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FOR MORE INFORMATION:

Lee Graham
For The NPD Group
(212) 333-4983
lee@leegraham.biz

The NPD Group, Inc.
900 West Shore Road
Port Washington, NY 11050

PROGRESS REPORT: DIGITAL MUSIC LANDSCAPE SHIFTING, BUT SLOWLY

As Supreme Court nears decision, peer-to-peer (P2P) file sharing overshadows legal downloads, but paid digital music continues to gain share among consumers

PORT WASHINGTON, NEW YORK, June 23, 2005 — With a Supreme Court decision looming in the *MGM vs. Grokster* case – a case poised to dramatically alter the digital landscape as we know it – The NPD Group today released its latest data on the state of the digital music marketplace vis-à-vis peer-to-peer (P2P) file sharing.

According to NPD, although the paid download digital music marketplace continues to grow and demonstrates the potential for more growth in the future, downloading free digital content from P2P services continues to draw the vast majority of downloads in the United States. NPD noted that in March 2005, 243 million songs were downloaded from P2P services. By comparison, 26 million songs were purchased from digital music stores during that same month.

DIGITAL MUSIC MARKETPLACE – PAID VERSUS P2P

Two years ago there were nearly 20 P2P music downloading households in the U.S. for every household in which a member paid to download music files. By March 2005 that gap had narrowed to almost two to one. Though paid digital music download services have hurdles to overcome, they are making progress as an alternative for many digital music consumers.

The following chart shows the percentage of U.S. households downloading music files from P2P services (December 2003 through March 2005) and the percentage of U.S. households downloading music files from paid digital music download services during the same time period. Note: This chart illustrates the penetration of these services used to download at least one music file from the respective service (this data does not include video, games or other types of files that might also be shared or sold).

POTENTIAL FOR LEGAL MUSIC SERVICES

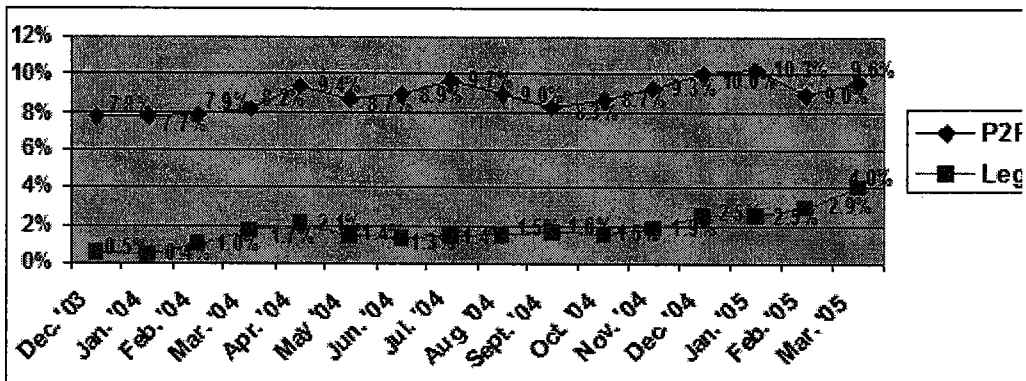
According to NPD's MusicWatch Digital Service, 4.2 million households tried paid digital music services in 2004. NPD's estimate of the current market potential is 30 million consumers. That potential market consists of music buyers who are both broadband-enabled and who use their PCs for other digital music activities such as burning, ripping or playing songs stored on their PCs. Both broadband and computer-enabled music activities are on the rise, which continues to raise the ceiling on the number of potential customers.

More than most other factors, better technology offerings also helped drive the upswing in digital music downloads. Forty-one percent of digital music consumers say they began to download because of faster Internet access, 30 percent said it was because they had purchased a better computer and

22 percent attributed their digital music consumption to the fact that they had recently purchased a digital/MP3 player. Promotions were also important to consumers: 34 percent reported that they first downloaded music legally because of a special offer.

At the same time, consumers are somewhat confused by perceived restrictions on what they can do with the music they purchase and download. They are also concerned by the price of the services. As a result only 55 percent of consumers who tried legal services came back for more in subsequent months. By comparison, 85 percent of peer-to-peer (P2P) users engaged in repeat usage in 2004.

"Legal services have gained a strong foothold among consumers over the past year, and there's definitely room for more growth," said Crupnick. "NPD data also shows a slow but steady migration of P2P users trying legal a la carte download services. In first quarter of 2004 only four percent of P2P users also purchased at least one song from a legal service. That percentage rose to 12 percent of P2P users in the first quarter of 2005. "



Source: The NPD Group, Inc./MusicWatch Digital

P2P STILL A FORCE TO BE RECKONED WITH

NPD estimates that 11 million U.S. Internet households had at least one member who downloaded a music file in 2004, nearly three times as many as paid to download a music file. Many younger consumers continue to use P2P services to download music, but consumers in other demographic brackets have reduced usage of P2P or stopped entirely. This finding was especially apparent among older, middle-income consumers.

The number one reason cited by consumers for stopping P2P file sharing was concern about potential lawsuits. Nearly half (49 percent) of P2P users age 13 to 25 reported that lawsuits were a primary reason they stopped using P2P sites, while 44 percent of those age 26 and older felt similarly.

"The music industry's litigation has had an adverse effect on overall P2P usage," Crupnick said. "Between April 2003 when the lawsuits were announced and April 2004 there was a 16 percent decline in the number of songs acquired from P2P; however, those levels have been creeping up again recently although the rise is lagging the growth of broadband."

"Just as pay-to-download services have challenges, P2P users are sometimes frustrated with their user experience," said Crupnick. "Nearly 40 percent of consumers report having issues with the amount of spyware, adware and viruses that can be found on these services. Thirty percent complain about not getting the right song, which may be a result of corrupted files on the networks or the song spoofing efforts of the record companies."

Sources: NPD MusicWatch Digital information is collected continuously from the Windows PCs of

40,000 online panelists balanced to represent the online population of U.S. Internet-enabled PC households. Information reported in this press release compares household activities of music consumers from 2003 through 2005. The NPD Digital Music Study asked 7,000 U.S. individuals about their music purchasing habits. The study was fielded in December, 2004, and the results were weighted and projected to represent the total U.S. internet population age 13 and older.

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Since 1967 The NPD Group has provided reliable and comprehensive consumer and retail information for a wide range of industries. Today more than 1,400 manufacturers and retailers rely on NPD to help them better understand their customers, product categories, distribution channels and competition in order to help guide their business. Information from The NPD Group is available for the following major vertical sectors: apparel, appliances, automotive, beauty, consumer electronics, food and beverage, foodservice, footwear, home improvement, housewares, imaging, information technology, music, software, travel, toys, video games, and wireless. For more information visit www.npd.com

The NPD Group - 900 West Shore Road - Port Washington, NY 11050 - www.npd.com