MEDIA

EMI needs a magic touch from Hands

NEWS ANALYSIS

A vision statement from the Terra Firma chief has to inspire, write **Joshua Chaffin** and **Andrew Edgecliffe-Johnson**

As a student at Oxford, Guy Hands secured a background role in a Hollywood blockbuster being filmed at his college. Tired of waiting around, he led his fellow extras out on a strike that succeeded in doubling their pay.

The film, *Heaven's Gate*, went so far over budget that it nearly bankrupted United Artists and ended the era when directors, rather than studios, controlled budgets.

The impatient Mr Hands was only a footnote to the saga, but a generation later he found himself weighing the balance of power between artists and media companies from a different perspective.

Weeks after completing his £4bn buy-out of EMI in September, the fabled but troubled British music company, the dealmaker faced a classic talent business dilemma.

Radiohead's contract was up for renewal and Terra Firma, Mr Hands' private equity group, had to decide whether it was worth re-signing one of EMI's best-known bands at a time when the record company was losing sales and desperate to cut costs.

He canvassed veteran music executives for advice and they urged him to do whatever it took to agree terms. With EMI in turmoil, they argued, he could ill afford to lose a top act that served as a creative magnet, drawing other artists to the label.

Mr Hands disregarded conventional wisdom, however, deciding the band's earnings did not justify a possible £10m investment.

According to people familiar with the matter, he offered just £3m.

Radiohead soon headed for the exit, earning enormous publicity for an online album launch and blasting EMI's new owners in the process.

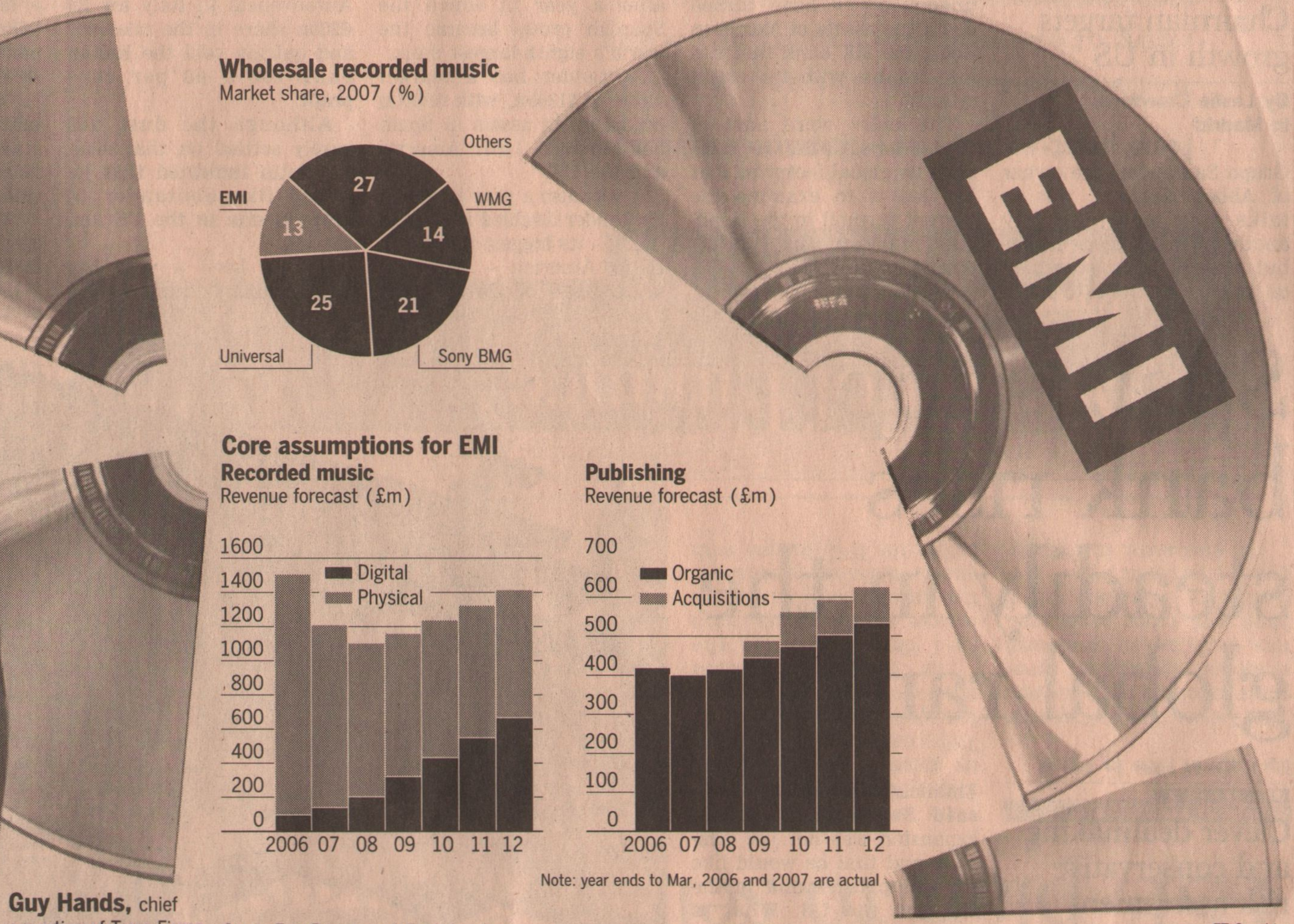
"Terra Firma doesn't understand the music industry," Radiohead guitarist Ed O'Brien said flatly.

