

See You On The Other Side

By Ed Christman

Circuit City was forced to turn its Chapter 11 filing into an outright liquidation. In this tough environment, how is Muzak's walk through the U.S. bankruptcy process proceeding?

Muzak -- which tailors playlists for retailers and other clients that need music to play in their stores and while customer-service callers are on hold -- is attempting to restructure its balance sheet and hopes to emerge as a stand-alone business. An examination of its financials suggests that its chances look good.

During the last five years, Muzak's annual sales have been stagnant, due to increased competition from the likes of [PlayNetworks](#), In-Store Broadcasting Network, Trusonic, DMX Music, Premier Retail Networks and other rival service providers.

Although Muzak stopped submitting 10-K filings to the Securities and Exchange Commission in 2007, the company's more limited financial reports since then indicate that it remains profitable on an operating basis. In its final 10-K, Muzak reported 2006 revenue of \$248.6 million and \$60 million in earnings before interest, taxes, depreciation and amortization (EBITDA), although it posted a net loss of \$75 million due to depreciation, amortization and interest payments. For the following year, the company reported revenue of \$250.2 million and EBITDA of \$68.7 million, while in 2008 it generated \$248.9 million in revenue and \$65 million in EBITDA.

But the company's approximately \$50 million in annual debt service wiped out its annual profits, and the bulk of its debt came due Feb. 15. The interest payments and maturing debt forced Muzak to file for Chapter 11 bankruptcy protection Feb. 10.

While the company listed \$437 million in total liabilities, the Chapter 11 affidavit of Muzak CFO/treasurer R. Dodd Hayes describes more than \$471 million in total debt. From 1998 to 2003, prior Muzak management financed an acquisition spree through three separate bond and note issues that raised \$370 million. Besides the money owed to bond and note holders, a senior secured term loan from Bear Stearns -- presumably now in the [JPMorgan Chase](#) portfolio following its acquisition of Bear last year -- was drawn down \$101 million as of the Feb. 10 filing date. Vendors, labels, publishers and other music suppliers appear to be owed less than \$5 million.

While Muzak doesn't have debtor-in-possession financing, its secured lender didn't object when the company petitioned the Delaware District U.S. Bankruptcy Court to access what's known as cash collateral, also known as cash on hand. According to court documents, cash on hand totaled about \$35 million in mid-April, which the company says is enough to operate the business going forward.

What happens now? In the current environment, Chapter 11 companies are more likely to be either sold or liquidated piecemeal than come through a bankruptcy reorganization intact. But Muzak has already been down the sale path, when it proposed merging with DMX in 2007 and then sought a buyer for the proposed combined entity. The companies received several bids last September before the economic downturn killed that effort.

Meanwhile, an outright liquidation appears unlikely in that the company's \$392 million in assets includes tangible assets of only \$82 million in the form of the hardware it installs in retail stores and uses to manage its 2.5 million-song database. The rest is mostly composed of \$266 million in goodwill and intangible assets.

That's why it looks like Muzak could emerge as a stand-alone company, with the secured lender likely to get most of the equity and bondholders perhaps also getting a stake. Current shareholders, such as ABRY Partners (with 64%), which also has an equity stake in Music Reports, and Clear Channel unit AMFM (20%), will probably be wiped out. Down the line, though, the new owners may look to merge or sell the company to cash out.

Although music publishers, songwriters and labels combined could lose \$2 million or so in the short term due to the Muzak Chapter 11, this appears to be a case where the music industry will benefit in the long run and should throw its support behind Muzak's reorganization effort. Muzak generates about \$16 million annually in royalties paid to about 1,000 music companies, including music publishers, rights organizations and labels, with ASCAP and BMI receiving the bulk of that. According to its last 10-K filing, Muzak paid ASCAP and BMI about \$12.8 million in royalties in 2006.

Muzak director of music industry relations Jason McCormick makes a pretty good case for industry support.

"We are all about using music content in the right way and making sure [rights holders] get paid," he says. "We have been writing checks to them for 75 years."