

Executive Summary

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Overview

Over the past 18 months, Napster has proven consumer readiness for digital music. However, for all of the press coverage surrounding Napster, MP3.Com, and potential entrants such as Yahoo, no company has created a digital music product that provides both clear benefits to the consumer *and* makes money. Echo Networks was founded to create the first profitable, compelling consumer music service and ultimately to become a dominant product and infrastructure provider for the digital delivery of music.

Echo Networks currently operates the largest and fastest growing streaming music community on the Internet. With almost no marketing, Echo has attracted over 500,000 registered users since launching its "Music Messenger" beta service in Q3 2000. Echo's community-centric product design not only provides a superior consumer experience, it also creates customer lock-in unprecedented in the on-line music market – as evidenced by Echo's industry-leading 3.5-hour average session length. To further strengthen the barriers to entry created by Echo's product design and extensive technological assets, the company has filed four patent applications covering its GroupCast and Song Selection infrastructure technologies. With its user base growing at a rate of over 10% per month, Echo believes its audio-ad supported music service can reach profitability within the next 12 to 18 months.

As the race heats up to capture recurring monthly subscription revenue from advanced on-line music services, Echo has already built, tested, deployed, and successfully scaled the back-end technology and consumer interface required to operate an on-demand subscription service. Echo is extraordinarily focused on achieving healthy subscription margins to supplement the anticipated 70% gross margins of its ad-supported product, and to that end has assembled a top-tier team to pursue truly economic subscription licenses from the major label groups. This team includes Strauss Zelnick, former CEO of BMG and now an investor, board member, and active advisor to Echo's management team, and Gary Stiffleman, a leading entertainment lawyer who has negotiated licensing deals with all five major labels. Echo has already signed a pioneering license with Warner Music Group, covering interactive radio, locker services, and advanced community music-sharing functionality. Echo is currently leveraging its proprietary technology to build a broadly integrated subscription offering that extends beyond a simply "click and listen" service and maximizes customer value while minimizing streaming and royalty costs.

From its inception Echo has maintained a disciplined financing and spending profile; as a result, Echo has weathered the recent contraction in the private equity markets and is now one of the few early-stage companies positioned to compete in the on-line music market. With little product competition from other start-ups, Echo has a historic opportunity to distribute its service through partners such as Yahoo, Excite, AOL, etc. as these portals compete for profits, customer lock-in, time-to-market, and market share.

Echo has raised \$8M in Series A and Bridge financing and is currently completing a Series B round to fund additional label deals and the completion of Echo's next-generation subscription service.

Team Highlights

Echo was co-founded in December 1999 by Dan Hart, a successful Silicon Valley entrepreneur and the former managing partner of Fundamental, an early-stage venture fund whose portfolio companies included Silicon Spice, recently acquired by Broadcom for \$1.2B. In addition to Strauss Zelnick and Gary Stiffleman, Echo's investors, advisors and directors also include Rikk Carey, the General Manager of Yahoo! Music through March 2001, JP Morgan's former CFO Tom Fox, eBay's co-founder Jeff Skoll, Peter Paterno, attorney for Metallica and Dr. Dre, and Lee Eastman, attorney for Paul McCartney.

Product: The Echo Music Messenger

Echo's first generation product (currently available at www.echo.com) places interactivity and community at the core of the streaming music experience and provides the foundation for Echo's evolution into a fully integrated Music Service Provider (MSP). The appeal of Echo's unique product is best evidenced by its success in the marketplace. Echo's Music Messenger was rated "The #1 Free Music Product On The Web" by PC World and received the "Editor's Choice Award" for best Internet radio product by PC Magazine. With almost no outside marketing or advertising, Echo has attracted over 500,000 registered users since its beta launch in Q3 2000. Echo currently averages over 1,000 concurrent listeners, boasts an 3.5-hour average session length, and has collected over 10 million song, artist, and album ratings. Furthermore, usage data from Echo's product indicates that Echo's members are heavy users of Echo's proprietary community functionality. Echo members are not just email addresses in a database, they are loyal community members who are hooked into Echo's service by their music ratings, group stations, and buddy lists.



