

The State of the Compact Disc

A Coolfer Analysis
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Executive Summary

In the compact disc – the CD – there is cause for concern and some optimism. As they have for most of the decade, U.S. CD sales are dropping and will continue to drop in the coming years. After a surge in store closings and reductions of shelf space, the CD's rate of decline is expected to slow over the next four years. There is evidence that inventory reductions will not lead to a commensurate decrease in sales. Store closings and consumers' migration to digital music, however, will continue to harm sales. Wholesale prices will come under greater scrutiny as pressure rises to prolong the CD's useful life and further justify their place on retail shelves.

Coolfer forecasts U.S. CD sales to drop 16% in 2008, 14% in 2009 and 12% in 2010, 2011 and 2012.

Retailers reported large drops in CD sales over the last 18 months. Same-store music sales at Trans World stores were down sharply in the first quarter of 2008, and same-store sales from its top 50 titles dropped by an even wider margin. Circuit City's music sales in the fourth quarter of 2007 were down by "double digits." Borders' music sales were down sharply in first quarter of fiscal 2008.

Retail space is shrinking as shelf space is diverted to other products and stores are closed. Trans World reduced stores' music inventories by 10% in fiscal 2007. Borders reduced music inventories 32% in fiscal 2007. Virgin Megastore will close its Times Square location in early 2009. The possibility of greater reductions in CD shelf space will be an ever present threat going forward.

In spite of the decline in CD sales, its demise has been exaggerated. In the face of changes in the ways people acquire and listen to music, physical formats continue to be the preferred music vehicle. The format still represents the majority of all recorded music revenues and has a good deal of life left in it. One study found 41% of music buyers purchase only physical formats.

Many retailers are pressing labels more than they have in the past for lower wholesale prices. This will put downward pressure on labels' margins, force labels to cut additional costs and encourage the release of more higher-margin packages such as limited-edition CD+DVD packages.

Non-traditional retail will represent a growing share of CD sales. Internet retailers accounted for 6% of all physical album sales – the vast majority of which were CDs – in 2007. That was up from 5% in 2006.

There are a few bright spots for the CD. Many retailers have been outspoken in their continued support of the format. Trans World sees hope and believes it is "the only player left from a catalog perspective." Best Buy has said it will improve its CD selection by customizing each store's stock to local tastes.