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PersonalTraks™ Corporation Business Plan

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MANAGEMENT TEAM RESPONSIBILITIES

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Executive Summary
Section 1 — The Company
Final document editing and compilation

Brian Wherrett:

Section 3 — The Product(s)
Section 5 — Manufacturing

Andrew Rupf:

Section 2 — Markets and Competition
Section 7 — Investment

Nelson Yu:

Section 4 — Selling
Section 6 — Financial Data

ORAL PRESENTATIONS

Plan interim oral presentation Oct. 27 — Wilbur Wong and
Nelson Yu
Plan final oral presentation Dec. 1 — Brian Wherrett and Andrew
Rupf

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EXECUTIVE SUMMARY

I. The Concept

We believe there is a demand for personal compilation CDs containing approximately 10 of a person's favorite songs. We also believe that many purchasers of modern pop music CDs would buy a personalized CD if it were priced within a few dollars of a regular CD. The customer merely pays for each song chosen plus some initial cost for the blank CD.

II. Background

However, there has been no supplier of such a product as of yet. Thus, an excellent business opportunity exists for a company that is able to manufacture and distribute pop music CDs that are tailored to the customized demands and tastes of individual consumers. Our preliminary market research shows that the best method to collect orders is by means of a central location such as a web site, mail order or call center. These orders are processed and the resulting customized CDs are manufactured en masse at a central factory location. The custom CDs are then distributed via a shipping company. Problems associated with this scenario include the legal details that must be worked out with single song licensing. Currently, the costs associated with setting up a basic library of songs from which a customer can choose his compilation are quite high. This is because a royalty fee must be paid out for each song that is placed on the custom CD.

III. The Obstacles

Thus, in order to exploit the market for personal compilation CDs, three obstacles must be overcome. They are as follows:

- 1) Insuring that the price of a customized CD is within a few dollars of the price of a regularly priced album.
- 2) Convincing music publishers that customized CDs will not excessively cannibalize existing album sales. This must be accomplished by demonstrating that the profits generated through the sales of customized CDs will far outweigh any potential losses suffered because fewer albums are purchased.
- 3) The high costs of working out the legal details associated with single song licensing. This might involve interfacing with the legal departments of each of the major record producers.

IV. The Company

Our company will specialize in the marketing and distribution of personal compilation CDs. As such, our company will collect and fill orders for personal compilation CDs obtained from the end user public.

Orders will be obtained through a web site, mail order, call center or some combination of the three. We will distribute the filled orders via a shipping company such as Federal Express. We will pay music publishers a royalty for each song we intend to copy. We will use our proprietary compilation technology to facilitate the manufacturing of personal compilation CDs. Our compilation technology will enable us to compile information (in this case music) from a variety of discrete sources (such as multiple single CDs) into a single location (a single CD).

V. The Market

Our market will consist of the end user public that will purchase our personal compilation CDs. This market will consist of individuals who wish to purchase single songs from a variety of different artists without purchasing the albums of each of these different artists.

VI. Overcoming the Obstacles

We will overcome the obstacles in the following way:

- 1) By partnering with one of the major record companies, we can keep the price of a personal compilation CD within a few dollars of the price of a regularly priced album. This is accomplished in two ways. First, we will avoid the legal issues involved with single song licensing, allowing the record companies to deal with these problems themselves. Second, we will eliminate the high costs of building a song library from which consumers will build their personal compilation CDs. The large record companies will be able to draw upon their own internal music collections in order to satisfy consumer choice.
- 2) Our market research indicates that most of the revenue that an album produces occurs within the first few months from when the album is first introduced. Once unit sales for a given album drop below a given threshold, the songs from that album can be added to our song library. As a result, our personal compilation CDs will only minimally cannibalize album sales while at the same time providing another revenue stream for record companies.

VII. Client Benefits

By partnering with us in the production of personal compilation CDs, large record companies enjoy the following benefits:

- 1) Since our company is responsible for collecting and filling orders, record companies can make money with minimal risk. Their only risk is the seed capital that they initially provide us. After that initial

investment in our company, they would receive royalty payments from each song that we copy with no further risk to themselves.

