More Woes for Warner

The music group is reassigning a key official amid problems over royalty-accounting systems. Could the difficulties affect the company’s expected IPO?

WEB EXCLUSIVE
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March 10 - Edgar Bronfman Jr.’s Warner Music Group is quietly reassigning its chief comptroller, NEWSWEEK has learned, drawing renewed attention to problems with its systems for paying artists their royalties. Last week, Cher sued the company’s music publishing arm, Warner/Chappell, alleging that it failed to pay her $250,000 in royalties over the last four years, though it is unclear whether the dispute is related to the systemic problems.

Both developments come at an inopportune time as Bronfman, a scion of the Seagram liquor fortune, and his financial backers are reportedly weighing a plan to take the company public. Barely a year ago, Bronfman led an investment group that purchased Warner Music, whose roster ranges from Led Zeppelin and Madonna to Sean Paul and Josh Groban, for $2.6 billion from Time Warner. In a regulatory filing last December, Warner Music itself first warned that the problem might pose a risk for potential public investors. Warner Music noted that outside auditors were concerned about incompatible "royalty systems." The problem “created certain complexities in reconciling royalty expense and payables,” the company added, without elaborating. To help remedy the problem, Warner Music said it had hired outside experts. In addition, it is seeking a longer-term solution through a joint venture with, among others, rival Universal Music Group, to build a new royalty system.

Now, according to people familiar with the matter, the reassignment of the worldwide comptroller, Jos De Raaij, stems in part from Warner addressing the royalties matter. These sources say the comptroller—who reported to an acting chief financial officer—is being moved to a post in London, from which he returned in recent days after exploring the new assignment. (The appointment of a new comptroller has been announced internally in New York.) “It’s a huge problem,” says an executive with knowledge of the matter. It couldn’t be determined whether Cher’s royalties-related lawsuit, which was filed in Los Angeles Superior Court, is related to this broader problem.

De Raaij, whose official title was senior vice president of finance and comptroller, deferred to Warner Music’s corporate spokesman when contacted by NEWSWEEK. The spokesman declined comment on Cher, the royalties problem and any plans by the company for an initial public offering. Typically, companies planning to go public in the near future are barred by securities regulations from commenting about the business.

The royalties matter, however severe or tame, is just the latest in a series of tumultuous events to hamper Warner Music over the past several years. In the mid-1990s, the company tumbled from the industry’s No. 1 position, when its top management disintegrated into a prolonged period of turmoil. It enjoyed a respite with the hiring of music executive Roger Ames as CEO in 1999. But Time Warner was forced to sell the music operation as part of its effort to recover from its disastrous takeover by America Online in 2001. Like the rest of the industry in recent years, Warner Music was susceptible to rampant online piracy and plunging CD sales, leading many observers to question Time Warner’s prospects for divesting the music unit.

But enter Bronfman. With the backing of such major private equity investors as Thomas H. Lee, the Bronfman-led group purchased the company for the surprising handsome (at least to Time Warner) sum of $2.6 billion. The transaction provided an opportunity for the Seagram booze scion to write a comeback story for himself. With the Seagram fortune at his disposal, Bronfman embarked on a foray
into the entertainment business that many described as undistinguished, culminating in the sale of Seagram and its entertainment holdings (Universal Studios and Universal Music Group) to Vivendi, a diversified French concern. Subsequently, the resulting Vivendi Universal, in which the Bronf-mans were the largest shareholder, flirted with bankruptcy. The company salvaged it-self, and Bronfman has said his invest-ments generated huge returns for his original shareholders.

Yet Bronfman had removed himself from the stage as an active executive and deal-maker until the Warner Music deal. He swiftly embarked on a dramatic cost-cut-ting campaign. Within months of gaining control last March, they shed 1,600 em-ployees and about 375 artists. It also com-bined Warner Music’s Atlantic and Elektra labels. By this May, the retrenchment will produce annual savings of $250 million.

Warner has implemented the cost reduc-tions with cool efficiency under Bronfman’s direction. Originally, he and his top executives had estimated paying out $310 million to fire and drop workers and artists and to combine labels. Yet, according to the regulatory filing, Warner’s will end up paying out about $60 million less.

Meanwhile, the company has made a few notable additions to its stable. Among them: legendary producer Rick Rubin and his American Recordings label. And the company reportedly is negotiating to acquire part ownership of P. Diddy’s Bad Boy label. So far, the purchase of Warner Music overall has been a huge success for Bronfman and his financial backers. Warner Music has already returned their entire initial in-vestment—$1.2 billion. And now the investor group is poised to reap a windfall if it goes ahead with a likely public offering.

Yet Bronfman’s stewardship hasn’t been without some fallout. Warner Music’s total debt, including loans by its parent compa-ny, is a whopping $2.5 billion, about the same as its total revenues. Several top exec-utives reportedly aren’t on speaking terms. And sagging morale within the rank and file may be a problem, a recent resignation letter from an employee to Bronfman sug-gests. In the blistering missive, which was later posted on the Web site popbitch.com, the employ-ee complained about, among other things, the $22 million in bonuses paid to a hand-ful of top executives. The total payout, the employee figured, equaled “more than 20 times my total lifetime salaried income.” He added: “If you want to make us feel like maggots, you succeeded.” Earlier, one of Warner Music’s biggest stars, Kid Rock, also publicly lambasted the company’s direction. Citing little support from Warner Music for his 2004 tour, he complained that he needed new partners “that are more interested in music than IPOs.” Commenting solely on the bonuses, one investor, Thomas Lee, recently told NEWSWEEK, “We were happy to pay that money.” He noted that the executives had performed extraordinarily in meeting the plans. “If hedge-fund managers can make $500 million” for what they do, bonuses of “$2 million, $3 million or $4 million” were small in comparison. “The capi-talist system,” he added, “is alive and well.”

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