/ Digital equiv week 2006	% ch Albums/ Digital equiv YTD 2004	% ch Albums/ Digital equiv YTD 2005	% ch Albums/ Digital equiv YTD 2006
1	-14.0%	4.5%	14.0%	-14.0%	4.5%	14.0%
2	6.7%	-2.7%	2.4%	-4.9%	0.9%	8.5%
3	7.3%	-5.0%	5.6%	-1.1%	-1.1%	7.6%
4	14.7%	0.3%	1.4%	2.5%	-0.7%	6.0%
5	33.0%	-7.1%	0.7%	8.3%	-2.2%	4.8%
6	52.2%	-22.2%	-3.2%	16.3%	-7.0%	3.2%
7	-7.8%	4.4%	1.3%	11.9%	-5.3%	2.9%
8	4.2%	-2.6%	3.8%	10.9%	-5.0%	3.0%
9	-2.9%	7.8%	-5.6%	9.2%	-3.6%	2.0%
10	-1.3%	-0.6%	3.5%	8.2%	-3.3%	2.1%
11	2.2%	1.0%	-0.3%	7.6%	-2.9%	1.9%
12	30.6%	-0.3%	-9.3%	9.3%	-2.7%	0.9%
13	11.4%	-13.2%	6.7%	9.5%	-3.5%	1.3%
14	26.2%	-22.9%	18.0%	10.6%	-5.0%	2.4%
15	-3.4%	-0.5%	22.0%	9.7%	-4.8%	3.6%
16	-17.8%	0.3%	-5.9%	7.7%	-4.5%	3.0%
17	4.7%	-1.1%	-5.6%	7.5%	-4.3%	2.5%
18	20.9%	-2.0%	-5.9%	8.2%	-4.2%	2.0%
19	-4.1%	3.2%	10.2%	7.5%	-3.8%	2.4%
20	12.5%	4.7%	-8.9%	7.8%	-3.5%	1.9%
21	13.0%	-3.6%		8.0%	-3.5%	
22	8.6%	-3.1%		8.0%	-3.4%	
23	5.5%	5.4%		7.9%	-3.1%	
24	0.9%	-2.2%		7.6%	-3.0%	
25	7.6%	-5.5%		7.6%	-3.1%	
26	16.9%	-6.0%		7.9%	-3.3%	
27	6.3%	-1.8%		7.9%	-3.2%	
28	16.0%	-6.4%		8.1%	-3.3%	
29	9.9%	-8.1%		8.2%	-3.5%	
30	15.2%	-12.2%		8.4%	-3.8%	
31	9.9%	-4.0%		8.5%	-3.8%	
32	11.0%	-7.5%		8.5%	-3.9%	
33	4.1%	-2.1%		8.4%	-3.9%	
34	10.6%	-16.9%		8.5%	-4.3%	
35	5.6%	-4.0%		8.4%	-4.2%	
36	4.3%	-4.3%		8.3%	-4.2%	
37	5.2%	-1.6%		8.2%	-4.2%	
38	-3.2%	-0.2%		7.9%	-4.1%	
39	-11.6%	-0.7%		7.3%	-4.0%	
40	-3.7%	3.3%		7.0%	-3.8%	
41	-6.2%	0.7%		6.7%	-3.7%	
42	-9.5%	4.1%		6.3%	-3.6%	
43	-5.9%	-5.1%		6.0%	-3.6%	
44	0.9%	2.8%		5.9%	-3.4%	
45	2.2%	-10.0%		5.8%	-3.6%	
46	3.3%	-11.4%		5.7%	-3.8%	
47	18.8%	-10.4%		6.1%	-4.1%	
48	-12.1%	-10.6%		5.4%	-4.3%	
49	17.0%	-10.1%		5.8%	-4.5%	
50	14.8%	-9.4%		6.2%	-4.7%	
51	2.9%	3.0%		6.0%	-4.3%	
52	-47.2%	12.9%		3.5%	-3.9%	

