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# EMI Annual Profit Up 14%

The record company is the latest to report stronger results, fueling industry optimism.

By Charles Duhigg, Times Staff Writer  
May 24, 2006

After years of suffering from illegal downloads and competition from other forms of entertainment, the music industry is singing a new song: A rebound may finally be near.

On Tuesday, London-based EMI Group became the latest major record company to post significantly higher profit, as well as its first annual sales increase in five years. That follows recent upbeat releases by rivals Universal Music Group and Warner Music Group.

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"In the long term, this is going to be a very strong industry," said Doug Morris, chief executive of Universal Music. "The short term will have mixed results, and there have been some tough years, but as long as there are hits, people will want to buy music."

EMI, which reports only annual results, said profit rose 14% to 86.1 million pounds (\$162 million) for the year ended March 31. Revenue rose 4% to 2.1 billion pounds (\$3.9 billion), thanks to strong-selling albums from Coldplay, Gorillaz and country singer Keith Urban.

The results may strengthen EMI's resolve to acquire Warner Music. This month EMI's offer of \$4.2 billion was rebuffed, but EMI executives believe Warner may be open to a higher bid.

EMI was especially buoyed by growth in digital revenue, considered the industry's future as iPod-like devices proliferate. It soared 135%, to 112.1 million pounds.

"In the next five years, digital downloads will increase sevenfold," said Larry Haverty, who oversees a media portfolio at Gabelli Asset Management Inc. "Downloads have higher margins than physical CDs, they're easier to sell and distribute — the industry is going to become more and more profitable."

Besieged by illegal copying and competition from video games and DVDs, music sellers are hopeful the latest trends signal a turnaround. The industry has seen six consecutive years of declines in global sales of compact discs.

Although that slump hasn't ceased, the increase in digital profit and new music products such as mobile phone ring tones and online subscription services are providing hope. Overall, digital downloads now account for 10% of U.S. album sales.

"MTV, Apple Computer, the cellphone companies — they're all building new ways to buy music," said Haverty, who oversees large investments in French firm Vivendi, Universal Music's parent company. "I went to the Apple store in New York, and on a beautiful Saturday afternoon there was a line of 500 people waiting to get inside. That makes it hard not to be enthusiastic."

Some industry executives caution that it's too early to proclaim a full-scale recovery.

"We won't know if we've turned a corner until this year's fourth quarter," said Andrew Lack, chairman of Sony BMG Music Entertainment. "That's when the bulk of sales occur. This is a pivotal year in determining if downloads will offset physical declines."

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As digital downloads increase, the industry has been frustrated with Apple, which sells 80% of digital music in the U.S., for resisting pressure to raise prices. Digital subscription models also have failed to take off, and although ring tones — the song clips that play on cellphones — have brought the industry more than \$3 billion in revenue, other cellular products have failed to mirror that success.

Music companies have been trumpeting fast-growing digital sales to investors, which some analysts caution could hurt their credibility if those sales hit a bump.

"As long as a big chunk of record companies' revenues still come from physical sales, they're running really expensive businesses," said entertainment analyst Mike McGuire of research firm Gartner. "The problem is that, right now, Wall Street punishes music companies if they don't increase profits every quarter. So there's not a huge amount of room for experimentation."

Pali Capital analyst Richard Greenfield, for example, is forecasting a decline in downloads in this year's second quarter.

"I don't know what the cause is," he said. "Sales of iPods and MP3 players are growing, but downloads are slowing. It's proof there's going to be a lot of volatility getting to a point where 100% of sales are downloads."

Others point out that music companies are generating much of their profits as a result of cost cutting that will inevitably end. More than 5,000 industry employees have been fired in the last four years.

"If you cut too deeply, you don't have any business left," said Morgan Stanley analyst Patrick Wellington.

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