BYTE OF THE APPLE
By Alex Salkever

Steve, Steer Clear of Universal Music
Talk of Apple buying the giant music company has been enough to sink Jobs & Co.'s stock. Going through with it would be even worse

When it comes to drama, *American Idol* has nothing on the unfolding saga of Apple Computer (AAPL) and Vivendi (V), which started on Apr. 15 with a report from *The Los Angeles Times* that Apple might bid on the French conglomerate's Universal Music Group. The new international sensation stars a vacillating Frenchman, Vivendi CEO Claude Bebear, and a man in a black mock turtleneck, Steve Jobs, dueting on *Denials in the Key of Nondenial*. This tale even has a cameo for everyone's favorite Hollywood heavy. No, not Simon Cowell, but media mogul Barry Diller, who's locked in a legal tango with Vivendi over monies he claims are owed him.
Catcalls from the markets drove Apple's stock down 8% on the news. It closed at $13.51 on Apr. 22, still way off its 52-week high of $25.98, as speculation continues to fly. Clearly, investors don't like the idea of Apple plunking down close to $5 billion, the widely accepted estimate, for the world's largest music company.

Personally, I'm with nervous investors on this one. Let's face the music: Even though Universal Music had an operating profit of $510 million last year and is cash-flow rich, the music business can fluctuate wildly year to year depending on the success of new stars and new songs.

NO TUNES FOR YOU. Besides, in my opinion, Apple is on the verge of a break-out quarter, with or without a music division in its future. A much-anticipated new line of chips should breathe new life into Apple desktop sales later this summer. And when graphic design and publishing program Quark finally comes out with an OS X version in the next few months, the pent-up demand for new Apple products in the creative sector could produce a surge in revenues. So looking to the music business for growth seems like an odd strategic move to me.

Proponents say Apple, with its highly creative and innovative multimedia software and tools, has to make a bold move to avoid being shut out of online music delivery. As it stands now, none of the major music services offers downloads for Mac clients. And with Mac owners representing a mere 3% to 5% of the total PC audience, Apple will need a crowbar to get into a market that Macheads believe it should own by birthright.

Having Universal Music would certainly accomplish that. And looking ahead, Jobs could use his seat at the turntable to break a looming Microsoft (MSFT) stranglehold on digital-rights management technology. But here are five good reasons why Apple should pass on this deal:

**History isn't on Apple's side:** No company has successfully managed to be both a device maker and a content producer at the same time. The only one that has come close is Sony (SNE) with its PlayStation game platform. Sony did well for a while making consumer electronics while producing movies and music. Now both units are lagging -- and moving in different strategic directions. The electronics unit wants to freely distribute content. But the entertainment units want to sell more premium content and restrict use. If Apple tries to do both, it may soon mirror Sony's plight.
The Mac stage has room for only one impresario: Jobs is the alpha male of Apple. His name is synonymous with the company, and he's a technophile to the core. As one top tech executive told me this week, "the reason Steve likes the talent at Pixar [home of cool movie special-effects wizardry] is because it's computer-generated." I shudder to think what might happen when he has to deal with a business full of entertainment moguls accustomed to massive perks, star treatment, and getting their way. And at the next level are the top music execs, who sometimes have salaries bigger than the CEOs they serve. Does Jobs really want to share his space with this crowd? Or more to the point: Can he? I have my doubts.

Messing with the House of Diller: The CEO of e-commerce giant USA Interactive (USAI) is suing Universal for $620 million that he claims the French conglomerate owes him. USAI and Vivendi remain intricately linked through arcane deals and cross-holdings. Both sides want to unravel that mess. But Diller says he'll exercise what he perceives as his contractual right to approve future Vivendi deals. That means Diller may try to dictate the terms, and he's a tough cookie. Besides, buying any company that faces pending litigation and a lot of confusion about its asset disposition is a clear no-no in the corporate world.

Money, money, money, money: Apple has scant options to raise cash for this deal. On Apr. 16, it reported that first-quarter profits had dropped 65% year-over-year. It's facing stagnant or declining sales in the key education and creative markets. CFO Fred Anderson warned in a conference call that the picture looks challenging for the foreseeable future.

That's not exactly what an underwriter of bonds, particularly to buy into the music business, wants to hear. Apple has $4.5 billion in cash right now, but that's probably short of the amount needed to cover the tab without help from a partner. As the computer world's lean, lone wolf, Apple has no track record with partners. And if it blew even a big portion of its wad on the deal, the response from Wall Street would be devastating.

Time is on Apple's side: Pssst, Steve. You could probably get a better deal in six months. Both Time Warner and Vivendi are also shopping their music businesses, while the sector's fundamentals are rapidly weakening. As the music biz continues to shift from CDs, a lucrative but
tightly controlled distribution business, to the wild new frontier of online delivery (see BW Online, 4/22/03, "Web Music Gets Its Act Together"), music sales could face further upheaval. Jobs could well be foolishly buying an asset at a price that'll look inflated in the very near future.

Call me crazy. But if I were Jobs, I'd start singing a different tune.

**Salkever**, Technology editor for BusinessWeek Online, is filling in while regular Byte of the Apple columnist Charles Haddad is on leave

*Edited by Douglas Harbrecht*

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