Echo's service enables Internet users to create "group stations" which are similar to AOL Instant Messenger communities, eGroups or Yahoo! Clubs combined with a stream of music that all community members hear simultaneously and which reflects the community's aggregated musical preferences. Echo is the only on-line music company with the technology to enable this simultaneous listening experience. Through a web-based player called the "Echo Music Messenger" (see graphic above), Echo members rate music, chat with other members of their group stations, vote on songs playing, invite friends to listen, accrue Prize Patrol rewards points and track their friends across the Echo service. At core, the Echo experience derives from the emotionally powerful feeling of shared "presence" that occurs when geographically dispersed Echo members communicate with one another while knowing they are experiencing the same music - and thus, shared emotions - at the same time. No other entertainment product on the Internet is able to offer the addictive draw of such powerful emotional connection.

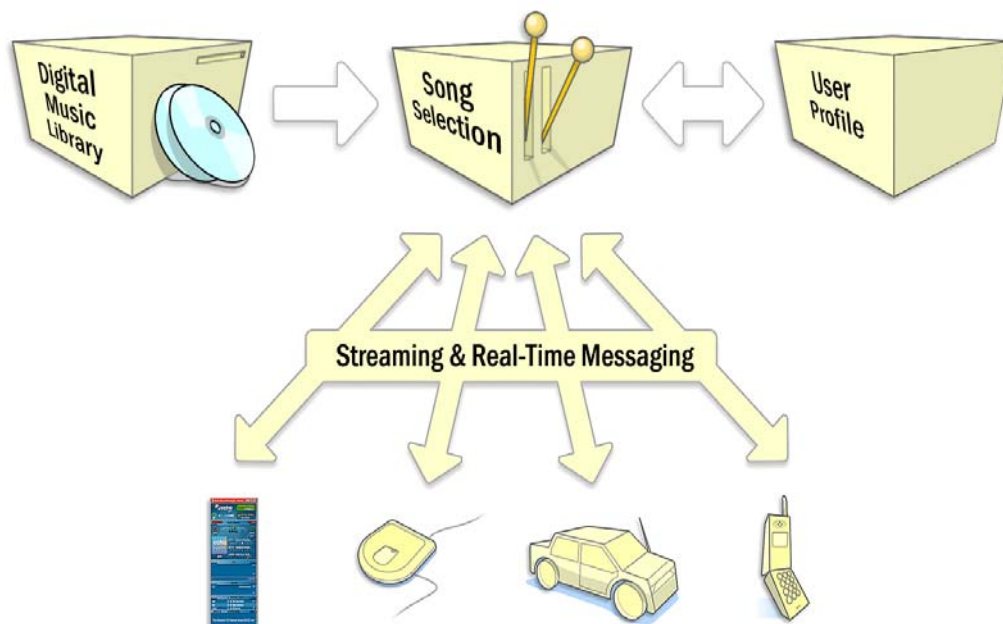
Widely praised in the press for its ease of use, Echo automatically selects songs for a user based on members' ratings and preferences, editor picks, chart hits and data describing correlations between artists and styles using Echo's proprietary Song Selection Algorithm (see Technology discussion below), and eliminates the need for time-consuming downloads and complicated file and playlist management.

Both consumer experience and customer lock-in will be enhanced by the next iteration of Echo's first generation product (to be released Q3 2001), which integrates fully with Yahoo and MSN Instant Messenger. This integration will enable Echo to reach the 27 million users of Yahoo's and MSN's messaging services, enabling these users to easily spread Echo throughout their buddy lists. Furthermore, Echo users will be able to run an "always on" client in their system trays that automatically launches when they start their computer - thereby increasing concurrent listening, lock-in, and the inherent asset value of Echo's user base.

Technology: Proprietary and Scalable

Echo is more than an Internet radio service; it is a set of sophisticated and flexible technologies that can support any type of streaming music service, including a richly featured on-demand subscription service that extends far beyond a simple "click and listen" jukebox. While some of Echo's competitors, such as MP3.Com, currently possess a straight-forward streaming capability, only Echo has the technology to enable dynamic song selection and features such as on-the-fly song rating, skipping, chatting, buddy-list tracking and instant messaging. Among Echo's core assets are its proprietary Groupcast and Song Selection technologies and the accrued technological experience garnered from the unprecedented speed at which the company has scaled its streaming music community. (Echo's concurrent user number has peaked at over 2,800 listeners, the company's current hardware can handle at least 5,000 concurrent listeners, and Echo's software can scale to between 20,000 and 50,000 concurrent listeners with the simple addition of inexpensive Linux servers.)