In addition, the end user public will enjoy the following benefits:

- 1) An end user will be able to enjoy the convenience associated with listening to a CD that contains only their favorite songs.
- 2) An end user will be able to save money. For example, instead of paying for three CDs that contain their desired songs, customers will be able to purchase one CD that costs only a few dollars more than a regularly priced CD.

VIII. Current Status

PersonalTraks™ is currently in the process of building a prototype to demonstrate the feasibility of the idea of personal compilation CDs. Our current financial forecasts indicate that the payback period for our business is under one year.

IX. Company Objectives

Our company's overall objective within a three-year time frame is to successfully implement our process in partnership with one of the major record companies. After this initial objective has been successfully achieved, we plan on expanding our market by applying our compilation process technology to other intellectual goods such as music videos and shareware games. Our expansion strategy will be implemented through franchising. Our successful entry into this expanded market should occur within seven years from when the company is first started. We plan on expanding into this second market by using our initial installation in one of the record companies as a showcase for our product. We hope that our company can eventually be taken public.

X. Financing Required

We will require approximately \$1,000,000 over two years to start our business. Our startup costs include the cost for office space, computers, office supplies and facilities to maintain a web site and call center. Money will also be required to pay the salaries of the members of the management team as well as any office support staff. Currently, the knowledge and personnel resources required for building a prototype for our personal compilation technology exists within our management

team. Given the amount of money required to start our business, we anticipate that only part of our funding requirements can be obtained through loans from the family and friends of our management team. To obtain the remaining capital needed to fund our business, we expect to receive some seed capital from one of the record companies that we will be in partnership with.

Mission Statement

To be the world's leading consulting company in the area of marketing and distribution of personal compilation CDs. To serve the needs of our customers to the best of our abilities and to add value to every venture in which we endeavor.

1.

The Company

1.1 Current Status

PersonalTraks™ is a consulting company specializing in the area of marketing and distribution of personal compilation CDs. Working in partnership with music publishers, we will process and distribute orders for personal compilation CDs that are obtained through our web site, mail order and call center. Through the use of our proprietary compilation technology, we are able to manufacture personal compilation CDs on a large scale. We are currently in the process of building a prototype to demonstrate the feasibility and utility of the idea of personal compilation CDs. Our current financial forecasts indicate that the payback period for our business is under one year.

1.2 Objectives, Near-Term

Our company's overall objective within a three-year time frame is to successfully implement our process in partnership with one of the major record companies.

1.3 Objectives, Long-Term

After our initial three-year objectives has been successfully achieved, we plan on expanding our market by applying our compilation process technology to other intellectual goods such as music videos and shareware games. Our expansion strategy will be implemented through franchising. Our successful entry into this expanded market should occur within seven years from when the company is first started. We plan on expanding into this second market by using our initial installation in one of the record companies as a showcase for our product.

1.4 The Management Team

Our company currently consists of a four-person management team encompassing skill sets in software, marketing, finance, sales and multimedia. The management teams is as follows:

Wilbur Wong will function as the President of PersonalTraks™ Corporation, providing overall management and strategic direction for the company. Mr. Wong is a graduate of the University of Toronto with a Bachelor of Arts degree specializing in philosophy. He is currently pursuing a second degree from the University of Toronto majoring in computer science. Mr. Wong brings a strong knowledge of financial markets and computers systems acquired from his time working for an IBM subsidiary specializing in building automated financial trading systems. Mr. Wong has also completed the Canadian Securities Course. In

addition, Mr. Wong brings a strong knowledge of database systems having designed and built a database for an information technology-recruiting firm.

Brian Wherrett will function as the Vice President for Manufacturing, responsible for all manufacturing related activities for PersonalTraks™ Corporation. Mr. Wherrett is a graduate of York University with a Bachelor of Fine Arts degree in musical composition. He is currently pursuing a second degree from the University of Toronto majoring in computer science. Mr. Wherrett is an experienced film/television composer literate in MIDI/computer/digital audio. He currently operates his own studio and brings experience in professional film and television sound editing and digital audio production.

Andrew Rupf will function as the Vice President for Marketing and Sales, responsible for all marketing and sales related activities for PersonalTraks™ Corporation. Mr. Rupf is currently completing his final year of a Computer Engineering degree from the University of Toronto. Mr. Rupf brings extensive experience in the marketing and sales areas as well as in the software and hardware design areas. For the past three summers, he has held positions ranging from doing market research for a company trying to decide whether or not they should export their products into Canada to being a salesperson in the investment relations industry.