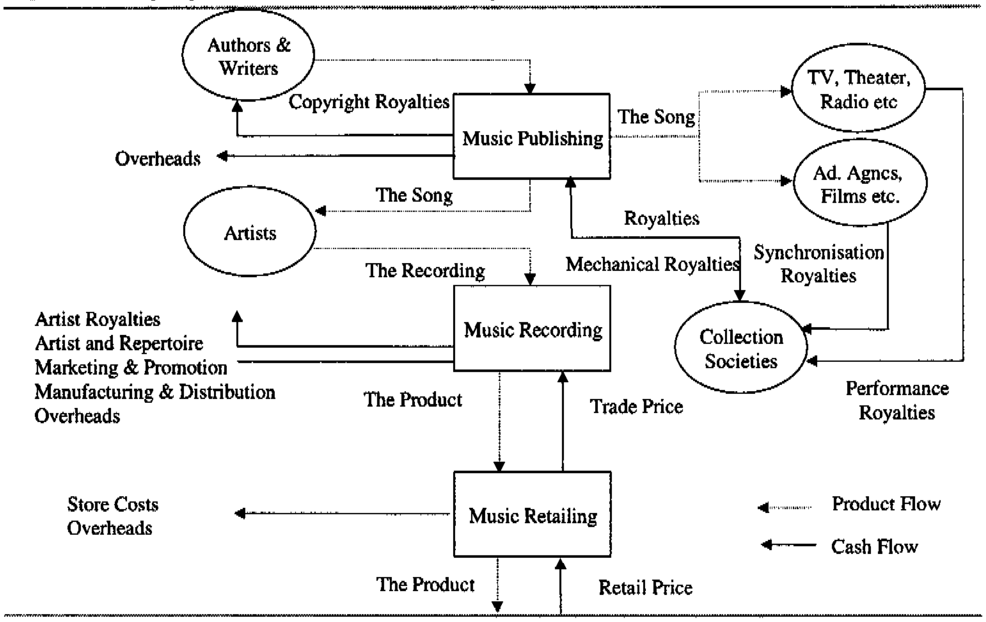
Source: Soundscan.

Music Publishing

Music publishing is a poorly understood business, in our view. It refers to the exploitation of the commercial ownership of a song. Owners of publishing rights are entitled to royalties whenever music is sold (e.g., CD, tape, vinyl, and digital), played in public or on the air, or when a song is used in a film or a commercial. There are three types of owners of publishing rights: (1) the author of the lyrics; (2) the composer, who wrote the music; and (3) the publisher, who owns the rights to exploit the song (just like a book publisher).

In Figure 36, we set out the various flows of royalties within the music industry.

Figure 54: **Royalty Flows in the Music Industry**



Source: Company data, Credit Suisse estimates.

There are three main royalty streams.

1. *Mechanical.* These royalties are collected whenever a CD or other music format is sold. In the UK, mechanical royalties are 8.5% of the PPD (published price per dealer or wholesale price). In Europe, mechanical royalties are typically 9.1%, and in the United States they are 6.95 cents per track up to five minutes, based on the retail price. Usually 50% of mechanical royalties go to the publisher, 25% to the author, and 25% to the composer.
2. *Performance.* These are collected when a song is played on air, typically split evenly between publisher, author and composer.
3. *Synchronization.* These are royalties received for music in advertisements, films, games, etc.

The songwriters may sign publishing deals with publishing companies for financial advances (e.g., for up-and-coming songwriters) or expertise (e.g., contacts, session artists, and studio facilities, etc.). The publisher may also assist in marketing the song to record companies and other media (e.g., advertising agencies) and may collect the royalties through the respective collecting societies (PRS/MCPS in the UK) on behalf of the songwriter. Alternatively, songwriters may want to retain their publishing rights and collect direct from the collecting society—or retain the rights to sell later for money if confident of the eventual success of the song.

Copyright duration—not an issue, even for recorded music copyrights

There has been some concern among investors that valuable music publishing rights will expire imminently. In fact, they last for 70 years after the death of the last remaining author. A more relevant concern is the finite duration of the copyright for music recording rights. These rights relate to the commercial ownership of a recording, e.g., The Beatles' *Love Me Do*, which belongs to EMI. Recorded music copyrights last for 95 years from the date of first release in the United States (having been recently extended after extensive lobbying by Disney), although just for 50 years in Europe.

