THE MUSIC DISTRIBUTION INDUSTRY IN CANADA 2006

BY LARRY LEBLANC

FEB. 2006

This report has been prepared by Larry LeBlanc for the Canadian Association of Broadcasters (CAB). The purpose of this document is to provide a profile of the English and French-language components of distribution of the Canadian-owned label and artist sector as well as Canadian artists signed or distributed by multinationals in Canada.

The report specifically discusses changes in the music distribution sector in Canada since 1998. As well, such newly emerging factors as the rise of widespread Internet-based downloading; the rise of music subscription services; and the use of ringtones, ringtunes and podcasting in affecting music sales are also discussed.

The report indicates that Canadian music retail has become more consolidated and more selective with product choices. Major music retailers carry a different product mix today than a decade ago. There are fewer music CDs, and more film-related DVD and computer game product.

Although radio remains a critical vehicle for the Canadian record industry, labels and retailers cite a waning impact of the medium on overall sales.

The study is based on a review of existing documentation, secondary research as well as analysis and findings drawn from 11 interviews conducted by Larry LeBlanc, as the principal source of primary research.

OVERVIEW

Canada's small market size, and a sizable support infrastructure is enabling the domestic industry to develop distinct acts for audiences home and abroad.

In the past three years, global markets have embraced a new wave of formidable Canadian English-language rock acts including: Arcade Fire, Broken Social Scene, Death From Above 1979, Feist, Stars, the Dears, Alexisonfire, Metric, Bedouin Soundclash, and Hot Hot Heat; as well as such French-language acts as Corneille, and Lynda Lemay.

These join such established Canadians on the world stage as Celine Dion, Bryan Adams, Shania Twain, Diana Krall, Nickelback, Barenaked Ladies, Nelly Furtado, Avril Lavigne, Alanis Morissette, Ron Sexsmith, Daniel Powter, and Bruce Cockburn.

Additionally, French-language markets abroad recognize Canada as a leading repertoire source with the popularity of Natasha St-Pier, Garou, Roch Voisine, and Isabelle Boulay.

Continuing with significant North American profiles are Canadian rockers Our Lady Peace, Simple Plan, Finger Eleven, Three Days Grace, Default, and Theory of a Deadman; singer/songwriters Sarah McLachlan, Fred Eaglesmith, Sarah Harmer, and Kathleen Edwards; and country acts Terri Clark and George Canyon.

Stirring interest domestically are such recent newcomers as K-OS, Billy Talent, the Trews, Rex Goudie, Hedley, Matt Mays, Buck 65, Divine Brown, Jully Black, Massari, Fefe Dobson, and Corb Lund; as well as veteran acts Blue Rodeo, Jann Arden, Great Big Sea, The Tragically Hip and Sloan.

Quebec's explosive music scene continues such vibrant established French-language acts stars as Jean Leloup, Eric Lapointe, Boom Desjardins, La Chicane, Stephanie Lapointe, Wilfred Le Bouthillier, Mario Pelchat, Daniel Bélanger and Dany Bedar as well as with more recent newcomers La Cowboys Fringan, Marie Chantal-Toupin, and Anni Villeneuve.

While Canada's music market has been locked into a six year long sales slump, there have been signs the trend is slowing down. Album sales in Canada for 2005 held up at 48.6 million units, down only 1.8% from 49.5 million in 2004, according to Nielson SoundScan.

While downloading of music via the Internet and widespread CD-R copying, continue to be regarded by industry figures as factors adversely affecting recorded music sales worldwide, the global music industry is starting to see digital music as a key driver of revenue growth.

Apple Computer shipped about 32 million iPods in 2005, up from 8.2 million in 2004. Apple announced on Feb. 23, 2006 that one billion songs have been legally downloaded from its iTunes Music Store since being launched three years ago.

According to figures released by the International Federation of the Phonographic Industry (IFPI), total sales of physical recordings in the first half of 2005 fell. But that decline was largely offset by a rise in digital sales.

For the first half of 2005, the retail value of physical recorded music was down 6.3% compared with the same period of 2004, settling at $12.4 billion US, with a corresponding 6.6% drop in unit sales. At the same time, digital sales more than tripled to $790 million US from $220 million US.

Taken together, the figures yield a combined retail value of $13.2 billion US, cutting the year-on-year loss to only 1.9%.

Still, there is a debate within the music industry about what went wrong in recent years and widespread concern about the future. Some industry executives blame the downturn in Canadian sales in the past six years on downloading and CD-R burning. Others blame the dearth of superstar product. Still others say the digital music market is developing too slowly, even with its gains.

There are concerns that despite a significant increase in digital track sales in 2005--largely driven by iTunes--the downloading market is not developing quickly.

“Downloading is a competitive factor, especially among kids. But I don’t think that’s the real reason we are having such a tough time. The real reason is probably that there isn’t a lot of good new music around.” MALCOLM PERLMAN, PRESIDENT, SUNRISE RECORDS

While the traditional way of selling music to consumers via retail will likely remain a significant business for some time, there is further concern over the sizable shift in the Canadian retail marketplace in recent years—a shift in consumers buying from traditional music retailers like HMV Canada and CDPlus toward mass merchant accounts like Wal-Mart, Zellers, Best Buy and Costco which carry limited music selections. At the same time, varied forms of entertainment products are now competing for consumer dollars at traditional music retail.

OVERVIEW OF MUSIC DISTRIBUTION IN CANADA

Canada's music recording market is dominated by four foreign-owned multinationals—The EMI Group , Universal Music Group, Sony/BMG Music, and Warner Music Group—that collectively account for 90% of total revenue of Canada’s $800 million music market. As well, there are a handful of key independent distributors. All derive most of their revenue from marketing foreign product.