Nelson Yu will function as the Vice President for Finance, responsible for all finance related activities for PersonalTraks™ Corporation. Mr. Yu is currently completing his final year of a Computer Science degree from the University of Toronto. Mr. Yu brings an extensive background in the multimedia, software development and human-computer interaction (HCI) areas. Mr. Yu has held summer and part-time positions ranging from doing work in a construction-engineering firm to working in an Artificial Intelligence (AI) lab.

1.5 Management Objectives

Management hopes to eventually take the firm public.

2. Markets and Competition

2.1 Market Overview

The North American market valuation of CDs is over \$12.1 billion. In Canada, the 1996 total sales were approximately \$42 million or \$800 million by revenue. The average selling price of a CD was \$14. This price includes all types of CDs from \$4.99 at supermarkets to box sets.

In Canada, the market segmentation by type can be expressed as follows:

Rock	32.5%	Pop	19.3%
Country	14.5%	R & B	12 %
Rap	9%	Gospel	4%
Jazz	3.3%	Classical	3.3%
Sound Tracks	0.8%	New Age	0.7%

Furthermore, the market is expected to grow in revenue by 16% and in sales by 24%.

In the Greater Toronto Area (GTA) market the picture is slightly different. Price of a CD before it hits the retail shelf is around \$13-14 and the consumer buys it at \$16-17. By the year 2000, the final retail price is expected to increase by \$2 to about \$19. This translates into GTA consumers buying about 6 million CDs in 1996 and they expected to buy about 7.5 million CD by the year 2002.

To see the break down by market segment see the following figure 1.

Music type	Sales (1996)	Sales (2002)
Rock	1.95	2.44
Pop	1.158	1.45
Country	0.87	1.09
R & B	0.72	0.9
Rap	0.54	0.675
Gospel	0.198	0.25
Classical	0.198	0.25
Sound Tracks	0.048	0.6
New Age	0.042	.052

Fig. 1

2.2 User Benefits

Thus far the market description has been described empirically. The question, however, still needs to be addressed as to where would PersonalTraks™ fit into the market. The market in Toronto is definitely competitive. This is evident by the dramatic price drop of retail CDs over the past 2 years. Although consumers like the idea of buying cheaper CDs, there still is discontent about the CD buying process.

Typically consumers hear songs on the radio and wish they could have a personal copy of that song. When they visit the retail store they are dismayed that the one song that they want to buy is packaged with 10 other songs that they feel are worthless. As a result the consumer is forced to make a tough choice -- either they must buy an entire album to get their favorite song (a costly option) or leave the store empty handed (which is often the case). This is not a win-win situation for the customer or the record company.

PersonalTraks™ will attempt to alleviate this problem by creating a custom CD publishing business. In the situation everyone can be a winner. The customer can select his/her favorite songs with ease and know that they will receive top quality song recordings. The record companies will gain a new revenue stream by turning potential customers who would walk away from a sale into buying customers. Also another advantage that a record company receives is that now if a customer chooses to have their CD custom published instead of doing

their own low quality recording then the company is retrieving lost royalties.

By creating a win-win situation for all, this will create an opening for PersonalTraks™ to enter the music market. This opportunity is even better since the price of CDs will be rising by several dollars over the next 2 years, and consumers don't like spending \$18 or \$19 for an album that contains only 1 or 2 good songs.

2.3 Competition

Custom CD publishing is an evolutionary idea. To PersonalTraks™ management team's knowledge there doesn't seem to be another company that has a custom CD publishing unit. The closest competition resides with pre-arranged mixed CD's like Dance Mix CDs. How Dance Mix are addressing a different music segment than PersonalTraks™.

Sony Music has come out with a very similar idea as PersonalTraks™ in that it will distribute single songs as a computer sound file over the Internet. This product addresses a computer savvy customer who has the ability to download the file. In order for them to transfer this sound file to a tape or CD they will need elaborate recording equipment. This type of distribution may become a viable form of competition in the future as sound recording equipment enters mainstream but the consumer will always have the inconvenience of physically creating their own album.