Once the copyright expires, anyone can produce a CD with that particular song- although they would still have pay publishing royalties. So in theory copyrights of major recordings produced in the early 1960s will expire sometime after 2010. For EMI, this would include some of The Beatles' songs, which were so lucrative (e.g., the number 1 double album released a few years ago). In fact, we believe there are several mitigating factors.

1. EMI's management is hopeful that it can persuade the European Union to extend the copyright period to that of the United States, for consistency and in sympathy with the value of intellectual property rights.
2. EMI would most likely try to ensure these recordings were fully exploited just before expiry of copyright.
3. Not all the tracks for one artist (e.g., The Beatles) would expire together, limiting the ability to produce a comprehensive collection of songs.

Companies Mentioned *(Price as of 16 Jun 06)*

Apple Computer Inc. (AAPL, $57.56, OUTPERFORM, TP $90.00, MARKET WEIGHT)
EMI Group plc (EMI.L, 271.00 p, OUTPERFORM, TP 300.00 p, OVERWEIGHT)
Napster, Inc. (NAPS, $3.08)
Sony (6758, ¥4,940, OUTPERFORM, TP ¥7,500, MARKET WEIGHT)
Time Warner, Inc (TWX, $16.96, OUTPERFORM, TP $22.00, OVERWEIGHT)
Vivendi (VIV.PA, Eu26.95, NEUTRAL, TP Eu24.00, OVERWEIGHT)
Wal-Mart Stores, Inc. (WMT, $48.31, OUTPERFORM, TP $55.00, MARKET WEIGHT)
Walt Disney Company (DIS, $29.45, OUTPERFORM, TP $41.00, OVERWEIGHT)
Warner Music Group (WMG, $27.15, OUTPERFORM, TP $30.00, OVERWEIGHT)
Yahoo Inc. (YHOO, $30.36, OUTPERFORM, TP $45.00, OVERWEIGHT)

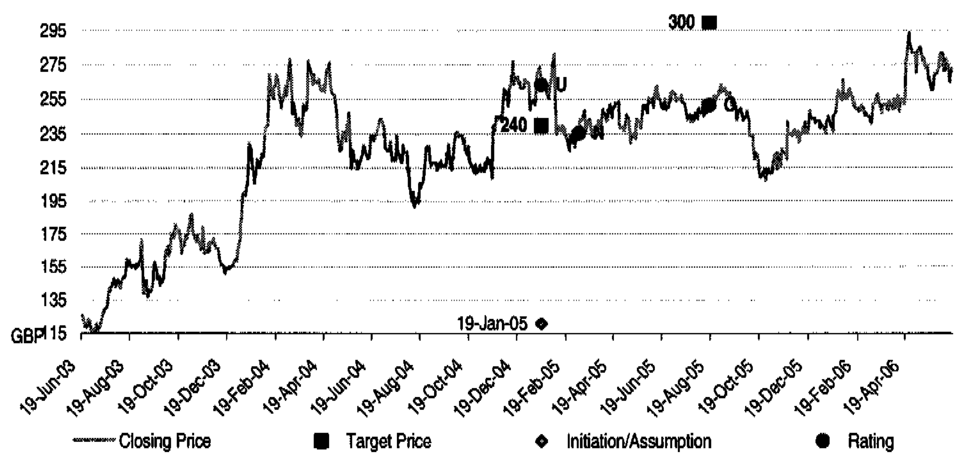
Disclosure Appendix

Important Global Disclosures

William B. Drewry, Jolanta Masojada, Nick Bertolotti & Giasone Salati each certify, with respect to the companies or securities that he or she analyzes, that (1) the views expressed in this report accurately reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

See the Companies Mentioned section for full company names.