Echo's Universal Back-End



Echo has filed four applications for patent covering the company's GroupCast and Song Selection technologies as well as a business method patent covering the concept of group consumption of consumer-influenced streams of media. Even in the absence of such protection, the company believes that it has at least a 12-month technology lead with respect to its competitors.

Echo's Groupcast technology is a significant breakthrough in streaming media that enables synchronous group media consumption. The Groupcast technology solves asynchronicity and latency issues inherent to streaming media that result from differences in client bandwidth, net congestion, processing speed and buffering time. Echo has over 18 months of "hard core" engineering invested in its technology and is the only company with this Groupcast capability. As a stand alone technology, Groupcast has application far beyond the Echo service by virtue of its power to enable the emotionally powerful experience of shared "presence" around other media types including video, flash animation and multi-player gaming.

The company's proprietary Song Selection technology (SSA) delivers music based on users' music profiles using a sophisticated algorithm. Sophisticated song selection is key to mass-market acceptance of streaming music because it makes the online music experience simple, eliminating the need for continuous song requests and time-consuming playlist creation. Moving beyond the first version of the Echo service, Song Selection will be integrated with Echo's under-development subscription functionality (discussed below). Through a "smart shuffle" playback mode, users will be able to apply their preference and ratings profiles to their own music collections.





Echo's Subscription Service: On-Demand, Integrated, and High-Margin

Echo is leveraging the flexible back-end supporting its current product to deploy an advanced digital music subscription service integrating on-demand streaming, downloading, non-interactive and interactive radio services. While many of Echo's competitors are struggling simply to define the term "subscription service," Echo is focused on creating an advanced, integrated product with a significant gross margin. Echo has studied consumer desires and behavior patterns to design a product that: (a) provides enough value to the consumer to warrant a monthly subscription fee; (b) drives user behavior to hold streaming and infrastructure costs within the limits dictated by that monthly fee; and (c) drives user behavior towards activities that minimize royalty payments. The result is an integrated product that: (1) enriches consumer experience by enabling features such as "IM this song to a friend"; (2) generates demand by upselling customers from basic radio to premium subscription services; (3) increases customer switching costs through community music functionality; and (4) increases margins by migrating user behavior towards activities that are subject to lower royalty rates.



- Enhanced Consumer Experience
- Community Creates Customer Lock-In
- Demand Generation
- Integrated Services Increase Margins

Echo is leveraging its technological capacity to integrate multiple services to minimize streaming costs and royalty payments. For example, a radio user who uses Echo for 20 hours a month and then purchases an on-demand “Jazz Pack” but still only listens for 20 hours a month costs Echo the same in bandwidth costs before and after the “Jazz Pack” purchase. Thus, net of record label royalties, the customer’s “Jazz Pack” purchase represents pure profit for Echo. Similarly, a user of Echo’s unlimited on-demand service might build explicit playlists for half of their listening time while listening to their collections on “smart shuffle” for the remainder of their listening time. In this case, illustrated in the chart below, Echo pays per-song on-demand streaming royalties for only half of the user’s listening time and interactive-radio royalties the other half. Since per-song on-demand royalties are typically 2.5 times the rate of interactive-radio royalties, Echo’s blended royalty rate can add 15% or more to Echo’s net margins – resulting in millions in additional quarterly profit for high volume distribution partners.

Type of Service		Cost to Consumer	Per Hour Metrics			Gross Profit	Quarterly Partner Profit (\$MM)
			Revenue	Royalties	Delivery		
SUBSCRIPTION ONLY		\$9.99	\$0.33	\$0.17	\$0.01	\$0.15	\$13.4
LOCKERS ONLY		\$4.99	\$0.17	\$0.05	\$0.01	\$0.10	\$9.1
INTERACTIVE RADIO ONLY		free	\$0.16	\$0.03	\$0.01	\$0.11	\$10.2
INTEGRATED MUSIC SERVICE		\$9.99	\$0.33	\$0.09	\$0.01	\$0.23	\$20.6

Echo has already built and scaled the technology required to operate an integrated music service. Many of Echo’s competitors are contemplating only straightforward “click and listen” services driven by technology fundamentally incapable of providing the advanced services – such as ratings and song-selection – required to offer consumers a subscription-worthy experience and capture the higher-margins of an integrated service.

