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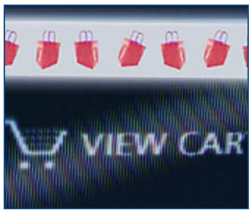
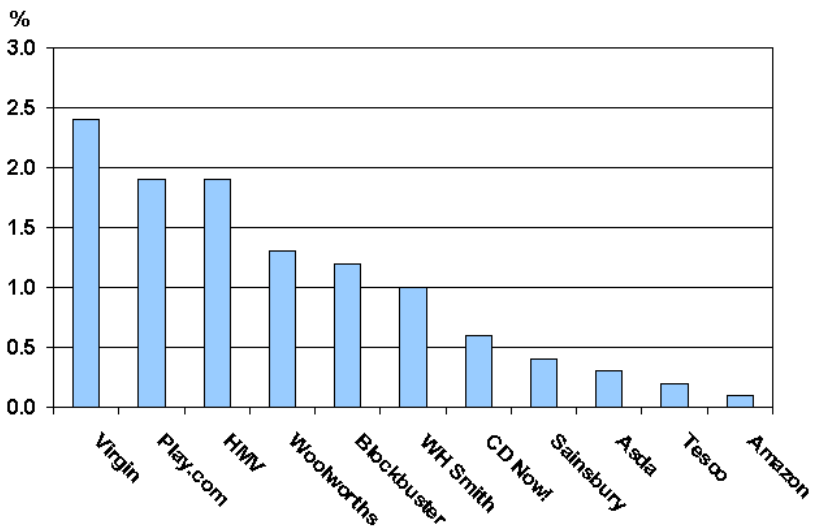
UK Music & Video Retailers 2007

HD DVD provides some relief for beleaguered sector

Sector Report - Published October 2007



2006 advertising spend as % of 2006/07 turnover



Source: UK Music & Video Retailers 2007

"Specialists spend most on advertising as a proportion of their revenue. Verdict estimate Virgin Megastores spends 2.4%, followed by online specialist Play.com and HMV at 1.9%. Essentially specialists need to spend a higher proportion to attract footfall to stores. In contrast, grocers maintain high levels of footfall because of their food offer. Amazon spends least on its advertising, as a proportion of revenue. This highlights the immense strength of its brand, in that many customers will type Amazon directly into their browser windows as a first port of call when making an online purchase..."

About Verdict Research...

Verdict Research has been producing independent retail analysis and comment on the UK retail marketplace for well over 20 years and is regarded as a key source by BBC, ITV and the leading broadsheets including, the FT, Times, Independent and Daily Telegraph. Many leading trade publications also frequently refer to Verdict's opinion and research including Retail Week, DIY Week, Cabinet Maker and The Grocer.

Products and services include:

- **Consumer Research Reports**
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- **UK Sector Reports**
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  - Out of Town Retailing
  - Town Centre Retailing
- **Retail Futures**
  - Quarterly Forecasts to 2009
  - Annual Forecasts to 2011
- **Retail News & Comment**

Some key findings from this report...

- **Music and video was the worst performing sector in UK retail in 2006** by a considerable margin. Verdict expect it to severely underperform throughout 2007 with continuing price deflation and weakening underlying demand for CDs and DVDs.
- **The UK music and video market is past the worst.** Although piracy will continue and CD volumes will decline further, retailers are generally better placed to cope with new market challenges. Many weaker players have fallen from the market and digital downloading is starting to pick up pace and has future potential.
- **A new generation of digital-savvy consumers is emerging.** The next generation of consumers has a different mindset. Brought up with the Internet, broadband and services such as MySpace, these younger consumers have a less emotional attachment to physical CDs. Their music collection is a list of tracks stored on their PC or iPod.
- **In the short term next generation DVD will help stabilise the market.** HD-DVD and Blu-ray are unlikely to drive a surge in sales to the extent DVD did when it became mass market. For many consumers that have bought an HD ready TV, next generation DVD will be the first opportunity to test their new equipment's full abilities.