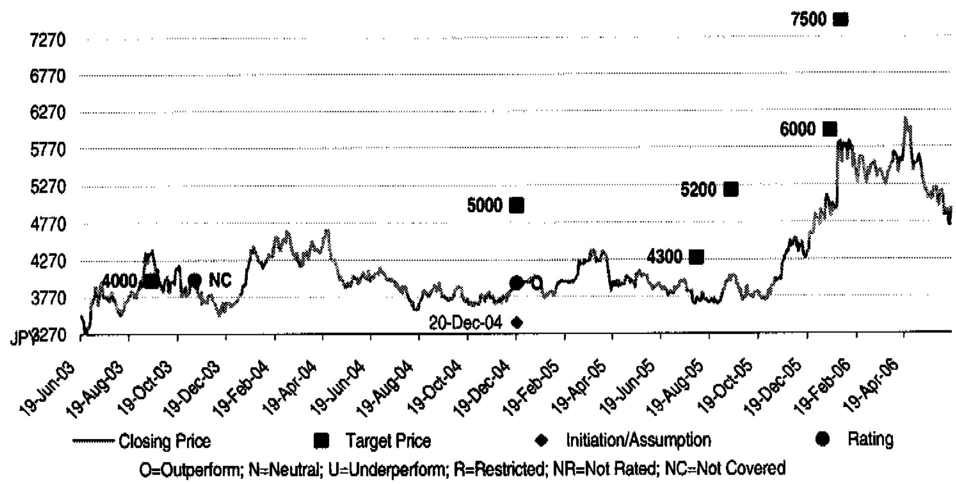
3-Year Price, Target Price and Rating Change History Chart for EMI.L



O=Outperform; N=Neutral; U=Underperform; R=Restricted; NR=Not Rated; NC=Not Covered

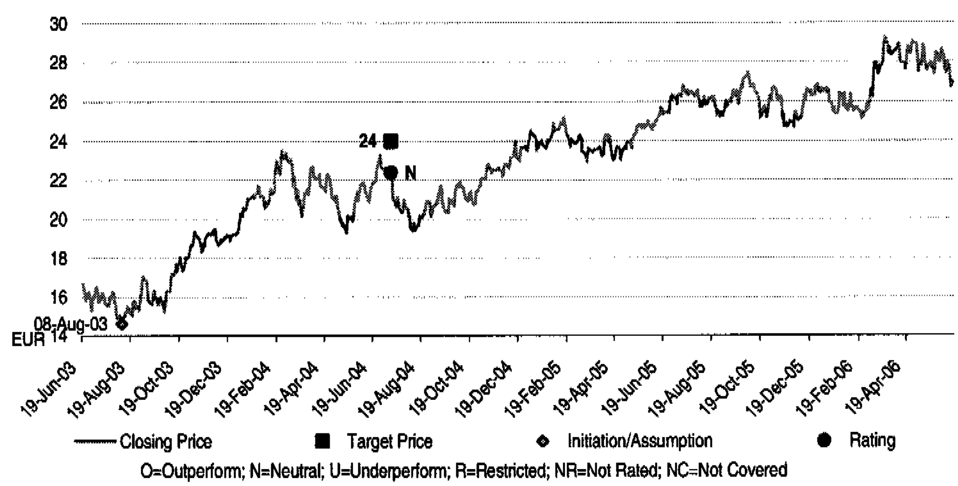
EMI.L Date	Closing Price Price (p)	Target Price Price (p)	Rating	Initiation/ Assumption
19-Jan-05	263.5	240	UNDERPERFORM	X
7-Mar-05	235.25		NEUTRAL	
18-Aug-05	251.5	300	OUTPERFORM	