In a sharp contrast to other parts of Canada, Quebec has a more centralized music industry with some 75 independent production firms that record 90% of the province's domestic artists; and distribution dominated by distributor/retailer, Groupe Archambault with an estimated 40-65% penetration in the French-speaking marketplace.

An independent distributor is a distributor not owned by a major record manufacturer. It distributes product for independent record companies and sometimes for a major if the manufacturers want to supplement a certain market.

Independent distributors range from operations that distribute product in one local or regional territory to those that have branches in various cities and can distribute a label on a national basis. Independent distributors may represent up to 40-50 different labels in their territories. Unlike the multinationals that are part of integrated global company, independent distributors must obtain the rights for Canada for recordings. These distributors handle many labels on an output basis or album-by-album basis.

The leading player in independent distribution in Canada--and is a significant retail force-- is Toronto-based Entertainment One Income Fund (formerly ROW Entertainment). It is Canada's largest wholesale distributor of CDs, DVDs, video games, and accessories to small and large retail chains and independent retailers in Canada. Entertainment One also owns and operates more than 90 CD Plus retail outlets; operates a retail Internet sales division, cdplus.com; and owns Koch Entertainment, one of the largest independent distributors of music and video content in North America.

Other significant Canadian-owned independent distributors in Canada include: Distribution Select, DEP Distribution Exclusive, Distribution Fusion III, FAB Distribution, and Madacy Entertainment Group in Montreal; Outside Music in Toronto; Sonic Distribution in Hamilton; and Festival Distribution, and Scratch Recordings and Distribution in Vancouver.

There are also a number of second-tier or regional Canadian-owned independent distributors including: Indie Pool Canada, Spinner Music Group, CMC Distribution, Joe Radio, Landwash Distribution, and Spirit River Distribution.

As well, many Canadian acts produce recordings, and handle distribution themselves. They rely primarily on touring to promote and sell their recordings. While some local retailers, particularly in the Maritimes, still take goods on a consignment basis, few major retailers deal directly with artists with consignment product.

This is in sharp contrast to 1988-1996 when Canada's major retail chains, particularly HMV Canada, and Sam the Record Man, provided national springboards for many indie-distributed grass-roots acts that later acquired major-label ties, including Barenaked Ladies, Loreena McKennitt, Cowboy Junkies, Sarah McLachlan, The Rankin Family, Sloan, and Great Big Sea.

In 2003, Sony Music's RED Distribution, America's leading independent distributor, entered Canada with the formation of RED Distribution Canada, a cooperative effort between RED and its parent.

A foreign master may be licensed by a multinational, independent distributor or independent label for the Canadian market at typically 30% of the wholesale cost, about $3.30 a record. The licensor pays none of the recording, artwork or video costs. However, in order to promote and market these recordings may take significant investments in marketing and promotion.

Both the multinationals and major independent labels generally pay a royalty to directly signed Canadian artists which varies widely, (averaging 12%-15% of suggested list price or $1.40 to $2.00 per record), and entails advancing recording costs, and paying for 50% of video production costs. These costs are largely incurred up front, although recoupable if enough units are sold. Artists are generally allowed to sell their CDs at their shows—buying them from the label at $7-$8-- and generally earn $10-$12 per CD. Canadian acts who handle distribution themselves can earn $8-$10 per CD at retail and 10-$12 per CD from stage sales.

CLOUT OF THE MULTINATIONALS

While foreign ownership and control of Canada's recording industry rarely raises issues of principle comparable to those that arise in broadcasting or publishing, where independence is a major policy concern itself, there should be reasons for concern.

Since the multinationals control their own distribution, and distribute their own records as well as foreign-owned independent labels, and those of Canadian-controlled record labels, they dominate the Canadian music market. Their strategies and trade practices are the de facto industry practices--particularly in distribution and at retail.

Also a sizable portion of Canada's music talent pool is, in fact, signed to multinational sources outside the country—including Shania Twain, Nickelback, Avril Lavigne, Alanis Morissette, Nelly Furtado, and Simple Plan.

The multinationals and the Canadian-owned independent labels operate as two distinctly different strategic groups within an industry. Whereas, Canadian-owned independent labels tend to concentrate on a limited product or genre, the multinationals generally provide mass products for a mass audience or a wide range of products for different groups of consumers. Their enormous impact is further enhanced by their control or access to a range of media. They can cross-market or negotiate product across multiple media including through recordings, films, television and advertising.

Multinationals are all involved in coordinating record and video production, signing and promoting artists, distributing product to retailers and wholesalers. These companies may also be involved in music publishing. While, most multinationals have made significant investments in Canadian music, their core activity is maximizing the sale of recordings made by their parent and fellow subsidiaries.

The multinationals have significant advantages over the Canadian-owned labels as well as over independently-owned distributors. This includes having sales revenues, and working capital from their parent company lines; having their own national distribution systems to distribute their product to retailers; and having marketing, promotion and distribution networks worldwide that offer access to foreign markets for their Canadian-based signings.

Brian Chater, then president of Canadian Independent Record Producers Association acknowledged this clout at a meeting of worldwide independent associations at the MIDEM conference in 2005.

“The international agenda of the music business has been dominated by four multinationals. The independents priorities get ignored. Without separate associations, governments never hear that the priority issues for their national companies are very different and very real, from market access, concentration, access to finance through to the unraveling of collective licensing. Co-ordination at international level is vital.”