One supporter of Mr Hands counters that the incident shows he understands it "all too well".

The exchange goes to the heart of the debate over Mr Hands' biggest deal. Is a brash but brainy outsider exactly what the industry needs at a moment of crisis, or will such culture clashes make him the latest wealthy amateur to fail on its glittering stage?

"It is too early to answer that question as we've not seen the grand plan," says Rich Greenfield, a music industry analyst at Pali Capital.

Guy Hands, chief executive of Terra Firma



Source: Terra Firma presentation to investors

FT Graphic

Mr Hands' "vision statement" is due in mid-January. But most of the industry has taken the negative view. "I think they don't know what the hell they're doing," says one long-term music executive. "Guy Hands overpaid."

Interviews with some of the experts Mr Hands consulted reveal that several fear that what he calls Terra Firma's "invasive" style may be too much for an industry notorious for insecure egos.

It has been a rocky start. Managers for artists such as Joss Stone and Robbie Wil-

online discovery, an evolving ecosystem that many record executives confess they barely understand.

The sales picture has become bleaker since Mr Hands made his offer and Mr Greenfield says it will get worse in 2008 as retailers such as Wal-Mart and Tesco reduce shelf space devoted to CDs.

The pain is visible across the industry.

Shares in Warner Music, where private equity investors have been working for three years to find a more profitable business model, have fallen almost 75 per cent in 12 months.

Mr Hands' supporters say past cuts failed to address the bureaucracy of which artists such as Sir Paul McCartney complain. For every talent scout, EMI is said to have 19 other employees.

Ironically, Terra Firma interviewed dozens of music executives to formulate its plan. Even before the deal closed, it is understood to have begun talks with Jim Caparro, founder of Entertainment Distribution Company and former head of the Island Def Jam Music Group.

Mr Caparro, who declined to comment for this article, stressed the need to first pro-

nies but still familiar with the business. These included Paul Caine from People Magazine and Tom Poleman from Clear Channel.

People close to Mr Caparro claim the two sides shook hands on a deal in early August, but Terra Firma ended up not hiring him, taking on just one of the executives he recommended: Billy Mann, a songwriter.

Mr Hands' rejection of much of the advice he received has soured the views of some in the industry, who say his plans are not original.

All record companies are working overtime to find a

ening credit markets appeared to call a halt to such highly leveraged deals and Citigroup has since been unable to syndicate its $2.5bn loan.

People familiar with Terra Firma say it has its bank's support and firmly deny rumours that it is forced by covenants on borrowings to make rapid improvements in EMI's profits.

What is clear, however, is that tougher markets have closed off some options. Terra Firma had wanted to securitise EMI's publishing business, which owns some of the most valuable catalogues around, including

£4bn Mr Hands paid, but a broader question of whether he has a recipe to save the media business suffering most acutely in the digital era.

"It's the beast," Mr Sukin says, "It's the question everyone in the industry is trying to answer."