3-Year Price, Target Price and Rating Change History Chart for 6758



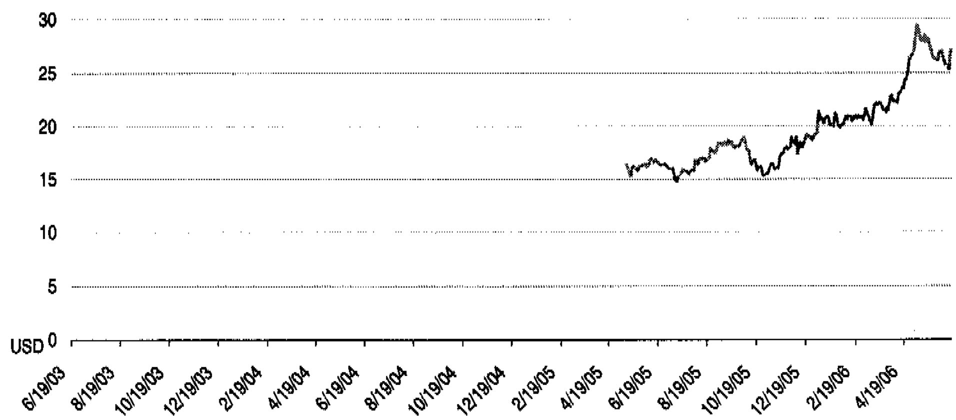
6758 Date	Closing Price Price (JPY)	Target Price Price (JPY)	Rating	Initiation/ Assumption
16-Sep-03	4360	4000		
10-Nov-03	4000		NOT COVERED	
20-Dec-04	3950	5000	OUTPERFORM	X
3-Aug-05	3750	4300		
15-Sep-05	4010	5200		
17-Jan-06	4910	6000		
31-Jan-06	5700	7500		

3-Year Price, Target Price and Rating Change History Chart for VIV.PA



VIV.PA Date	Closing Price Price (EUR)	Target Price Price (EUR)	Rating	Initiation/ Assumption
8-Aug-03	0		NOT COVERED	X
12-Jul-04	22.38	24	NEUTRAL	

3-Year Price, Target Price and Rating Change History Chart for WMG



WMG	Closing Price	Target Price	Initiation/

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Analysts' stock ratings are defined as follows***:

Outperform: The stock's total return is expected to exceed the industry average* by at least 10-15% (or more, depending on perceived risk) over the next 12 months.

Neutral: The stock's total return is expected to be in line with the industry average* (range of ±10%) over the next 12 months.

Underperform:** The stock's total return is expected to underperform the industry average* by 10-15% or more over the next 12 months.

**The industry average refers to the average total return of the analyst's industry coverage universe (except with respect to Asia/Pacific, Latin America and Emerging Markets, where stock ratings are relative to the relevant country index, and Credit Suisse Small and Mid-Cap Advisor stocks, where stock ratings are relative to the regional Credit Suisse Small and Mid-Cap Advisor investment universe.*

***In an effort to achieve a more balanced distribution of stock ratings, the Firm has requested that analysts maintain at least 15% of their rated coverage universe as Underperform. This guideline is subject to change depending on several factors, including general market conditions.*

****For Australian and New Zealand stocks a 7.5% threshold replaces the 10% level in all three rating definitions.*

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Overweight: Industry expected to outperform the relevant broad market benchmark over the next 12 months.

Market Weight: Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.

Underweight: Industry expected to underperform the relevant broad market benchmark over the next 12 months.

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***An analyst's coverage universe consists of all companies covered by the analyst within the relevant sector.*

****The broad market benchmark is based on the expected return of the local market index (e.g., the S&P 500 in the U.S.) over the next 12 months.*

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Global Ratings Distribution

Outperform/Buy*	40%	(61% banking clients)
Neutral/Hold*	42%	(55% banking clients)
Underperform/Sell*	15%	(49% banking clients)
Restricted	3%	

**For purposes of the NYSE and NASD ratings distribution disclosure requirements, our stock ratings of Outperform, Neutral, and Underperform most closely correspond to Buy, Hold, and Sell, respectively; however, the meanings are not the same, as our stock ratings are determined on a relative basis. (Please refer to definitions above.) An investor's decision to buy or sell a security should be based on investment objectives, current holdings, and other individual factors.*

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See the Companies Mentioned section for full company names.