Music and video channels of distribution

	2002 Share of Music & Video %	2007e Share of Music & Video %
Music & Video Specialists	42.2	38.4
High Street Non-specialists	21.7	11.9
Grocers	18.5	25.5
Online Specialists	7.1	18.0
Mail Order	6.4	3.0
Others	4.1	3.2
Total	**100.0**	**100.0**

Source: UK Music & Video Retailers 2007

"Despite the vast quantity of new space rolled out by market leader HMV, specialists have lost share of the music & video market over the past five years. Weaker players have been forced out of the market by aggressive price competition and Virgin, has seen overall store numbers decline as it has adjusted its store estate to focus on larger formats. Though they are making the right moves now, online specialist iTunes has already taken a substantial lead..."

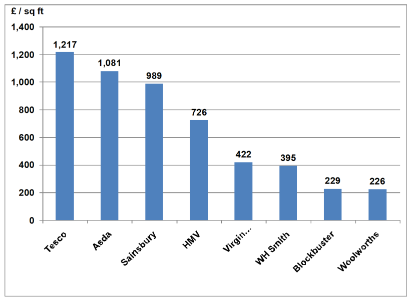
UK Music & Video Retailers 2007

Music and video retailing is in the midst of traumatic change with established music and video specialists needing to fundamentally alter their business models to retain their appeal with customers. While digital downloading offers a low cost platform to sell to shoppers, it also means high street music and video retailers need to reinvent their propositions to continue to trade from high street locations profitably.

UK Music and Video Retailers 2007 is a new report published by Verdict that examines the dynamics of the UK music and video sector and the reasons for its recent poor performance. This report provides UK music and video market shares, market sizes, space, distribution, advertising and forecast market values and volumes to 2012.
It profiles the leading retailer's key operating statistics including margins, profits, stores, space and sales densities.

This new report will help you understand the key issues in the UK music and video sector and develop effective growth strategies in this rapidly changing market.

Grocers achieve the highest sales densities



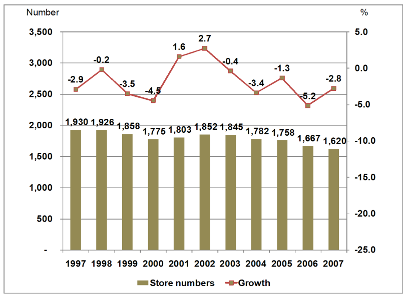
Source: UK Music & Videos Retailers 2007

"Grocers achieve the highest sales densities, with Tesco heading the table returning £1,217 per sq ft, followed by Asda on £1,081. Sainsbury occupies third place achieving £989 per sq ft. Grocers' sales densities are higher than others because of the tremendous footfall generated by food..."

This new report will enable you to...

- **Benchmark your competitive strategies using the company profiles contained in this report** for key retailers including Amazon, Apple/iTunes, Asda, Blockbuster, CD Wow!, HMV, Play.com, Sainsbury, Tesco, WH Smith, Woolworths, WH Smith and Virgin Megastores/Zavvi and music and video online retailers.
- **Quantify key retail trends and accurately predict future UK music and video retailing growth** with this report's ten year trend data detailing market sizes, market shares, specialists sales, specialist store numbers, space growth, total selling space, sales densities, channels of distribution and forecasts to 2012.
- **Assess key retailers performance** with the five year trends in key operating statistics, retailer market shares, sales densities, operating margins and advertising spend by media contained in this report.
- **Enhance strategies to capitalise on market opportunities** with analysis of technological developments, market trends, operators' development plans, trading performance and Verdict's outlook and recommendations for each retailer.

Music and video specialists store numbers



Source: UK Music & Video Retailers 2007

"Specialist store numbers have declined over recent years with continuing closures of independents struggling under the pressure of a weak market environment, price deflation, and rising costs on the high street. The closures of Music Zone, Silverscreen and Fopp (excluding stores bought by HMV) have also impacted..."

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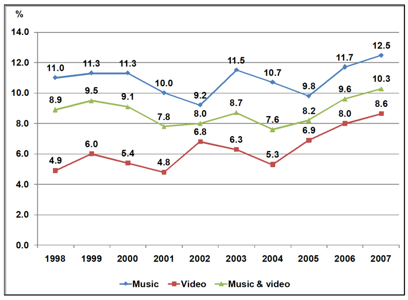
Some key issues examined in this report...