Some observers still hope to see a "silver bullet" in Mr Hands' plan. "When an industry declines faster than expected, everybody looks like they're idiots, and these are not all idiots," says Osman Eralp, an industry analyst. Indeed, most of Mr Hands' past investments have shown an uncanny

Surprise at Terra Firma's grounds for rapid growth

Edgecliffe-Johnson

Guy Hands is planning to tell the staff of EMI in mid-January what he sees in the company that the legions of doubters do not.

Some of his plans have already emerged from presentations to potential co-investors and the memos that have been e-mailed around a gossipy industry.

At the heart of his optimism is an analysis that EMI is an asset-rich but poorly managed business that is ready to make fundamental changes precisely because of the turmoil in which the music industry finds itself.

Many analysts agree, but some have been startled by the aggressive assumptions Terra Firma has made. According to one presentation, it expects EMI's recorded music business to deliver £528m in earnings before interest, tax, depreciation and amortisation by 2012, up from just £61m in 2007.

The projection assumes a huge increase in online revenues, a rapid take-up of mobile subscription and heavy cost cuts. To get there, Terra Firma will step up EMI's use of social networking sites to find acts, shift its marketing towards digital sales and digitise more of its catalogue.

Mr Hands has also let on that he is looking to acquire independent labels, and has left open the prospect of a more transforming deal such as a move into touring and artist management or a revival of merger talks with Warner Music.

Even in the steadier publishing business, Terra Firma expects to more than double ebitda from £107m to £221m over the period. Much of this will come from catalogue acquisitions, which could add £40m to EMI Music Publishing's net publisher share.

Less headline-grabbing group-wide initiatives such as centralising procurement, back office and IT functions could also save tens of millions. The ambition is to reinvest some of the savings into developing new talent. The challenge will be to ensure that artists are not first scared off by the turmoil.

Some acts were not pulling their weight.

His detractors argue that his previous investments, in pubs and motorway service stations, were not creative businesses.

"It's difficult to lead people who believe in their heart that you don't get it," a former label executive says. "You can't go and tell the creative community how screwed up they are," another veteran says.

According to people in Mr Hands' entourage, what the doubters miss is that the culture clash is, at least in part, deliberate. "You couldn't do what we're trying to do without three things," says one: "a very supportive bank, a clear view of where you're going, and chaos within the industry."

Most EMI staff know change is needed. But the chaos may be worse than Mr Hands was betting. Compact disc sales are tumbling at double-digit rates – much faster than they are being replaced by digital revenues.

The old model of launching artists over radio is giving way to a more complex and fragmented system of

to crack the US, it has struggled to develop big artists since the glory days of signing the Rolling Stones and the Sex Pistols. Previous cost-cutting initiatives have done nothing to improve its market share.

ists to branch into areas such as touring, according to people familiar with the matter.

As part of the plan, Mr Caparro proposed a team of executives, who were not from major record compa-

time and most labels are looking for ways into touring, artist management or merchandising businesses.

Industry stalwarts also question the financial side of Mr Hands' plans. His deal went through just as tight-

looks unlikely in the near term. A revival of merger talks with Warner, described as "an obvious stop-gap solution" by Michael Sukin, an industry lawyer, also looks tricky in the current market.

At stake is not just the

Many doubt the silver bullet exists, however. David Byrne and Brian Eno, the musicians, questioned the need for traditional record companies in Wired magazine this month.

With the recording, manufacturing and distribution costs labels once bore falling to almost nothing, "all they represent now [is] capital", Mr Eno said. "Some labels will disappear," Mr Byrne predicted.

Unless Mr Hands pulls out a surprise next month, many executives will focus on the feathers he has ruffled rather than the hard numbers of profits, interest payments and exit valuations by which his investors will measure success. But industry gossip is not irrelevant to the bottom line.

In a business where success still depends on chart positions, losing artist support could be the biggest mistake EMI has made.

"Artists are like depositors," one analyst says, adding that: "If they find out you're distressed they won't give you their record. Then you have the equivalent of a run on the bank."

