Digital Music Sales Lift Warner

By Charles Duhigg, Times Staff Writer

Warner Music Group, the world's fourth-largest music company, on Thursday announced a smaller-than-expected loss in its fiscal third quarter thanks in part to fast-growing sales of digital music.

Sales of crooner Michael Buble's, rocker Rob Thomas' and punk band Green Day's hit albums helped drive up Warner Music's revenue from legal Internet downloads, which increased 26% from the second quarter, to $44 million. Digital sales accounted for 6% of the quarter's revenue, up from 5%.

"We are encouraged to see digital gains outpacing the physical business," Warner Chief Executive Edgar Bronfman Jr. said.

Thursday's news was welcomed by investors, some of whom had been skeptical about Bronfman's faith in Internet music sales since the company went public in May.

Warner shares rose $1.06, or 6.7%, to $16.79, the closest they have come to the $17-a-share IPO price in nearly two months.

Analysts cautioned that digital music, although growing, still is a small part of the market.

"It will be at least 10 years before digital downloads rival physical sales of music," said Phil Leigh of Inside Digital Media. "Digital music should have a higher profit margin, but it's still just a small number of people who prefer downloading to buying CDs."

The New York-based company reported a net loss of $179 million, or $1.41 a share, for the three months ended in June. Revenue rose unexpectedly, by 2.2% to $742 million from a year earlier. The loss included a one-time settlement to end management agreements with private-equity partners.

Those partners, which include Thomas H. Lee Partners, Bain Capital and a company owned by Bronfman, had been due to receive a $10-million management fee each year for 10 years, but settled for $73 million.

Excluding that and other one-time costs, the company posted a loss of $35 million, or 27 cents a share, handing beating even the most optimistic Wall Street estimate of a 33-cents-a-share deficit.

Earnings also were affected by $29 million in IPO bonuses and cash payments to employees whose stock awards were below market value. The company paid the tax burden related to employees who received stock before the public offering.

Warner Music has cut expenses significantly through layoffs and consolidation since Bronfman and his partners purchased Warner Music Group from Time Warner Inc. for $2.6 billion in 2004. Those savings were slightly offset by a 2.1% rise in recurring expenses in the last quarter, closely mirroring the company’s revenue growth.

"They did what they said they were going to do: deliver cost containment and get digital going," said Bishop Cheen, an analyst with Wachovia Securities. "But two quarters of public information doth not a long-term trend make. It's easier to lose weight when you're bloated than to keep it off once you're thin."

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