2.4 Market Niche

There are two basic types of consumers out in the marketplace. The first type is the hard core music fan. These people have an intense loyalty towards particular groups. When they purchase a CD album they prefer to obtain the original album so that they can get up to date info about the group from the jacket sleeve.

The second group is what PersonalTraks™ dubs as the "radio group". These people like to listen to the radio. When they hear a song they like, they will go out and purchase that particular album. Because this latter group's purchasing decision is based on particular songs and not on the group they are more sensitive to pricing of albums. If there is not more than 2-3 quality songs on the CD they won't consider buying the album.

It is PersonalTraks' intention to service the needs of the "radio listener" niche. Major record companies, especially in the area of pop and rock music typically undervalue this market niche. These two music segments represent the largest music categories, but customers don't have any choice in the assortment of songs that they can buy on a CD.

From direct market research, PersonalTraks™ has discovered that over 85% of consumers that purchase pop albums, really like the idea of being able to create their own CDs. The group that was the most favorable to the ideas was students, typically in there teens to early twenties. They spend a good deal of there disposable income on music and related entertainment.

2.5 Sales Projections

The sales projections are based on the Pop music segment of the Greater Toronto Area. The first chart is the most conservative estimate of our market acceptance rate. It assumes that PersonalTraks™ will obtain a 10% market share of its niche, and that all growth will be supported by the general growth of the market.

	1997	1998	1999	2000	2001
CDs	135 000	142 500	15 000	157 500	165 000
Sales (\$1,000)	\$2,700	\$2,850	\$3,000	\$3,150	\$3,300
Market Share	10%	10%	10%	10%	10%

The second chart illustrates the case of high acceptance by consumers. Instead of just buying one personal compilation per year, they are buying more than one. The music catalogue offered by PersonalTraks™ grows drastically, thus attracting even more consumers.

	1997	1998	1999	2000	2001
CDs	135 000	170 000	207 500	243 000	282 500
Sales (\$1,000)	\$2,700	\$3,420	\$4,140	\$4,860	\$5,650
Market Share	10%	12%	14%	16%	18%

The third case represents phenomenal consumer response that PersonalTraks™ starts to enter a new market niche of rock music. Note that the market share figure represents the combined market share of both the pop and rock music segments.

	1997	1998	1999	2000	2001
CDs	135 000	200 000	265 000	332 500	400 000
Sales (\$1,000)	\$2,700	\$4,000	\$5,320	\$6,640	\$8,000
Market Share *	10%	6%	8%	10%	11%

* From years 1998 to 2001 PersonalTraks™ will enter into the new music segment of rock.

2.6 Sales Strategy

The sales strategy for PersonalTraks™ is quite straightforward. It is our intention to set up a business model that is similar in approach to a music club like BMG or Columbia House. We would create our own distribution and sales channel. Initially these channels will be tested in the Greater Toronto Area (GTA) market. Once the process has been refined, it is our intention to create a franchise system to expand our growth to other markets within North America.

The sales channel will be created through the combination of database marketing. We'll purchase a customer list outlining our target market in the GTA. We'll send brochures to those people, outlining our product and music selection. The effectiveness of this approach is good, however the initial cost of starting up this sales approach is high. At a cost of \$1 to \$2 dollars per person, and an allotment of 25% of our gross sales we'll be able to reach over 350,000 potential customers in the first year. Once we have created a viable operation in the GTA it is the intention of PersonalTraks™ to create a franchise system out of our company. This has several advantages. First it would allow for rapid expansion to other geographical markets in North America since the capital needed for expansion is a lot less than if we would initiate the expansion with our own resources. The franchisees would be the main source of capital for the expansion. We would then take a royalty for the franchise license that we provide. With this form of expansion we could probably move into at least 10 new markets per year.