Excess all areas – especially China, Mayfair and LA

China's roads are paved with CDs that turned from gold to dust in EMI's hands, according to people familiar with Terra Firma's discoveries since taking control, **writes Andrew Edgecliffe-Johnson.**

EMI had been destroying about 35m CDs a year, they say, bearing the £30m-£50m annual cost of shipping albums to stores, taking back those that failed to sell and recycling them into road-building materials for the Chinese.

When Guy Hands announced in September that "we get really happy when things are really, really bad," he was only just realising the belt-tightening opportunities at EMI. Since then, details – colourful and prosaic – have leaked out of excesses that stand out even in an industry famous for its profligacy.

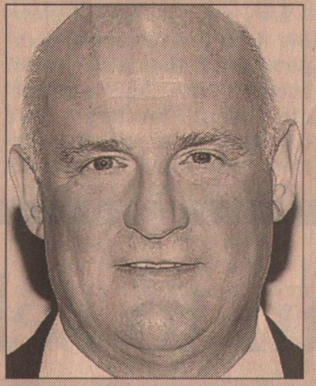
First on the list was a mews house in Mayfair, used by Eric Nicoli, the former chief executive, and visiting executives from overseas. The property was promptly sold for £5.6m.

Spending reviews threw up more oddities: a £20,000 monthly candle bill for a Los Angeles apartment, untold sums for often unwanted parties and gifts for artists, and the estimated £200,000 annual cost of flowers and fruit for EMI's offices.

Mr Hands has been equally unimpressed by the sheer number of offices, including two in central London alone. Individual labels have maintained their own buildings and marketing teams and there has been little centralisation of back office activities between EMI's 50 international outposts.

Terra Firma has already succeeded in negotiating a cut to the $25m (£12.5m) EMI was spending each year on music industry associations and is enforcing long-ignored policies on artist signings and travel expenses.

Mr Hands will also have to end the miscalculations that led to past over-shipping and his ambitious targets suggest that expectations of further lay-offs among EMI's 5,500-strong staff are well-founded. Having told would-be co-investors that



Eric Nicoli: mews

Terra Firma can take £135m from fixed costs and marketing budgets by 2012, over and above the £112m savings identified by previous management, cancelling florists' orders will clearly not be enough.

Shell looks to outsource nearly all 3,600 IT jobs

OIL & GAS

By Rebecca Bream

Royal Dutch Shell is expected to outsource the bulk of its information technology division next year, a move that could affect about 3,200 jobs.

The oil group aims to make pre-tax cost savings of about $500m-a-year (£250m) through streamlining its structure and cutting and outsourcing jobs.

As part of this cost-cutting drive, Shell has been examining whether to outsource most of its IT division, which numbers about 3,600 people.

According to Shell protest website royaldutchshellplc.com, an e-mail from Goh Swee Chen, vice-president of IT infrastructure, was leaked by a Shell employee on December 19 and outlined details of the outsourcing deal.

The e-mail said three outsourcing companies had been selected – EDS, AT&T and T-systems – with contracts expected to be signed in March.

Ms Swee Chen told staff: "I acknowledge that there will still be uncertainty as we are working through the finalisation of contracts, open resourcing and transition preparations.

"I encourage you to keep an open mind and take the time to learn more about the suppliers as employers and as business partners."

Jeroen Van der Veer: costs

Shell refused to comment on the apparent leak but confirmed it was talking to companies about the outsourcing of IT functions.

Shell said: "We are in the middle of commercial discussions and expect contracts to be signed in 2008."

It is understood that about 3,200 IT jobs are to be outsourced and about 10 per cent of these jobs are UK-based positions. They include contractors and staff on Shell's pay-roll.

If the outsourcing deal goes ahead as planned it would be one of the largest ever. Shell employs about 108,000 people worldwide.

Jeroen Van der Veer, Shell chief executive, said this month the group had to cut costs to make up for the fact that the cost of getting oil out of the ground had risen 65 per cent in two years.

