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MARKET PLACE

Lower Bid for Music Unit Could Tempt Time Warner

By ANDREW ROSS SORKIN

For Time Warner, the lower bid may be the better deal.

The company's board plans to meet today to compare two proposed deals for Warner Music. One, a merger with EMI involving only the recording unit of Warner Music, could end up being worth more than $2.8 billion to Time Warner, executives involved in the discussions said. The second, an outright sale of Warner Music, including its music publishing business, to a group of investors led by Edgar Bronfman Jr. would give Time Warner only about $2.55 billion, the executives said.

But if regulatory risk is factored in along with price, then Time Warner's board might find the Bronfman proposal a more appealing bird-in-the-hand offer.

The fact that Sony and Bertelsmann are already proposing to merge their music businesses makes the likelihood that regulators in Washington and Brussels would approve a Warner-EMI deal appear quite distant. Indeed, if faced with the prospect of four of the world's five major record companies merging into only two, regulators might choose to reject both deals.

The European Commission already forced Warner - whose stable of musicians includes R.E.M. and Missy Elliott - to abandon a similar deal with EMI in 2000. The next year, the commission pressed Bertelsmann to abandon plans to merge its music business with EMI.

These days, however, the music companies have been struggling with piracy and are experiencing slow sales. In this changed climate, the companies hope that regulators will sympathize with their arguments that consolidation is the only way to keep the industry from slowly dying.

"If the market-share numbers are as high as suggested, it is difficult to conceive of both mergers being approved simultaneously," said Glenn B. Manishin, an antitrust partner at the law firm of Kelley Drye & Warren in Washington.

Time Warner, which has pledged to cut its $24 billion debt, has been intending for months to sell the Warner Music recording unit to EMI for about $1.5 billion, according to the executives. The value of the deal could be worth an additional several hundred million dollars, if the combined company was able to slash duplicative costs, the executives said.

Under the terms of that proposal, Time Warner would get $1 billion in cash from EMI and retain a 25 percent stake in the combined group - a stake the parties estimate to be worth about $500 million. Keeping a stake in the combined business is an important point for some Time Warner executives and directors, who are reluctant to abandon the music industry entirely, in case it rebounds.

In accepting the EMI offer, Time Warner would then have the option of selling separately its music publishing unit, Warner Chappell, for what analysts expect would be about $1.3 billion. There are any number of private investors who are said to be interested, because music publishing has a significant and steady cash flow. With all those elements factored in, the total implied value of an EMI deal would be about $2.8 billion.

But with the Warner-EMI deal being such a regulatory gamble, the Bronfman bid, worth only $2.5 billion, may be the better bet. That group, which also includes the media entrepreneur Haim Saban, Thomas H. Lee Partners, Providence Equity Partners, Bain Capital and Quadrangle Partners, is offering to buy more than 80 percent of all of Warner Music - recording and publishing - for cash. The offer would give Time Warner the option of receiving less cash and retaining a stake in the company of as much as 19.9 percent.

The Bronfman group is also offering something of an insurance policy rider with its proposal. If at any time in the future the Bronfman group sought to merge Warner Music with another major music company, and that merger received regulatory approval, Time Warner would get an additional 19.9 percent stake in the merged company, meaning it could end up with as much as 39.9 percent of the new entity.

That provision is meant to assure Time Warner that it can avoid the current regulatory risks of an EMI deal, but would still have an opportunity to benefit if regulators eventually approved a music merger.

Among all music companies, a merger is most crucial for EMI, a British-based company whose artists include Coldplay and Norah Jones. Despite surprising analysts yesterday by reporting a better-than-expected pretax profit of £39.4 million ($67 million) for the six months that ended Sept. 30, it is one of the smallest of the five major music companies and is threatened by the prospect of mergers among its rivals.

But for Time Warner, the Bronfman deal is simply less risky. If Time Warner chose to pursue a deal with EMI - and regulators blocked the deal - the company would be left with a considerably devalued asset.

No major music company would be likely to try buying it, because of the regulatory cloud, and few private equity investors would be interested in buying without the publishing arm, assuming that Time Warner had already sold it separately. The recording unit is only attractive to private equity firms if it comes with the publishing unit, whose steady cash flow could help offset the ups and downs of the recording business.

Mike Gallant, a media and entertainment analyst at CIBC World Markets, concluded in a note to clients on Tuesday that Time Warner, "should strongly consider accepting Bronfman's bid, as it eliminates any regulatory risk associated with a sale at an attractive multiple for its weakest asset."

Of course, a Bronfman deal would not be risk-free. Indeed, some of the private equity firms involved in that bid have a history of renegotiating deals - with the price they ended up paying being significantly lower than had originally been planned.

And there might be a good defensive reason to accept the EMI bid, even on the assumption that it would be blocked - if it prompted regulators also to reject the Sony-Bertelsmann music merger.

In the view of one executive close to Time Warner's deliberations, a year of regulatory delays that ended up with all the big companies on a level playing field would be beneficial, if the industry's economic outlook improved next year. In other words, a year from now Time Warner might have many more music options than it does currently.

But if Time Warner is intent on doing a deal now, the $300 million extra that it would get from EMI, may not be worth the risk.