3. The Product(s)

3.1 Theory of Operation

An installation of the process will function as follows. The end user visits our web site. The user can then browse through the database of offered songs. Of great importance is the interface, it must be designed to assist the user in easily and quickly finding or “discovering” what songs they desire. The user must be able to use it with little difficulty. It will share similar characteristics as a search engine that web most users are familiar with. The user will be able search for songs by various criteria: title, artist, style, “suggestions” (if you like A then you might like B), etc. By simply clicking on a button a selected song will be added to the user's list. The web page displays and updates the list as the user builds it and gives feedback as to the resulting CD's total length. The user will also have the option of including a text message that will appear in the CD's booklet. Once the user has completed their song list, filled in appropriate payment and mailing information, he or she can then electronically submit the form or print a “mail in” order form. The submission will be checked for omissions and warn the user accordingly. When the user electronically submits the order it gets logged into the

“orders database”. The user will have the choice of submitting credit card information electronically via the web form, or by dialing a 1-800 number. If the user chooses to mail in their information they will also have the choice of paying by check. This option will help us offer the product to the youth market. Once payment has been processed, the order will then get processed. The CD is “burnt” by the CD writer and then labeled. The CD booklet will be printed and then the CD will get packaged. In the final step, the mailing address is printed and the CD gets mailed.

3.2 Applications

The general concept of the venture is to provide a process for compiling information. The process can be applied to any situation where customized compilations need to be drawn from a large data source. The initial application of music songs as the “unit” of data helps to simplify the process. Future applications could include compilations that are composed of numerous and varied data files. Many potential applications exist in the growing electronic document distribution and archival field.

3.3 Product Performance Data

There are currently no retailers providing customized CD in the manner or scale that we propose. In fact there may be no CDs offered for sale that have the “customizability” that our process can provide. This value-added component of our product has only recently become technically feasible. As well, the continuing growth in the number of web users has meant that the means for requesting our product is becoming increasingly available and understood by a growing market. The only existing comparable products are “Greatest Hits” or “Dance” compilations, which are mass-produced and not customized. These existing “compiled by consensus” CDs have an obvious and successful existing market.

3.4 Product Economics and Advantages

The end user will benefit by being able to choose the contents of the CD. The music publisher benefits by having an extra source by which they may further exploit their existing products.

3.5 Present Product Status

We will build a small scale manufacturing plant (with easily expandable capacity) to demonstrate capability to prospective music publishers with whom we’d like to form agreements with.

3.6 Patents and Proprietary Know-How

The company's major proprietary characteristic is the process and expertise in implementing the process. Although we plan to create as little original software as possible in order to reduce development costs, our process will have some proprietary software. This software will perform the crucial role of dealing with the communication between parts of the process.

4. Selling

4.1 Sales

Given that the current market size for CDs in Canada according to RPM is 42 million and the U.S market being 778 million in size (1996). We expect to eventually sell between 100,000 to 500,000 CDs a year. Having done preliminary market research with favorable results and researching our competition such as Columbia House, we believe these are reasonable numbers. In fact, Columbia House, a direct marketer, sells around 250,000-500,000 CDs a month. All of the CDs they sell have been on the market for at least a year and we expect typically to get song-licenses to material that is older than a year. The two largest markets appear to be the teenagers and the baby boomers, so there is still value/sell-ability in material that is older than a decade or two.

The cost of a CD to the customer will be \$20-\$25+ tax/shipping, which is no more than the average cost of a CD at retail. Thus we expect to achieve \$2-\$10 million in sales within 2-3 years of operation. I.e. 100,000-500,000 CDs/year.

4.2 Methods of Selling

The web-site will allow the user to pick, choose and pay for his/her selection. The customer is given an order number to be used as reference or possibly to pay for the CD via 1-800 number at a later time. The customer can decide at the web-site not to reveal any credit card information. At the moment, studies show people lack trust or feel insecure about Internet commerce transactions. So we provide a 1-800 and fax number where they can reveal their credit card information to a human safely.

All information will be presented to the customer at the web-site for he/she to verify or cancel. Since that information goes directly to the machine for recording, we only need to worry about quality and

methods of distributing the CD to the customer vs. the possibility of incorrect songs placed on a CD due to human error.

4.3 Method of Distribution

After ordering the CD will be sent via post to the customer's address. If the customer finds defects, etc. he or she may return it at our cost. If the customer has a complaint we have a technical support line available for them.

5. Manufacturing

5.1 Facilities Needed

Installations of the process will require sufficient space to house the computers, hard drives, CD writer, CD labeler, and label printer. We'll also require management office and phone center space. As our "store front" will be the web page, location will be less of an issue for us than for a retailer.

5.2 Make/buy Considerations

We will design the web interface software (cgi scripts, etc.) ourselves. We will buy a configurable database to reduce the amount of programming necessary. The remainder of the equipment required will have to be purchased or rented.