Big bookmakers in talks with Turf TV

TRAVEL & LEISURE

Negotiations a relief after stiff resistance

Coral deal weakens stance of big chains

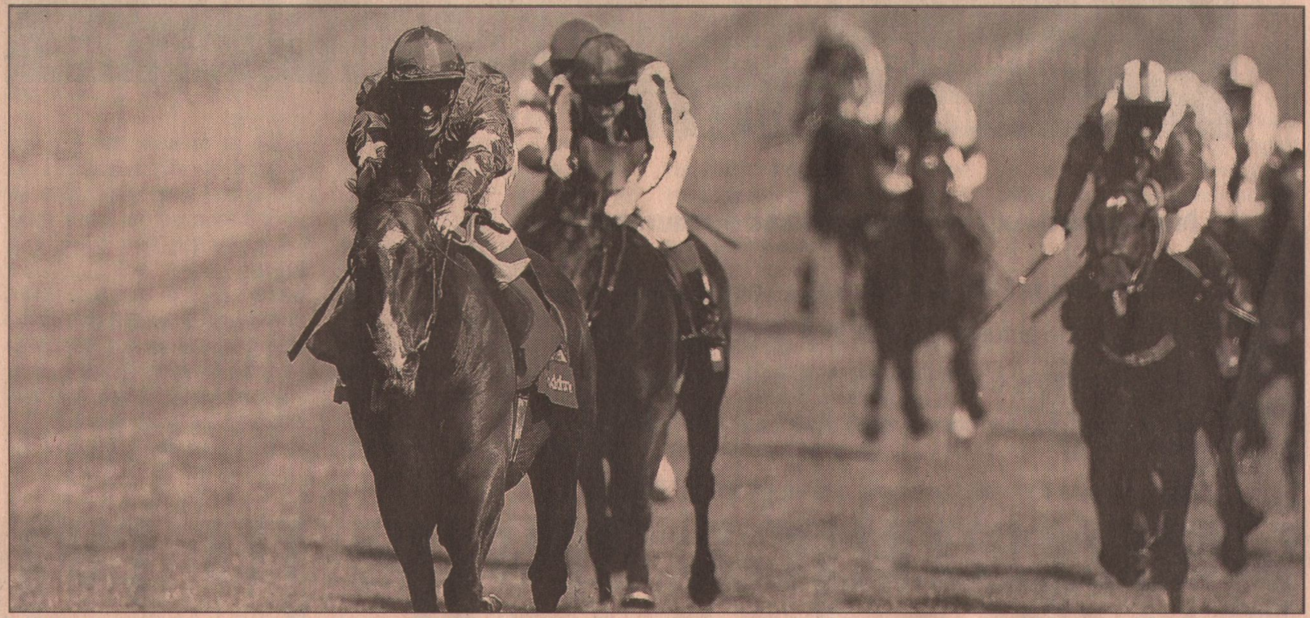
By Maija Palmer

Ladbrokes, William Hill and Betfred, three of the UK's largest bookmakers, are in talks with Turf TV to take its live TV horse-racing feed into their betting shops.

The talks come after Coral last week became the first of the big four bookmakers to break ranks and sign a deal for the new service.

The negotiations are a relief for Turf TV, which has faced stiff resistance from the high street bookmakers, some of whom run a rival service and who claimed Turf TV's annual fee of £6,500 per shop was too high.

A five-year deal to supply Ladbrokes – which has more than 2,000 stores – is thought to be worth about £60m. However, Turf TV said no further contracts had yet been signed.



Until last week, only smaller independent bookmakers had signed up for Turf TV Reuters

Turf TV is a joint venture between 31 of the UK's 59 racecourses and Alphameric, a technology company. The joint company, called Amalgamated Racing, is chaired by Alan Morcombe, the chief executive of Alphameric. It includes top racecourses such as Ascot, Newbury, Aintree and Cheltenham.

The other 28 racecourses are contracted to Turf TV's rival, Satellite Information Services, whose shareholders include Ladbrokes, William Hill and Betfred. SIS previously showed racing from all UK courses, until about half of the racetracks broke off to form their own company at the end of last year.

From January 1, 2008, bookmakers will need to have a deal with both SIS and Turf TV to ensure coverage of all the races.

Until last week, only smaller independent bookmakers, such as Paddy Power, Totesport and Stan James, had signed up to Turf TV.

After signing up Coral, the only one of the big four bookmakers with no shareholding in SIS, Turf TV will be on offer in about 60 per cent of betting shops in the UK – more than 4,000. This makes it difficult for the remaining big high street chains to continue their resistance to the service.