- **Next generation technology will accelerate the transition to digital.** A series of new technologies will help drive mass market adoption of digital downloading. In particular developments which will aid convenience, such as wirelessly purchasing of MP3 tracks, and fast, easier to use websites will be of great importance.
- **Specialist diversification.** Rapidly falling demand for CDs and stagnation of the DVD market is forcing specialists to diversify their offers. HMV is aggressively pursuing growth in digital downloading and is introducing a wider range of products to stores. HMV has added electrical goods such as MP3 players and their accessories.
- **Digital downloading.** Since the launch of the earliest legal digital downloading services in 2004, substantial progress has been made. The increase of fast and affordable broadband internet connections and the proliferation of new services in recent years have underpinned rapid growth in sales. However, despite strong growth, it is still early days for this market compared with the CD market.

Virgin Megastores music & video shares 1998-2007e



Source: UK Music & Video Retailers 2007

"In addition to the continual improvement in broadband download speeds, the removal of Digital Rights Management software will help to drive demand for downloads. Nonetheless downloads will have to compete for share of leisure time with the increasing popularity Web 2.0 applications and podcasts. ..."

Some key questions answered by this report...

- Who are the leading music and video retailers in the UK and why are they successful?
- Which retail channels are growing their share of the UK music and video sector?
- Which factors are inhibiting growth in the UK music and video market?
- How important are downloads in the UK music and video market and how can retailers drive traffic to their online stores?
- What measures are retailers taking to cut their costs and protect their margins?
- What initiatives are retailers taking to make their store environments more compelling and differentiate their product offerings?
- What should retailers do to gain music and video market share in the UK?

Online specialists estimated market shares 2007 (%)

Online Specialist	Share of Music & Video Market 2007 %
Play.com	5.8
Apple/iTunes	2.0
CD WOW!	1.3
Other	3.3
Total	**18.0**

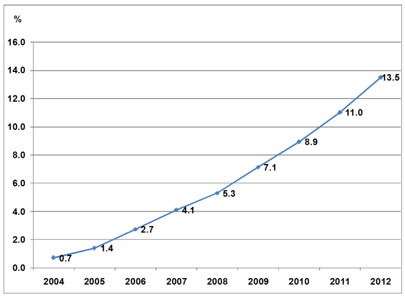
Source: UK Music & Videos Retailers 2007

"Online specialists have increased their share substantially over the past five years. Having accounted for 7.1% of music & video spending in 2002, we expect their share will reach 18.0% by the end of 2007, up from 15.7% in 2006. We expect 2007 will be a particularly strong year for online specialists because of a sharp increase in sales of digital downloads..."

Sample information from 'UK Music & Video Retailers 2007'

Chapter 4: Key Issues

Figure 8: Digital downloading as % of the music & video market



Source: UK Music & Video Retailers 2007

DRM-free Downloading

- In 2007 EMI announced that it would remove Digital Rights Management software from premium digital downloads on iTunes. This represented a significant turnaround from the music industry's traditional viewpoint.

- Keen to prevent growth in the piracy which has plagued the UK music market greatly over recent years, the industry backed the idea of Digital Rights Management (DRM). This is a copyright protection system that locks tracks purchased from legal download sites until a valid password is provided. Also it restricts tracks so they can only be played on a limited number of devices like iPods and PCs, 'authorised' by the user.

- It is broadly fair to say that the technology has not been successful. Pirates have continued unabated by simply copying or burning CDs – which do not have DRM. Also, many otherwise law abiding consumers download songs from illegal websites. If anything, DRM has acted as a bar on market growth as the technology increases complexity for the consumer and lacks essential flexibility.

- Unfortunately for the music industry, it arrived late at the downloading party. While file sharing software has facilitated illegal downloading since the end of the last millennium, legal services were not launched on any significant scale until 2004. With illegal downloading well established, new legal services are viewed by many as an overpriced, difficult to use and inflexible alternative.

- The latest move seeks to address this and, in our eyes, has little downside. Though there is a degree of risk being taken by EMI as consumers will be able to share files they buy, this is of little consequence, since tracks are already widely available for illegal downloaders. But, most importantly, the removal of DRM, reinforced by an improvement to quality of sound on these 'premium' tracks, provides consumers with a strong competitor to illegal file sharing.

- Looking ahead we believe DRM-free music will be crucial, if legal digital downloading is to combat illegal downloading, particularly because it will enable users of any digital music player to buy from any digital download player. The restrictions currently in place restrict competition, causing a lack of consumer choice and high prices.

- By the end of the year, we expect Amazon will have launched its digital download service, which is set to be free of DRM.

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