At the 2006 MIDEM conference, a global organization The Worldwide Independent Network was launched by members of some 20 independent groups—including CIRPA and Quebec's music industry arm Association québécoise de l'industrie du disque, du spectacle et de la vidéo)--to provide a single voice and structure to represent the indie community globally. The group intends to negotiate agreements to benefit the whole indie sector with such players as Internet service providers, mobile phone operators and broadcasters.

RELIANCE BY CANADIAN INDEPENDENT LABELS ON MULTINATIONAL-BASED DISTRIBUTION

While foreign-owned multinationals once held the principal A&R position in Canada, their role has changed. The Canadian-owned label sector is now the primary market window for new Canadian acts.

In the past decade, as multinationals reduced staff and services worldwide, and pulled back on A&R and development commitments worldwide, multinationals significantly increased their tie-ins with independent labels in Canada via pressing and distribution (P&D) agreements, co-ventures, and licensing deals.

The trimming of major-label rosters has led to a wave of Canadian artists from major labels being made available to Canada’s independent labels for direct signing, licensing or pressing-and-distribution deals. This has included mainstream singer David Usher; blues-based Colin Linden and Colin James; alternative-styled Andy Stochansky; and country singers Michelle Wright and Paul Brandt;

As well, a 2005 deal saw Vancouver-based Nettwerk Music Group's artist management affiliate effectively become an international A&R arm of Sony BMG Canada. Under the deal, Nettwerk Management will bring Sony BMG Canada new acts discovered around the globe by its managers. Sony BMG Canada will then have first option of signing the act for an undisclosed fee. The pact was announced alongside confirmation that Sony BMG will exclusively distribute NMG's record label Nettwerk Productions in Canada.

The distribution of leading Canadian-owned independent labels in English Canada is primarily handled by the multinationals. This includes: EMI Music Canada (Battleaxe, Aquarius, Arts & Crafts); Warner Music Canada (Coalition, Six Shooter, Stony Plain); and Sony/BMG Canada (Nettwerk Productions, and Bumstead Productions).

Over the past four years, Universal Music Canada has picked up distribution of Canadian labels at a dizzying clip.

In 2002, Universal acquired a minority share of Toronto-based MapleCore, which operates alternative-rock-oriented MapleMusic and country imprint Open Road Recordings. MapleMusic is home to Kathleen Edwards, the Cowboy Junkies, Pilate, the Dears, Gordie Sampson and Joel Plaskett. Open Road has the top Canadian country acts Doc Walker, The Roadhammers, and Jason McCoy.

Universal has also acquired Black Smith Entertainment, the Orange Record Label, Paperbag Records, Alma, Last Gang, Distort Entertainment and Linus Entertainment, all in Toronto, and DEP Distribution and Curve Records in Montreal.

These join Universal's domestic roster of: Anthem, Alert Music, True North, and Somerset Entertainment, all in Toronto; 604 Records and Maximum Music, both in Vancouver; and the artist-run imprints of Sarah Harmer, and Loreena McKennitt.

ROLE OF CANADA'S INDEPENDENT LABELS

The reliance by Canadian independent labels on multinational-based distribution has also been due to Canada's independent distribution sector being dramatically transformed in the past decade.

Since 1997, there have been the bankruptcies of such major distributors as Cargo Imports and Distribution in Montreal; Saturn Distributing, Song Entertainment Distribution, Quality Special Products, Page Music Distribution, Holborne Distributing, all in Toronto; the closure of Denon Canada's distribution arm in Toronto; and the merging of Distribution Trans-Canada, with Select Distribution and GAM Distribution in Montreal. As well, Toronto-based entertainment company, Entertainment One purchased Koch Entertainment including its Canadian operations.

Still, there are small entrepreneurial Canadian-owned indies with independent distribution ties like Mint, Sonic Unyon, G7 Welcoming Committee, Smallman, Grenadine, Teenage USA, Stomp, and Endearing

that work with either specific artists or genres of music that have largely been ignored by the mainstream music market.

Canada's independent labels give a voice to Canadian artists who might not have an outlet otherwise. There are many artists who sell 5,000-10,000 albums that multinationals are not interested in because sales of 10,000 can be a loss to them. If an independent label or individual artist sells 10,000 albums, they can make a considerable profit.. Break-even point can even be reached with sales of 2,500 units or less.

With the arrival of new technologies, Canada's independent labels now look more outside Canada early for support of their rosters. While these Canadian labels face many of the same problems as their predecessors such as lack of money, geographic isolation, and economic barriers, unlike their predecessors, they continue to increasingly cater to an international audience.

In some cases, this has been because they have developed specific artists or music not as in demand in Canada. However, the combination of the Internet, and increased control of distribution and promotion, enabled them early on to export or license their catalogs or specific titles abroad, usually with independent distributors on a territory-by-territory basis.

Lacking capital, smaller Canadian-owned independent distributors generally are rarely able to secure the distribution rights to foreign labels in Canada directly.

However, there are expectations that the 2006 launch of Fontana North—a co-venture between Fontana Distribution in Los Angles and Toronto independent music distributor MapleNationWide will bring more U.S. profile opportunities to Canada's independent sector.

Fontana Distribution is the Los Angles-based independent distribution arm of the Universal Music Group and its Universal Music and Video Division. Canadian independent music distributor MapleNationWide is operated by Toronto-based entertainment company MapleCore, owned by a group that includes its CEO & president Grant Dexter, Universal Music Canada (with a 30%-35% share, according to sources), venture capital firm SDL Intervest, and privately owned Ideaca and Standard Radio.

Under the partnership, two year old MapleNationWide has ceased operations under that name and is now using the Fontana North moniker. With representatives in Toronto, Montreal, Winnipeg and Vancouver, Fontana North is providing marketing, promotional and publicity support in Canada for Fontana Distribution products while seeking to provide Canadian independent acts it handles access to the American marketplace.