Competition, Licensing, and Distribution – Echo v. the “Big Guys”

Operating at the lowest cost structure in the industry, Echo Networks has survived the recent contraction in the private equity markets and is one of a very few early-stage companies seriously positioned to compete in the on-line music market. As companies such as Napster and MP3.Com struggle under legal pressure and lack viable business models, Echo’s competitors are no longer MusicBank or Myplay or Gigabeat – instead they are Real Networks, AOL, Yahoo, Excite, and other Internet distribution hubs.

Echo’s larger competitors have serious advantages with which Echo must contend, primarily superior distribution and marketing capacity. However, Echo has the advantages of rapid product development capability, customer focus, and the technical and customer knowledge derived from running Echo’s existing service. Furthermore, Echo has assembled a top-tier team to pursue subscription licenses from the major label groups – including not only Strauss Zelnick, the only former major label CEO to ever become involved with a digital music company – but also Gary Stiffleman, a leading entertainment lawyer who negotiated MP3.com’s settlement and licensing agreements with all five major label groups. The quality of Echo’s licensing team places the company at least on par with anyone else in the industry, and at an advantage to many of the company’s competitors. Many of the large portals have little or no

experience negotiating with record labels and are willing to let a company such as Echo handle these relationships on their behalf. To date, the most successful licensing competition has come from Real Network's MusicNet, which has announced licensing deals with EMI, Warner, and BMG. All of these record labels have stated publicly and privately their intention to license other companies, and Echo is in advanced conversations with all three entities regarding licenses on competitive terms with MusicNet.

As the major labels begin granting economically viable licenses, Echo believes that the first company to deploy a music service with healthy gross margins will be positioned not only to build a strong destination business, but also to land distribution deals with major Internet portals such as AOL, Excite, and Yahoo. Echo's research and relationships indicate that the most powerful factors driving the portals' choice of service offering are: (1) consumer experience; (2) customer lock-in; and (3) gross margin – all factors directly impacting the economics of attracting, retaining, and profiting from consumers.



Echo's current product is already the clear winner with respect to consumer experience and customer lock-in. Achieving Echo's ambitious margin goals requires a mix of product, licensing, and technical savvy that adeptly creates a high-value consumer proposition while keeping royalty costs firmly under control. Echo believes that it has solved this complex equation, and by being the first to market with a moneymaking product, Echo will be in a position to partner with and harness the distribution power of the Internet portals rather than competing with them directly.

Echo's disciplined cost structure allows Echo to achieve profitability at a lower volume than its larger competitors. Once profitability is achieved through its web-based service, Echo will be an independent, profitable Music Service Provider. From this position of strength and focus, Echo will be well positioned to capitalize on emerging off-web wireless and mobile device opportunities – areas where Echo's current competitors (i.e., the big portals) lack dominance or even significant expertise. As digital music consumption gains momentum, Echo will be positioned to ride an "accelerating advantage" cycle (pictured right) as Echo's product, technology and licenses create ever-increasing barriers to entry.



Economics and Financing

Echo Networks makes money in three ways: (1) from sales of audio advertising into its streaming audio inventory; (2) from monthly subscription fees paid by customers of Echo's on-demand music services; (3) by selling song, artist, and album ratings data to record companies and radios stations. Of these three revenue sources, audio advertising and customer subscription fees make up the bulk of Echo's revenue.

Echo achieves a 70% gross margin on its current radio product assuming it fills its inventory with 8 audio ads per hour at a \$20 net CPM. Currently, this is a demonstrated market-clearing CPM, yet it remains challenging to fill Echo's full audio ad inventory given the lack of a central clearinghouse for Internet audio ads. Audio advertising is a \$73B worldwide market and a proven revenue generator for terrestrial radio. Targeting and click-through opportunities increase the effectiveness of audio advertising on the Internet. Echo believes that a robust clearinghouse for Internet audio ads will emerge over the next 6 to 24 months. Echo has agency deals with CyberReps and LightningCast and has signed direct advertising deals with customers such as Starwood Hotels, WWF, Budweiser, and NextCard.