5.3 Major Purchasing Issues

We will take the approach of building a skeletal system that will be easily expandable to meet increased demand. We'll try to rent the more expensive items with the goal of upgrading them, as capacity needs to grow. Since the speed and quality of items, such as CD writers for example, are continually improving while decreasing in price, we should avoid buying them if possible.

We will need to buy or rent the following hardware:

- "industrial" CD writers
- a CD label machine
- shrink wrap machine
- a RAID or optical storage drives
- computers, monitors, keyboards, mice, (one computer to act as a web sever and one to control the CD writers)
- laser printer.

We will need to buy operating system software for the computers, a customizable database, web development/maintenance software and appropriate general office software.

5.4 Second, Third Sourcing Needs

We will need a supply of CD blanks with jewel cases, original CD masters and an Internet service provider. We will need to have our “generic” booklet cover printed as well.

5.5 Manufacturing Engineering Support

As evident by the proliferation of home CD writers, the manufacturing of the actual CDs is fairly strait forward. The integration of our “larger scale version” will need strict monitoring to ensure quality control and timely production. This will be achieved by our software integration of the system. Other areas that will require personnel support are: the maintenance of the web site, the maintenance of the databases, management of the hard drive array, general computer maintenance and staff training.

5.6 Quality Control Plans

We will monitor the process at several levels to track its efficiency. We will create reports based on customer orders and web site “hits” to determine the effectiveness of the web interface and its supporting “add-ons” such as “automatic suggestions” that help someone find “that particular” song or links to record company promotional sites. Every CD can be checked after writing by a high speed CD-ROM drive to determine the accuracy of the copied data. The CD, its booklet and the order information will be tracked to ensure proper integration.

5.7 Staffing Requirements

Our company will require people to act in various capacities. We will fill the majority of these roles and will be assisted by hired staff where necessary. The various roles are outlined below.

Database manager:

This manager will be in charge of loading information into the databases. The digital song files can be read from existing CDs into the hard drive array with minimal computer knowledge. Unfortunately a certain amount of data entry may be required. This may necessitate hiring temporary help to set up the initial song database and when there are major updates. The song titles, album title and artist information will most likely have to be input manually into the database. Records of

this information may already exist at the disposal of publishing companies, so the solution may be as simple as transferring records into the song database and avoiding manual data entry altogether.

Web page manager:

We will need a full time web master for overseeing creation and maintenance of the “custom CD” page, responding to email inquires, and continually improving the site.

Manufacturing manager:

A staff member (perhaps more than one depending on scale) will be required to oversee the CD writers, performing duties such as loading the CD blanks, operating the CD labeler, packaging and mailing. Also included is the task of quality control.

Marketing/Sales manager:

Tasks include overseeing marketing strategy and advertising.

General Business manager:

Is in charge of overseeing accounting and legal issues.

The staff in charge of responding to phone and mail orders will also have to managed.

6. Financial Data

6.1 Costs

The materials cost \$5/CD and royalties are \$10/CD. The CD-burner machine + software cost approximately \$100,000-\$150,000 each and only 1-2 are needed. Each machine can produce 250,000+ CDs a year reliably. In general, the majority of the yearly costs go to the materials and royalties. So trimming the cost of the machine does little in the long run. Also marketing costs works out to be \$2 per CD, which is extremely ineffective and should be re-evaluated. Currently more research needs to be done on sales projections via market surveys and associated marketing costs.

The cost of administration has not been entirely settled. Rent, utilities, insurance, etc. are unknown variables that are assumed to cost up to \$100,000/year.

6.2 Profit Projections

The projected profit is negative until sometime later in the 2nd year. This fact is due to expect 'royalty payments' of \$10 per CD and possible cost of materials being \$5 per CD. Albeit \$10/CD is high, as only \$4.50-\$7 is actually royalty payments themselves. This number is taken from traditional CDs, where only \$4.50 of the manufacturer's cost (\$12) goes to the publisher, artists, etc. while the rest goes to promotion, materials, administration.

The other couple of dollars over and above the basic royalties goes to the record company for lost sales, use of their marketing services, etc. In general we only projected 50,000 and 100,000 CDs for the 1st and 2nd years although they could be much greater. Our breakpoint number appears to be 100,000 CDs/year where revenues exceed costs.