AN OVERVIEW OF MUSIC RETAIL IN CANADA

Leading music retailers in Canada include HMV Canada, CDPlus, Archambault Musique, Music World, Sunrise Records, and such mass retail stores as Wal-Mart, Zellers, Price Club, Costco, Future Shop, and Best Buy.

Canada's retail landscape changed significantly in 2001 when longtime retail giant Sam the Record Man filed for bankruptcy. The Toronto-based, privately owned chain had assets of $10.4 million, and owed $17.8 million.

At its peak in the mid-1980s, Sam the Record Man was a network of 106 corporate, franchise, and dealership stores, dominating the Canadian music retail marketplace with an estimated 25% share of all purchases. But its prominence diminished in the '90s with the growth of HMV Canada, in particular, as well as competition mass merchants.

Mass-merchandisers' share of the music market in Canada has soared over the past decade, accounting for 30-33% of music purchases in Canada. Ten years ago that figure was closer to 10%.

"Mass merchant used to be perceived as a convenience model. If you wanted to pick up music, you picked it up there. It didn't matter it cost a bit more. Today, because with advertising bringing people into stores and because there is more foot traffic than other retail, it has become the preferred destination. Generally, a typical Wal-Mart store carries 3,000-4000 titles with catalog being 1,500 to 2, 000 titles." NED TALMEY, VICE-PRESIDENT & GENERAL MANAGER, HANDLEMAN ENTERTAINMENT

The increase in mass marketers' share can be traced partially to the emergence of mainstream pop as a major seller in Canada during '90s. Also driving the expansion was the entry of U.S.-owned Wal-Mart into Canada in 1994,, and the purchase of British Columbia electronic chain Future Shop by U.S. electronics giant Best Buy in 2001.

"The entry of people like Future Shop and Best Buy have been major factor in making our life even more difficult. Their use of product as loss leaders puts tremendous pressure on us." MALCOLM PERLMAN, PRESIDENT, SUNRISE RECORDS

<u>SELLING MUSIC IN CANADA</u>

Since 2001, when music sales began to plummet in Canada, leading music retailers and multinationals and leading independent distributors have been working closely to improve sales, and to raise the profile of music products overall with consumers.

Canada's music sector has, however, increasingly lost significant merchandising space and sales to film-related DVD product and video games at retail outlets since.

The combination of diminished music sales and spiraling distribution costs has led to major music retail chains in Canada exercising extreme caution with their initial and follow-up buys. Inventory cutbacks are providing lessened opportunities to market and sell product. Major label and retail executives themselves acknowledge that few mainstream retailers are genuinely interested in breaking new acts today.

"You can't 'break' things in a retail store anymore. You really can't. It used to be you could start playing a new album in stores and have it on the front racks with a good price and it'd start moving. It is very rare today for customers to ask, 'What is that? I have to have that.' They are going into stores more and more with less time to browse. They come in for something and that's only what they want." BRUCE MacKENZIE, SENIOR BUYER, PINDOFF RECORD SALES

Retailers argue that, unlike past decades, they can no longer count on a 4-6 week window on major new releases before having to kick in with the next phases of their marketing campaigns. Additionally, many of their leading acts are no longer safe bets for sales success. Ardent fans might buy their albums on the first week of release, but the mass public—the occasional buyers who turn albums into big sellers—might not. Today, few albums have broad long-term appeal.

"Ten years ago customer loyalty was a huge thing with. There was a core group which would buy a new Elton John album immediately. That core has gotten smaller and smaller. You still see a core fan base with an act like U2 but the base today is smaller than the fan base that had to have 'The Joshua Tree' today. It means our window (of sales) loses up much faster today." BRUCE MacKENZIE, SENIOR BUYER, PINDOFF RECORD SALES

"There are probably two to four orders a day going into the four major audio suppliers from us." KEN KOZEY, VICE-PRESIDENT, PURCHASING, HANDLEMAN ENTERTAINMENT CANADA

As Canada's traditional music retailers continue to press distributors and labels to support discounted dealer pricing and in-house and consumer marketing spending, the cost of distributing music product--shipping, processing and warehousing--and marketing costs associated with advertising, in-store positioning, and retail campaigns have soared significantly over the past decade.

“We gauge releases by each store and the community. We establish a bench mark that indicates how many pieces to order based on the sales history for a particular store. We bench-mark titles against previous performances. Against artists or genres that are similar at similar points in the year based on consumer marketing, advertising, and instore support. ” NED TALMEY, VICE-PRESIDENT & GENERAL MANAGER, HANDLEMAN ENTERTAINMENT CANADA

“When you sell to retail, they want to see a marketing plan that is second to none. They want to see that a CD has either a hit 10,000 units in the first and second week in New York or there’s SoundScan on the previous album with sales of 65,000 copies. They want the facts and figures in front of them.” JIM WEST, PRESIDENT DISTRIBUTION FUSION III/JUSTIN TIME RECORDS, MONTREAL

“There isn’t a buyer in this country who believes anything from a record company’s marketing plan. Too many time they say they are going to do something and nothing happens. The easiest way to get a new act racked in my stores is bring the artist to town and invite my people out to see them. If they are good, they will feel more personally involved and push the act to their customers. There are people in retail who like music. I wish there were more.” TIM BAKER, BUYER, SUNRISE RECORDS

Seeking increased revenue in a declining music market, Canada's majors have been attempting to move in new directions. These include consolidating their manufacturing and shipping (Cinram Ltd. now handles manufacturing and shipping of all majors but EMI in Canada); selling new releases to non-traditional outlets; and further developing their on-line music operations.

