

Pop Music

Former Internet wunderkind Jeffrey Arnold is back with a wild invention--a way to distribute songs and videos in beverage cups.

BY MONTE BURKE

Anthony Missano, an executive at Sbarro, was looking for a way to attract teens to the pizza-and-pasta chain when a soft drink sales rep handed him a fountain drink with a mini music CD tucked inside the plastic lid. Intrigued, Missano ordered 500,000 of the lids, which featured four songs from a quartet of fringe bands, and offered them with large drinks for up to \$1.99 each last fall. He figured it would take 12 weeks for the 700-unit chain to sell all of the CDs. They disappeared in just 7 weeks and in the process raised drink revenue 30%.

Missano has ordered 2 million more of the mini CDs, the latest an exclusive mix of music from Britney Spears, Bubba Sparxxx and Black Eyed Peas. "We're hitting our target audience, getting the association with technology and music," Missano says. "It's exciting!"

His enthusiasm is no match for Jeffrey Arnold's. LidRock, as the CDs and the company that sells them are known, is headed by Arnold, a dealmaker who also founded WebMD. That Internet medical site is finally eking out a profit, but the irrepressible Arnold, 34, has not slowed down. Within a year of forming LidRock in January 2003, Arnold has sold 10 million LidRock CDs through fast-food outlets, theme parks and movie theaters. At Regal Cinemas, for instance, moviegoers are now offered drinks topped with CD and DVD samplers of tunes and music videos from Ashanti, Jessica Simpson and Elvis Presley. The 3-inch and 5-inch CDs can be played on stereos and computers.

Arnold is inking deals to put LidRock tops on fountain beverages at Universal Studios Theme Parks, Nascar events and BP convenience stores in 2004. And there are many more deals to be done: Arnold likes to remind potential partners that

21 billion large fountain drinks will be sold in the U.S. this year.

MGM is starting to put movie trailers on DVD-lids. A beverage company is interested in using LidRock to distribute 15-minute comedy shorts. Electronic Arts plans to put a sample of *The Need for Speed Underground* videogame on fountain drinks sold at BP convenience stores. This month a test version of its *Sims 2* is available with beverages at Atlanta-area McDonald's. "We've had to convince the marketplace that this is a massive distribution opportunity, one that's more accessible than traditional retail," Arnold says.

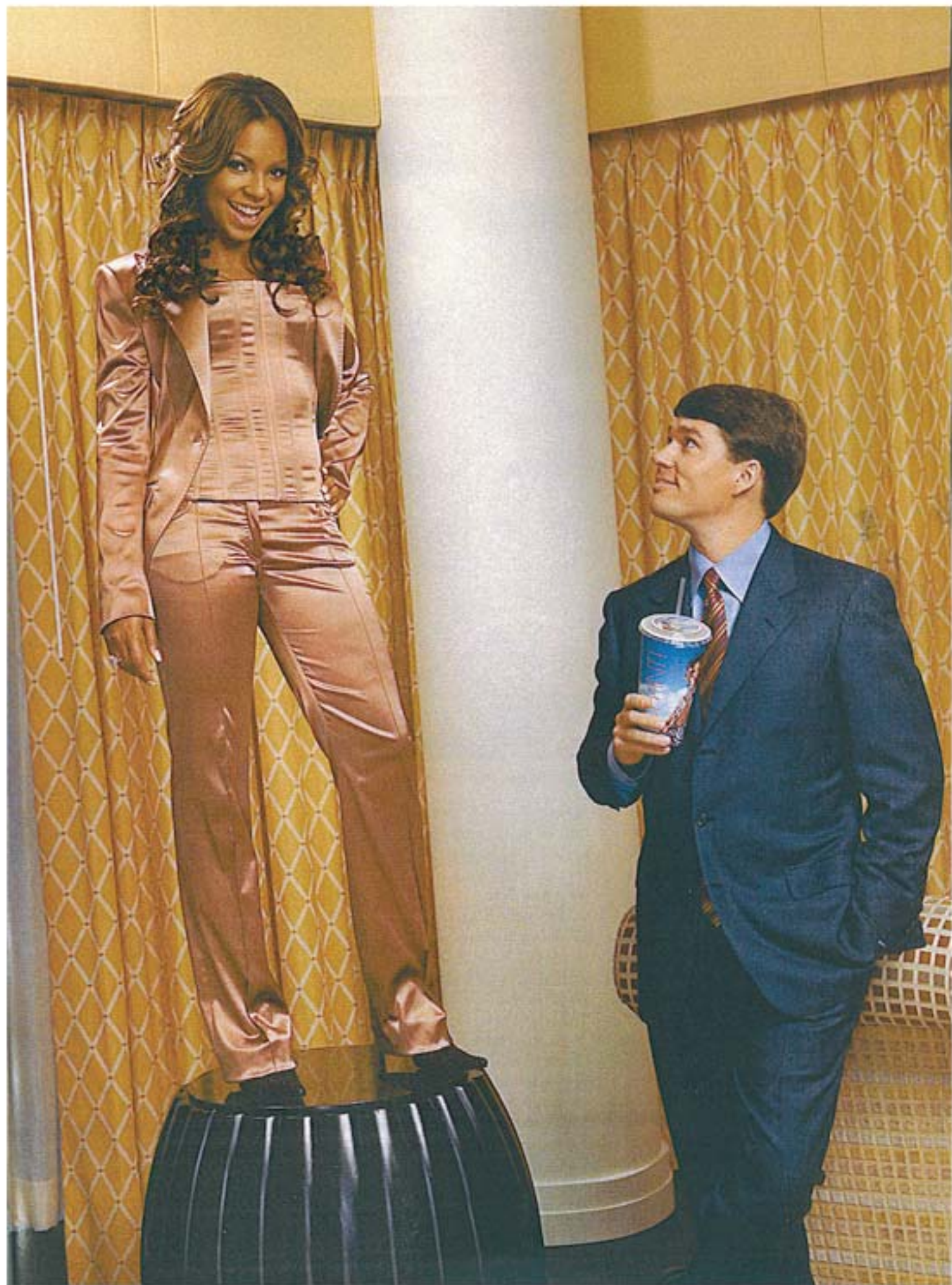
And that's only the beginning. Arnold plans to start putting full-length movies on LidRock DVDs. The lid flicks, due out in May, will be offered (with drink) for \$4--and they will only be watchable for 60 hours from the time the DVD is removed from the lid. The DVDs, manufactured for a New York City firm called Flexplay, change color when they are exposed to air, eventually making them unreadable. Movie studios aren't worried about the impact on sales because people who want to put a flick in a collection will need to buy a standard version.