The economics of subscription services are significant as recurring monthly revenue streams enable Echo to offer enticing marketing incentives based on the net present value of a customer's anticipated lifetime profit. For example, Echo will be able to offer a free set of speakers (at, say, a \$15 cost) to a customer who signs up for 1 year of Echo at \$10/month and thus earns Echo a guaranteed gross income of \$120 and a net profit of \$65 over the course of the year. Furthermore, Echo's planned integrated service offering enables Echo to make increased margins on premium services whose costs are already covered by existing customer behavior. (See discussion under "Subscription" section above.)

Once Echo has achieved a profitable margin, that margin can be applied to huge volumes. At any given time 18 million people are listening to traditional radio stations in the United States. Napster claims over 70M total users and hundreds of thousands of simultaneous users. Given these metrics, other similar statistics, and the anticipated growth rate of broadband and wireless Internet connections, Echo believes that it can scale to over \$250M in revenue and over \$40M in earnings within the next 5 years.

Just as Echo is focused on gross margins, the company is focused on controlling marketing expenditures to achieve profitable net results. To date, Echo has held its marketing costs to near zero by employing viral marketing techniques. Moving forward, Echo plans to enter into distribution agreements with major portals. Such deals will likely be structured as net revenue sharing deals that limit Echo's payout to a certain lifetime limit per customer. Echo believes that the company can achieve a positive cash flow in Q3 2002 and positive net income in Q4 2002 - when the company has fewer than 150,000 paying subscribers. While attracting paying customers is never a guaranteed proposition, Echo believes that signing up 150K subscribers in 12 months is a very realistic and achievable goal.

Echo has raised approximately \$8M in Series A and Bridge financing and is currently completing a Series B round to fund additional label deals and the completion of Echo's next-generation subscription service.

A more detailed economic analysis follows in the accompanying financials and MD&A.

Team Bios

Daniel Hart, Cofounder / CEO

Dan is the founder and former managing partner of Fundamental, an early-stage venture capital partnership that has created over \$1 billion in market value over the last four years. Fundamental's portfolio companies have received follow-on investments from prominent venture investors such as New Enterprise Associates, The Stata Fund, and Kleiner Perkins. From 1997 through 1999, Dan served as Chief Operating Officer of Deploy Solutions, where he helped build the company from its inception to over 40 employees, a completed management team, \$25 million in invested capital, and a client base including such Fortune 1000 companies as Federal Express and Sun Microsystems. Dan received a B.A. in Economics from Harvard University. Dan is an accomplished guitar player and serious Metallica fan.

Neil Berkman, Cofounder / Architect

Neil is the technical visionary behind Echo Networks, bringing to the company over ten years of experience architecting and building scalable, complex software and Internet systems. Neil was most recently Senior Technical Lead for the application server group at Deploy Solutions, a pioneer of enterprise-class ASP software. Previously, he was co-founder of Corvid Corporation, where he architected and built Java-based application management software. At Bay Networks, Neil developed key components of the market-leading Optivity network management suite. A technical reviewer for books on Java published by O'Reilly and Associates, Neil is co-author of an open source Java Virtual Machine, and the author of several publications in artificial intelligence. Neil has an M.S. in Computer Science from the University of Massachusetts and a B.S. in Computer Science and Mathematics from the University of Wisconsin. Neil is an avid guitar player and acoustic and bluegrass fan.

Bonney Pelley, Cofounder / President

Bonney first conceived the idea of a next-generation, streaming media community while serving as an Internet equity research associate at Hambrecht and Quist, where she worked with such Internet innovators as Broadcast.com, MP3.com, Inktomi, LinkExchange, Vignette, Garden.com, and Liberate Technologies. Bonney graduated magna cum laude in History of Science from Harvard University. She is a confessed jazz junkie and connoisseur of classic soul music.