With DVDs accounting for a greater portion of sales today, Canadian majors have also greatly increased the number of CD releases that include a DVD component or issued their own DVD music releases in the two years as well as boosting marketing tie-ins. These include releasing DVD titles by Diana Krall, Oscar Peterson and Hawksley Workman from Universal Music Canada and Blue Rodeo, Great Big Sea and Billy Talent from Warner Music Canada.

Retailer decision-making on product is greatly shaped by the use of their own automated in-house inventory systems, and point-of-sales (POS) data systems; as well data from Nielsen SoundScan that launched in Canada in 1997. SoundScan measures records sold at retail by reading the information from electronic cash registers that reads bar codes on records of reporting stores.

"There's a cost associated with tying up product that doesn't turn. We have an overall number we look at (for returning product) that relates to stock turns. We have different expectations of new releases and catalog. The faster-selling (new release) product you can afford to have lower margins because you turn it faster. The slower moving (catalog) product you have to get higher margins because it turns slower. We also try have an investment behind some titles that take a long time to develop." HUMPHREY KADANER, PRESIDENT, HMV CANADA

"Information allows you to make better decisions. You can't run a business on gut. Business is too complex these days and too different market by market. STEVE SIMON, VP OF SALES AND THE COMMERCIAL GROUP, SONY BMG MUSIC CANADA

"I can tell you at any given minute how well something is selling in our stores through our POS system. I know how many units I've sold, when I've sold them, where I've sold them and how long I've had the record in stock. The only reason I need SoundScan is to see if there are records that I should be paying attention to that I haven't been. I hate if I miss a record." TIM BAKER, BUYER, SUNRISE RECORDS

"We pay attention to both SoundScan and our own POS systems. I will take my charting from our own POS system and compare it against SoundScan to see what points I am weak on; what's breaking that I'm not seeing, what I'm breaking that doesn't seem to be breaking elsewhere. Try to pick a pattern out of that." BRUCE MacKENZIE, SENIOR BUYER, PINDOFF RECORD SALES

"SoundScan lets me look at an overview of the market. Let's me see where I'm ahead or behind, and what I can do to react to it. We have our own POS system and our own way of doing things." KEN KOZEY, VICE-PRESIDENT, PURCHASING, HANDLEMAN ENTERTAINMENT CANADA

“SoundScan, if anything, is usually a week behind. We are in the era of real time inventory. (Wal-Mart and Zellers) share that information with us daily and even by the hour. We don’t have to wait until the next day or two days to jump on something that is busting out. With that ability to get information instantaneously, you have the ability to make changes quicker. It doesn’t take long to realize if something is selling or not. Or whether it should come in or out. Our biggest capital expense is inventory.” NED TALMEY, VICE-PRESIDENT & GENERAL MANAGER, HANDLEMAN ENTERTAINMENT

Such inventory monitoring has enabled manufacturers to fine-tune their businesses. They are able to pinpoint with great accuracy where sales are, and be able to react quickly. Today, the shelf life of an album, particularly by an unknown artist, can be weeks. Albums are shipped back once they fall below a sales minimum. Unsold product—of any genre—is unlikely to remain in stores after 60 days—where 90 days was the norm five years ago.

“Many new release have a real spike (of sales) and then the drop-off curve is significant. The rule of thumb we generally use is: Week one to week two, there is nearly a 50% drop off. By the third week, you are down to 25% of what the first week was. We then get an opportunity to bring the CD to life by building it into promotional campaigns. If it’s something great like Green Day’s ‘American Idiot,’ the longevity can be well over a year or longer. But that’s a true exception. You can only count on five or six of those (CDs) a year.” HUMPHREY KADANER, PRESIDENT, HMV CANADA

“If you put out 20,000 copies, and you scan 10% in the first week and 10% in the second week, someone sitting on 25% of that inventory may want to reduce some of it after a month. That can happen to CDs by developing artists or big artists.” WESLEY HAYDEN, SENIOR VICE-PRESIDENT OF SALES, UNIVERSAL MUSIC CANADA

“After the first week, especially if it is not your number one seller, a new CD gets moved back (off the front racks). It still has a good space but not the best space. If people are only looking at the front rack, there is less opportunity to discover it.” HUMPHREY KADANER, PRESIDENT, HMV CANADA

“New titles that are not moving we pare down and ship back. We call it a ‘death week’. If it hasn’t sold X amount, it’s out of there. If a piece of catalog hasn’t moved in 40 weeks, it is taken out regardless of genre.” NED TALMEY, VICE-PRESIDENT & GENERAL MANAGER, HANDLEMAN ENTERTAINMENT

“Obviously, the first week a hot new release does pretty well. Once it starts to trail off, and hits a lower threshold of X amount of units per week across the chain two weeks in a row then it moves to a sell-off list. Then it has two more weeks to determine if it is going to go up again or become catalog. That happens in six to eight weeks.” TIM BAKER, BUYER, SUNRISE RECORDS

“Our policy on returns is and has always been 90 days but returns are coming back quicker today. It can come back as quickly as 60 days. If it is an artist you are developing, retail will work with you to keep it out there longer. But they either want extended terms or if their exposure on inventory is too high they might reduce it.” WESLEY HAYDEN, SENIOR VICE-PRESIDENT OF SALES, UNIVERSAL MUSIC CANADA

“Not everybody has 90 day terms. Regardless, they will send product back. They shouldn’t return product within 90 days but some will or they will shove the product into the basement and put something else out.” JIM WEST, PRESIDENT DISTRIBUTION FUSION III/JUSTIN TIME RECORDS, MONTREAL

Canadian retailers have also adopted a more aggressive stance with their suppliers in the past five years to ensure that labels deliver on their marketing and promotional promises for major new releases. If a label doesn't have marketing and advertising funding available, their products will almost certainly be relegated to the back row in racks or not be carried by the retailer.