Price Target: (12 months) for (EMI.L)

Method: Our 310p target price for EMI is based on a discounted cash flow valuation analysis, supported by an analysis of merger economics from a potential takeover or merger with WMG. Our merger analysis is based on a $30 offer price (a 5% premium to EMI's previous offer) and assumes cost savings of £125m per annum. Our discounted cash flow analysis uses a weighted average cost of capital of 9.1%, a terminal growth rate of 2.5%, net debt of £880m and 874m shares outstanding (including 78m convertible shares).

Risks: Risks to our 310p target price for EMI include: (1) an EMI/WMG merger not materialising; (2) the music industry economics are still in the process of evolving and downside risks exist if digital revenues fall below expectations or if physical sales decline more than we have forecast; and (3) the balance of power within the music industry possibly shifting more towards the artists and the retailers (both physical and digital).

Price Target: (12 months) for (6758)

Method: Our Y7,500 target price for Sony is based on a sum-of-the-parts valuation of the major divisions: (1) the electronics business is valued at 8x estimated FY3/07 EBITDA of Y429bn, adding back restructuring charges of Y64bn; (2) the game business at 12x the 5-year average EBITDA of FY3/06-10 of Y77bn; and (3) the pictures business at 10x estimated FY03/07 EBITDA of Y60bn. We value the finance business at 1.5x book value of Y584bn. Our analysis assumes net cash of Y104bn and 998mn shares outstanding.

Risks: Risks to our Y7,500 target price for Sony are: (1) earnings at the electronics business, which is the biggest single earnings and valuation contributor; (2) lower-than-expected demand or lower-than-expected pricing for television products; (3) launches at related PS3 businesses; and (4) foreign exchange fluctuations.

Price Target: (12 months) for (VIV.PA)

Method: Our eu 24 target price for Vivendi is based on a sum-of-the-parts valuation on which we apply a 15% holding discount. The main copmponents of our SOTP are: i) 56% stake in SFR valued at16.9x FCF 06E, or eu16bn; ii) UMG valued on 7.7x EBITDA 06E, or 6.6bn; iii) 20% stake in NBC-U valued at 8.9x EBITDA 06E or 5.8bn; iv) 51% of Maroc Telecom valued at market price, or eu5.4bn; v) Canal+ Group at 9x EBITDA, or 2.5bn for Vivendi stake. We also value the Global Tax System at eu1.6bn (NPV of cash flows from 2007 onwards, consistent with net debt of eu3.9bn at the end of 2006.

Risks: Risks to our eu24 target price for Vivendi are: (1) regulatory approval for the Canal+/TPS proposed merger and related restructuring plan; (2) European mobile telephony regulation; (3) impact of potential acquisitions on our holding discount; and (4) foreign exchange fluctuations.

Price Target: (12 months) for (WMG)

Method: Our target price of $30 for WMG is based on a discounted cash flow valuation analysis supported by an analysis of merger economics from a potential takeover from EMI. Our merger analysis is based on a

$30 share price, a 5% premium to EMI's previous offer. Our discounted cash flow analysis uses a weighted average cost of capital of 9.6%, terminal growth rate of 2.5%, net debt of $1.9bn and 150.7m shares outstanding.

Risks: Risks to our target price of $30 for WMG revolve around a further offer from EMI not being forthcoming. In addition, music industry economics are still in the process of evolving and downside risks exist if digital revenues are below expectations or if physical sales decline more than forecast

See the Companies Mentioned section for full company names.

The subject company (EMI.L, 6758, VIV.PA, WMG) currently is, or was during the 12-month period preceding the date of distribution of this report, a client of Credit Suisse.

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Credit Suisse provided non-investment banking services, which may include Sales and Trading services, to the subject company (6758) within the past 12 months.

Credit Suisse has received investment banking related compensation from the subject company (6758, VIV.PA) within the past 12 months.

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Credit Suisse has received compensation for products and services other than investment banking services from the subject company (6758) within the past 12 months.

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The analyst(s) involved in the preparation of this report have not visited the material operations of the subject company (EMI.L, 6758, VIV.PA, WMG) within the past 12 months.

Restrictions on certain Canadian securities are indicated by the following abbreviations: NVS--Non-Voting shares; RVS--Restricted Voting Shares; SVS--Subordinate Voting Shares.

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