Arnold, a natural salesman, has a knack for landing partners with big pockets. At WebMD, which he founded in 1998, he convinced Microsoft, DuPont and News Corp. to shell out about \$1.5 billion to support the health services network. Selling LidRock to retail and entertainment companies takes just as much finesse.

Movie theaters and fast-food restaurants are easiest to woo. The lids help them sell high-margin fountain drinks. The entertainment connection also appeals. Companies that wouldn't have a prayer of landing an endorsement deal with Britney Spears, whose picture graces one LidRock CD, still get her face on their drinks.

Fries with that? Jeffery Arnold looks to celebs like Ashanti to move songs and flicks on fountain drinks.

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Sip and spin: LidRock entertainment fits inside the plastic tops on large fountain drinks.

The implied endorsement worries some entertainment companies. But Arnold has persuaded Arista, Interscope, Sony and Def Jam that LidRock exposure will boost CD sales. He puts a link on the CDs to LidRock's Web site, where consumers can download movie tickets, songs and coupons. The pitch is timely, since music labels are looking for a way to boost sales in the age of Internet downloading.

The money doesn't hurt, either. LidRock shells out 25 cents to manufacture each CD. It pays up to 15 cents for the content. It sells the CDs to restaurants and so on at 70 cents. Distributors either offer the LidRocks for free or sell them for an average of \$1. If they charge, they have to split the gross profit with the entertainment

entertainment providers.

Privately held LidRock pulled in \$8 million in revenue in the fourth quarter of 2003. It was in the red last year, but Arnold boasts that LidRock can break even this year on \$50 million in revenue. This is his chance to spin a comeback.

Arnold, who started WebMD with money he made from a heart monitoring device, left the Internet health services company in 2000 as its stock tanked, falling from \$70 to \$10. (He escaped with a fortune of perhaps \$100 million from selling much of his WebMD stock.) At the time the company was having trouble getting doctors to use the site for office management and insurance claims. Swears Arnold: "I'll never go public again."

"But if it keeps moving in the direction it's going and fast-food restaurants are making good margins on the product, we'll be bigger than Napster."

He didn't plan to head a company again, either. But then a colleague at his Atlanta investment company, Convex Group, passed him a plastic lid with a coupon attached to it in August 2002. At the time he was looking only for money-making opportunities for Convex. But after meeting with the creators of the in-lid CDs, Strategic Integration, Arnold saw a lot of potential and decided he was the guy to mine it.

He started dialing for dollars. His first calls went to investors who had made money by betting on WebMD. One of them, Lucius Burch, a venture capitalist from Nashville, made \$50 million after putting just \$1 million into the medical site. He didn't know much about entertainment or the fountain drink biz, but he knew Arnold. "What sells me every time is Jeff," says Burch. It didn't take long for Arnold to raise \$25 million from five investors. That money helped provide the cash to secure 19 in-lid distribution patents owned by Strategic Integration, Avecmedia and other electronics firms. It also gave the investors a one-third stake in Convex, which owns 100% of LidRock.

While keeping potential competitors at bay, Arnold wants to get LidRock's partners to bear some of its cost of making the CDs and the lids. He needs to boost LidRock's value to distributors by offering content that's exclusive to them and/or affords the masses some reason for going out of their way to buy a drink. For instance, BP convenience stores might be the only place customers can get a certain music mix or video. He's also urging distributors to train employees to hawk CDs and explain how LidRock works.

Arnold still needs to prove he can sustain a business beyond the initial flurry of excitement from investors and corporate partners. "If it becomes just a toy in the box of a Happy Meal, then we're just a promotional company and we'll make a modest profit," says investor Bippy Siegal, chairman of Raycliff Investments in New York. "But if it keeps moving in the direction it's going and fast-food restaurants are making good margins on the product, we'll be bigger than Napster."