“With new or developing artists, if it is a major or independent we do business on a regular basis and they ask us to help out, we will give them a hand.” HUMPHREY KADANER, PRESIDENT, HMV CANADA

HOW CANADIAN RETAILERS DEAL WITH CANADIAN MUSIC

“We give (Canadian product) the benefit of doubt. There is a real determination on Wal-Mart’s part to support products made in Canada, particularly Canadian artists.” NED TALMEY, VICE-PRESIDENT & GENERAL MANAGER, HANDLEMAN ENTERTAINMENT

Canada’s indie label sector has traditionally done little business with larger music retail chains due to marketing costs associated with retail advertising campaign programs, and in-store positioning.

“We find it very difficult to deal with independent labels not signed to a major because we can’t afford that risk. That’s a fact. We buy the product on a basically guaranteed basis or close to it. If we go on something, independent labels can’t afford to take all that product back (if it doesn’t sell). They have to be well-funded.” NED TALMEY, VICE-PRESIDENT & GENERAL MANAGER, HANDLEMAN ENTERTAINMENT

“It is harder for a independent label without major label distribution to get product in our stores. Independent distributors, with the exception of Koch, don’t have marketing departments and can’t spend money with us to promote the record.” TIM BAKER, BUYER, SUNRISE RECORDS

“If you are a small rock, punk or electronica label and you want to get to the channels that will sell your product it won’t be with big box or traditional retailers but smaller retailers. And smaller independent (distributor) that has good relationships those ports. For instance, Sonic Unyon has a place in the market dealing with the independents. They know how to get product into those channels.” DARREN THROOP, PRESIDENT/CEO, ENTERTAINMENT ONE INCOME FUND

“(New Canadian) artists have to be really committed and get out there and perform, perform, perform. Stay out there and not give up. They almost have to win fans over one at a time until they have built enough off a buzz to get traction.” HUMPHREY KADANER, PRESIDENT, HMV CANADA

WHAT SELLS MUSIC AT CANADIAN RETAIL

Although radio remains a critical vehicle for the Canadian record industry, labels and retailers cite a waning impact of the medium on overall sales. They cite greater emphasis on a combination of other marketing sources: video, press, specialized promotions; touring schedules; the sales clout of the artist; and the Internet.

As well, while CHUM-owned video channels MuchMusic, and its AC-based counterpart, MuchMoreMusic (M3) remain powerful marketing tools in selling CDs; other CHUM-owned video channels, including the hard-rock/heavy-metal-based MuchLoud; and urban music-based MuchVibe, both launched in 2002—both highly receptive to videos by new Canadian acts not being heard on mainstream radio—are now also widely viewed as being part of a comprehensive marketing component.

Although the editorial space devoted to music coverage in Canada's daily newspapers is said to be thinning, coverage opportunities for labels has increased in community, campus and street papers, as well as such outlets as Radio-Canada, CBC Radio and various Internet-based publications.

"With the fragmentation of all forms of media, how do you get the message out (on a new CD) to large numbers of people? How do you get it out during the week of release? With a new artist, it's almost impossible." HUMPHREY KADANER, PRESIDENT, HMV CANADA

"Press and publicity, a video, who the artist is, and radio, all of those factors are important. It is more of them rather than one. Word-of-mouth, the Internet, instore play, TV appearances all are also in play." WESLEY HAYDEN, SENIOR VICE-PRESIDENT OF SALES, UNIVERSAL MUSIC CANADA

"Prior to booking a release, I see what kind of radio and media activity it has and in what regions. I also keep an eye on Internet sites like MySpace. If it has a good Web presence, you might take the chance. With a Canadian act, I want the label to show me how they are working it." KEN KOZEY, VICE-PRESIDENT, PURCHASING, HANDLEMAN ENTERTAINMENT CANADA

While radio airplay is still deemed as having significant value in driving music sales by retailers, they indicate it is usually not sufficient for overall sales success. Also retailers emphasize radio today drives sales of only a fairly limited range of music product, particularly pop, country and specific rock acts.

"There's not a strong formula that says 'X' happens at radio and 'Y' happens in the stores. Daniel Powter had no. 1 on Canadian radio last year but sales were not what you would expect." HUMPHREY KADANER, PRESIDENT, HMV CANADA

"Radio airplay is studied very closely. But we don't know whether the public is going to react to radio airplay. There are turntable hits. Significant airplay on a single but nothing in album sales. I don't understand that phenomenon but it happens. NED TALMEY, VICE-PRESIDENT & GENERAL MANAGER, HANDLEMAN ENTERTAINMENT

"Radio is not even close to being the leader in letting (retailers) know about new acts. Radio is reactive; not proactive. The Internet is far more important than radio today. Internet sites like MySpace let us look at new artists and see what kind of buzz is out there." BRUCE MacKENZIE, SENIOR BUYER, PINDOFF RECORD SALES

“We all have successful records from indies (sources) that don’t have any radio. They may only have Internet marketing behind them. There are a lot of word-of-mouth artists. Publicity plays a big role with those especially in trying to reach an older audience. Appearances on US talk shows can also really make a difference.” STEVE SIMON, VP OF SALES AND THE COMMERCIAL GROUP, SONY BMG MUSIC CANADA

“I hardly look at radio airplay. Having a track record comes first. It really does.” TIM BAKER, BUYER, SUNRISE RECORDS

“Certainly, a track record helps. It is the first thing that we look at and it is the first piece of information we have at our finger tips when we see a buyer. The first thing a buyer looks at is the track record from the previous record.” STEVE SIMON, VP OF SALES AND THE COMMERCIAL GROUP, SONY BMG MUSIC CANADA

There are an abundance of acts--and even several musical genres such as folk, blues, jazz, alternative and heavy metal---that sell CDs today without any significant commercial radio airplay. While this factor has been evident for decades--especially with easy-listening pop music and soft rock-- it is more pronounced today.