Tuhin Roy, Executive Vice President, Strategic Development

Tuhin joined Echo Networks after working as an attorney at Perkins Coie, a leading Silicon Valley law firm representing Internet companies such as Yahoo, Amazon.com and RealNetworks in strategic partnering, venture capital finance, initial public offering and M&A transactions. For six years prior to law school, he ran a successful music production and publishing company whose products sold more than two million copies and yielded Billboard #1 records. As a producer and songwriter, he developed relationships with senior executives and label heads at most of the major record labels. Tuhin's musical preferences currently lean toward electronica.

Oliver Roup, Director of Advanced Technology

Oliver came to Echo Networks from the MIT Media Lab, where he founded and oversaw Hive, an ongoing research project targeted at creating scalable distributed applications using Java and mobile agent technology. He holds Masters and B.S. degrees in Electrical Engineering and Computer Science from the Massachusetts Institute of Technology. His work has been published in IEEE Concurrency and Frames, and has appeared on Nightline, Scientific American Frontiers and World News Tonight. Oliver's musical taste is best described as "recovering rave junkie."

James Propp, Director of Internet Marketing & Business Development

James came to Echo from Jive Records, where he was Director of Internet Marketing and where he helped build the New Media department and wrote and oversaw the implementation of marketing plans for 13 times platinum artists such as Britney Spears, the Backstreet Boys, and *NSYNC. Previously James was Director of Internet Marketing for C Notes Interactive, the first online music marketing company. James has a degree in Studio Music & Jazz Guitar from the University of Miami, and he describes his musical tastes as "Eclectic, with a strong leaning towards melody and rhythm."

Shawna Gwin, Chief Customer Advocate

Shawna comes to Echo from MTVi, where she headed relationship marketing covering all online properties including sonicnet.com, MTV.com and VH1.com. For more than ten years, Shawna has focused on customer retention and relationships by representing the voice of the consumer in business strategy decisions. Shawna has an MBA from Northwestern's Kellogg Graduate School of Management with majors in Marketing Strategy and Management and has worked with clients such as Apple Computer, Pioneer and Bauer. Shawna describes her musical taste as "Anything but country."

➤ *Board of Directors:*

Raymond (Raymie) P. Stata, Director

With more than 13 years experience on the cutting-edge of software engineering research and implementation, Raymie Stata serves as a technical advisor to Deploy Solutions' software development efforts. Dr. Stata is a Java expert who built his Java credentials as a key researcher at Compaq Systems Research Center, where he led several projects contributing to Java's strength as a programming language for enterprise software. Dr. Stata has also been a contributor to next-generation software and distributed systems research at Hewlett Packard and the Charles Stark Draper Laboratory. He holds a Ph.D. in computer science from Massachusetts Institute of Technology.

Strauss Zelnick, Director

One of the most influential and widely recognized entertainment executives in the country, Mr. Zelnick's career has spanned top positions at a variety of the world's largest media conglomerates. As President and CEO of BMG Entertainment, Zelnick grew the record group's US current album share from less than 12-percent in 1994 to almost 20 percent at the time of his departure, making BMG the second largest record company in the country. During this period, BMG enjoyed record revenues and profits. Before joining BMG Entertainment, Zelnick was President and Chief Executive Officer of Crystal Dynamics, a leading producer and distributor of interactive entertainment software. Prior to that, he worked for four years as President and Chief Operating Officer of 20th Century Fox. He spent three years at Vestron, Inc. as a senior executive, becoming President and Chief Operating Officer, and also served as Vice President of International Television for Columbia Pictures. Zelnick holds an MBA and J.D. from Harvard University and a B.A. from Wesleyan University.

Thomas H. Fox, Director

Tom retired from J.P Morgan & Co. in 1993 after 27 years, most recently serving as Senior Vice President, Controller and Principal Financial Officer; and Managing Director responsible for Strategic Planning. Tom now serves on the board of several companies including Swiss Re America Holding Corporation, American General Life Insurance Company of New York, and The United States Life Insurance Company in the City of New York. Tom brings to Echo a wealth of financial and operational management expertise and is an active advisor to Echo's management team. Tom holds an MBA from the University of Michigan and a BBA from the University of Notre Dame.