6.3 Startup Capital Required

The total capital required is based on a three-year projection. \$1 million is needed in the first year to cover manufacturing, marketing, administration and especially the cost of CDs themselves. The expected royalty payments themselves to the record companies (who probably have exclusive rights with publishers for the songs we want to license) covers half that amount. The needed start-up capital could be reduced if the record companies help pay for cost of manufacturing & marketing or defer royalties for a period of time until revenues have reached a certain level.

More capital will be required if orders exceed 250,000 within the first year of operation as new machines need to be built and more employees are needed. Otherwise the monthly sales income can supply enough capital to keep the company afloat indefinitely.

7. Investment

7.1 Description of the Offering

The record companies have a vested interest in us and our goal for this company is to be bought out. So we could raise money by selling record companies debentures (debt-to-equity), in which they can convert into stocks/equity at a future date. Through this method, we maintain a favorable relationship with our suppliers, we supply an extra source of revenue through our 'royalty' payments to them and we can be bought out reasonably at a future date. This scenario resembles the Nelvana/Windlight Studio case that has occurred recently. Nelvana supplied much of the start-up capital to Windlight in the form of debt-to-equity shares. Windlight Studios became successful over a short

period of 2-3 years and was recently bought out by Nelvana for a size-able amount.

The other methods of raising enough capital include going to venture capitalist or getting bank loans. However loans of \$1 million without size-able collateral are highly unlikely.

7.2 Use of Proceeds

The proceeds from the investments would go to building the machines, developing the software, marketing and eventually when CDs are sold - royalties.

APPENDIX

A Five questions asked to a ten-person focus group to assess interest in the idea of personalized compilation CDs

- 1) When you make a decision to purchase an album, do you do so based on a desire to buy only one or two songs off that particular album, or are you interested in buying the album because it represents the work of one particular musical artist that you enjoy?
- 2) Would you be interested in purchasing a personal compilation CD consisting of 10 songs if the songs you were allowed to choose were a year old or older?
- 3) Would you purchase a personal compilation CD consisting of 10 songs if such a CD were priced within a few dollars of a regularly priced album? For example, would you pay \$20.00 for a personal compilation CD?
- 4) Do you think you would have trouble choosing 10 single songs to fill a personalized CD?
- 5) Can you see yourself purchasing more than one personalized CD containing 10 single songs per CD?

B Summary of Responses to Questionnaire

- 1) Many respondents wrote "both" or "depends", three said solely on the artists. Regardless of the answers, there are those who buy albums solely on artists (Led Zeppelin, Van Halen, Oasis and U2) and those who buy CDs because they like a couple of songs. For us, it does not matter; a CD can contain songs from one, two artists to 10 artists.
- 2) Respondents did not care how old the songs were, except for one respondent (who would not buy a personalized CD anyhow and is into whacked-out dance music). In short good music is long lasting. Whether personalized CDs would 'cannibalize' the new CD market due to people buying CDs w/older songs, is another question to be answered.
- 3) Everyone who liked the idea and wanted the product said yes. Only one said no. Price is not a major concern.
- 4) Some of the respondents would have trouble picking out songs, because the CD would be a gift, not for them. However there were 7 No's and I'm sure we would run into this problem in the real world, but never encounter it during a questionnaire. I.e. the questionnaire is written in a way so that it appears that if they say no, they'd be saying they couldn't name 10 of their favorite songs.
- 5) Half said yes and I got the feeling that only a couple of CDs would be bought vs. the 10-30 CDs these people normally buy a year.

Interesting notes:

1 girl only buys used.

1 guy only buys new dance-music.

The singles-market in the US is supposed to be big and very profitable according to the sole American in this survey.

C Discussion with a Music Marketing Manager at Columbia House

The man thought that traditional markets would be cannibalized slightly, his words not mine. This is a valid perception.

He could not give me specific numbers, due to confidentiality. However I know they ship under 300,000-500,000 CDs a month.

They do not have rights to individual songs, just albums. Only Sony (their parents) has these rights and each agreement with each artist may be different.

He believed the idea was workable, but it was outside his domain. He mentioned Quality records as having experience in this area.