“I rely on Radio-Canada in Quebec. It sells records. It is unusual. I’ve always ask myself why CBC in English can’t do the same.” JIM WEST, PRESIDENT DISTRIBUTION FUSION III/JUSTIN TIME RECORDS, MONTREAL

“Pop music is a more tried and true path, and you can (have success) quicker. But if you don’t get radio, you are in trouble. With successive records, you are often starting over. Whereas if it’s a singer/songwriter and you built the act up through touring there’s often a more enduring franchise. If you built your base through touring and you are not depending just on radio your body of work might be judged a bit differently.” STEVE SIMON, VP OF SALES AND THE COMMERCIAL GROUP, SONY BMG MUSIC CANADA

OVERVIEW OF THE INTERNET

Over the past two years, the legitimate digital music business has shifted from niche market to mainstream with more product available through more platforms than ever before.

According to the IFPI "Digital Music Report 2006" released Jan. 19, 2006 digital sales yielded an estimated $1.1 billion US in revenue in 2005 from Internet and mobile sales, up from $380 million US in 2004,

Consumers worldwide downloaded an estimated 420 million single tracks in 2005, twenty times more than two years earlier. The IFPI attributes the digital growth in part to support by rapid development in legal-music services, an increase in legitimately licensed repertoire, widespread anti-piracy educational campaigns and legal actions against illegal file-sharing.

The IFPI links the growth of the online music business to the expansion of high-speed broadband Internet services, and to the growth of portable digital music players.

In the United States, single-track downloads doubled year-on-year to 353 million units in 2005, according to Nielsen SoundScan data. Album downloads rose to 16 million and accounted for nearly 3% of the total U.S. album market.

The number of legal online services reached 335 worldwide in 2005, a 46% rise from 2004. The number of different tracks licensed by labels totaled more than two million, a six-fold rise over the same period the previous year.

The IFPI predicts increasing popularity of digital music sales in 2006 as mobile phone distribution begins to match online sales in popularity.

Canadian consumer interest in legitimate digital distribution services intensified with the iTunes Music Store opening in Canada in 2004 followed by Yahoo! Canada in Jan. 2006. They join such primary digital download services as Puretracks, Napster, and Archambault.

However, at the same time, legitimate digital music services still only represent 1% of the Canadian distribution market according to the Canadian Recording Industry Association (CRIA). The sale of physical CDs at traditional retail and online stores still represents the bulk of consumer spending on music in Canada.

"I don't see us on a trend towards an all digital world. It is not growing at a rate I would expect it would if that was the case. It is sitting at 1%. We'd be premature to have a funeral for physical retail. Digital is still not selling a lot of albums. Given that people buying digitally are heavy music consumers where are they getting their albums? I think they are still going to stores." STEVE SIMON, VP OF SALES AND THE COMMERCIAL GROUP, SONY BMG MUSIC CANADA

While physical CD sales —at traditional retail and online—still represents the bulk of consumer spending on music in Canada, significant revenue streams are starting to be generated from online music services, ringtones/ringtunes and other outlets.

"E-commerce sales are now over 50% of our of CDs business. We distribute to 19 digital distribution retailers around the world. Our iTunes revenues have been picking up and Puretracks has always been steady." GREGG TERRENCE, INDIE POOL CANADA

In recognition of the growing popularity of downloaded music in Canada, Nielsen SoundScan launched its Digital Songs chart in Feb. 2006. The new chart, which ranks the top legally downloaded titles in Canada, is based on sales data from four main Internet sites, sanctioned by the record labels Archambault, iTunes, Napster and Puretracks.

Although Nielsen SoundScan International compiles digital track lists for 17 countries outside of North America, the new Canadian log is the first Nielsen chart outside the United States that merges sales from various digital versions of the same song title.

Digital track volume in Canada for the week ending Feb. 19 stood at 243,000 transactions, up 115% over the same week in 2005. That is in sharp contrast to the sale of physical singles, which, as is the case in the United States, have become more scarce in Canada. Year-to-date single sales stand at 14,000, down one-third from where the category tracked in 2005. In most weeks, the No. 1 single in Canada sold less than 200 copies.

At present, the majority of digital music remain siloed in the home computer. It is expected as a host of MP3 players and related devices are introduced that there will be increased digital convergence—sharing of digitized content among disparate entertainment peripherals.

Meanwhile, as Canada's legitimate digital music business continues to evolve some sources have a concern that domestic content could be overshadowed by international repertoire on front web pages, and within search engines. Canadian rights holders are also concerned with the coming of web-based broadcasting services, streaming, and airing of music via mobile phones that such practices may be exempt from programming Canadian music.

Canadians have had access to master ringtunes since Universal Music Canada struck a deal with Bell Mobility. The agreement involves 700 clips from Universal artists including Canadians Fefe Dobson, Jann Arden and Sam Roberts.

As Canada's music industry continues to grapple with determining the business model of podcasting, the bulk of podcasting remains the province of hundreds of amateur hobbyists.

Podcasting software and services deliver digital audio content from the Web directly to the computers or portable media devices of consumers who request it. The content is delivered automatically to users' computers, with no need for them to search for or download it. The content can then be transferred to a portable device like an iPod (hence the name).

