NEW YORK (Reuters) - Apple Inc.’s digital music store iTunes is now the third-largest music retailer in the United States with 10 percent market share, overtaking Amazon.com in the first quarter, according to a survey released on Friday.

The NPD Group report highlights the growing strength of digital music in the U.S. market as physical sales of compact discs continue to slide.

Apple’s iTunes is third behind market leader Wal-Mart Stores Inc. with a 15.8 percent share, and Best Buy Co Inc. with a 13.8 percent share, according to the survey of 40,000 people aged 13 and older.

Both of those retailers mostly sell music in the CD format. Online store bestbuy.com has a 1.1 percent market share with sales of both CDs and digital music.

Amazon.com Inc. dropped to fourth with a 6.7 percent share. Its sales increased but not as fast as rivals.

Amazon also sells music mainly in the CD format, but last month it started selling digital music but without copy protection software such as that used by iTunes.

NPD said the iTunes digital music store had benefited from sales of Apple’s iPod digital music player during the holiday season. The vast majority of digital songs and albums bought on iTunes will only play on iPods, as well as the iTunes PC application.

iTunes last month rolled out a new service called iTunes Plus which sells higher quality digital songs without copy protection at a premium price.

NPD analyst Russ Crupnick said that iTunes had also benefited from the slowdown in CD sales, the dominant format for recorded music sales.

According to sales data from Nielsen SoundScan, first quarter sales of music CDs were down by more than 20 percent year-on-year, a trend analysts don’t expect to change.

"With only a couple of weeks remaining in the second quarter, industry CD sales have shown only marginal improvement over first quarter levels," said Richard Greenfield, analyst at Pali Capital in a note to clients on Thursday.

Though Wal-Mart is the top U.S. music retailer, it carries a relatively narrow selection of
CDs. Some analysts believe its rivals are likely to consider a similar strategy.

"Anecdotally we're hearing they're beginning to think about cutting back on retail space for physical (music)," said Crupnick. "But in the near term retailers like Wal-Mart and Best Buy are going to continue to be powerhouses."