Utilized initially by amateurs to create their own audio programs, podcasting hit the mainstream in 2005 when Apple Computer launched the latest version of its iTunes software worldwide, enabling users to access more than 3,000 audio programs—most of them talk-based.

In Feb. 2006, Rogers Wireless became the first North American carrier to offer subscribers a mobile podcasting service based on technology provided by Melodeon. The Canadian company's Mobilcast service allows wireless users to either stream or download their choice of more than 1,500 podcasts in such topics as news, sports, comedy and music. Available podcasts are listed in a menu that is refreshed daily, and users can schedule automatic downloads of the podcasts they choose. Rogers offers the service for $5 per month.

MARKETING MUSIC ON THE INTERNET

Canadian labels and artists have increasingly shifted their marketing strategies in recent years to the Internet--particularly in the absence of mainstream retail or radio airplay support. Most operate on-line sites where interested parties can listen to music, download MP3s or order music.

Labels and artists generally view the Internet as indispensable selling tool--along with off-stage sales—and as an inexpensive promotional tool in previewing new releases in conjunction with media campaigns that build a "buzz" ahead of an album's release date. Promotions can also include exclusive downloads, artist-specific streaming channels, behind-the-scenes footage, videos, artist chats, and retail links.

“The revolution is in the data. When an artist sells a CD directly to a customer they get their name, address, and email address. They are building their fan club base as opposed to retail or digital sales where there’s a buffer and they don’t build their fan club. Selling direct they can go into a city and tell fans up front about the date and sell them merchandise. There are all kinds of bands that every time they sell a CD, they sell a T-shirt or something else. Instead of the order being $20; it’s $50.” GREGG TERRENCE, INDIE POOL CANADA

However, many independents labels and acts have come to realize that many of the traditional roles of record companies, such as marketing and distribution, are not easily replicated. Having product available or operating a website does not provide a vehicle to draw interest on its own. But coupled with other factors, including touring and working within a specific musical niche, it can yield results.

With its focus on 16- to 34-year-olds, MySpace web site (myspace.com) has become the preferred marketing channel for many labels and artist to reach today's Internet-savvy consumer. A powerhouse for online music promotion, it has hosted "listening parties” for such international acts as Nine Inch Nails, Weezer, the Black Eyed Peas, Queens of the Stone Age, Foo Fighters, R.E.M. and Billy Corgan, exclusively streaming upcoming albums in their entirety weeks before street date.

MySpace maintains a collection of user-created blogs organized and connected to each other by shared interests. By providing users the tools to do what they want, MySpace has amassed a 32 million membership.

Other social networking services are now emerging seeking to capitalize on MySpace’s momentum. The newest is TagWorld, which launched in November, 2005 and now has 150,000 members. As with MySpace, TagWorld users create personal Web sites with photos, music and links. Unlike MySpace, users do not link to each other, but rather "tag" their content with Ids that link to similar tags.

One of the original partnered social networking sites is Habbo Hotel which has attracted 40 million members worldwide since its 2000 launch. The site targets 13- to 18-year-olds, and lets users create custom characters that move SIMS-style through "rooms," chatting with members via thought boxes that appear near their character.

The six-year-old Toronto-based firm Official Community offers a full social networking online package. Its sites include chat and message boards, lyrics, biographies, tour information, media archives, discussion forums and online exclusives. Sites can also offer CDs and other merchandise as well as presale tickets for tour dates. The company oversees e-businesses for such Canadian acts as Blue Rodeo, Great Big Sea, Triumph and George Canyon, as well as such international acts as the Cranberries, Ziggy Marley, David Sanborn and the Buddy Holly estate.

INTERVIEW SOURCES:

In proceeding towards the goal of providing the CAB with a profile of the English and French-language components of distribution of the Canadian-owned label and artist sector as well as Canadian artists signed or distributed by multinationals in Canada, the industry was broadly polled. The following are aware of this report and agreed to be interviewed and quoted.

DISTRIBUTORS

JIM WEST, PRESIDENT DISTRIBUTION FUSION III/JUSTIN TIME RECORDS, MONTREAL.

GREGG TERRENCE, INDIE POOL CANADA, TORONTO.

RETAILERS/WHOLESALERS

TIM BAKER, BUYER, SUNRISE RECORDS, TORONTO.

HUMPREY KADANER, PRESIDENT, HMV NORTH CANADA, TORONTO.

KEN KOZEY, VICE-PRESIDENT, PURCHASING, HANDLEMAN ENTERTAINMENT CANADA, TORONTO.

BRUCE MacKENZIE, SENIOR BUYER, PINDOFF RECORD SALES, TORONTO.

MALCOLM PERLMAN, PRESIDENT, SUNRISE RECORDS, TORONTO.

NED TALMEY, VICE-PRESIDENT & GENERAL MANAGER, HANDLEMAN ENTERTAINMENT CANADA, TORONTO.

DARREN THROOP, PRESIDENT/CEO, ENTERTAINMENT ONE INCOME FUND, TORONTO.

MULTINATIONALS

WESLEY HAYDEN, SENIOR VICE-PRESIDENT OF SALES, UNIVERSAL MUSIC CANADA, TORONTO.

STEVE SIMON, VP OF SALES AND THE COMMERCIAL GROUP, SONY BMG MUSIC CANADA, TORONTO.

BIOGRAPHY OF LARRY LeBLANC

Larry LeBlanc has been associated with the New York-based music trade Billboard since 1991. He is currently its bureau chief for Canada. He was the co-founder of the late Canadian music trade, the Record. LeBlanc has acted as a consultant for The Canadian Competition Bureau, The Canadian Private Copying Collective, CHUM Ltd., and the Neighbouring Rights Collective of Canada.