BRISTOL MYERS SQUIBB CO
Form DEF 14A
April 30, 2019

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant ý

Filed by a Party other than the Registrant o

Check the appropriate box:

o Preliminary Proxy Statement

o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

ý Definitive Proxy Statement

o Definitive Additional Materials

o Soliciting Material under §240.14a-12

Bristol-Myers Squibb Company

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

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PROXY STATEMENT

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430 E. 29th Street, 14th Floor
New York, New York 10016

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

Notice is hereby given that the 2019 Annual Meeting of Shareholders will be held at Bristol-Myers Squibb Company, 3401 Princeton Pike, Lawrence Township, New Jersey, on May 29, 2019, at 10:30 a.m. for the following purposes as set forth in the accompanying Proxy Statement:

to elect to the Board of Directors the 11 persons nominated by the Board, each for a term of one year;

to conduct an advisory vote to approve the compensation of our Named Executive Officers;

to ratify the appointment of Deloitte & Touche LLP as the company's independent registered public accounting firm for 2019;

to consider one shareholder proposal, if presented at the meeting; and

to transact such other business as may properly come before the meeting or any adjournments thereof.

Holders of record of our common and preferred stock at the close of business on April 30, 2019 will be entitled to vote at the meeting.

By Order of the Board of Directors

Katherine R. Kelly
Vice President, Associate General Counsel and Corporate Secretary

Dated: April 30, 2019

YOUR VOTE IS IMPORTANT

Regardless of the number of shares you own, your vote is important. If you do not attend the Annual Meeting to vote in person, your vote will not be counted unless a proxy representing your shares is presented at the meeting. To ensure that your shares will be voted at the meeting, please vote in one of these ways:

(1) GO TO WWW.PROXYVOTE.COM and vote via the Internet;

(2) CALL THE TOLL-FREE TELEPHONE NUMBER (800) 690-6903 (this call is toll-free in the United States); or

(3) MARK, SIGN, DATE AND PROMPTLY RETURN the enclosed proxy card in the postage-paid envelope.

If you do attend the Annual Meeting, you may revoke your proxy and vote by ballot.

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Dear fellow shareholders:

You are cordially invited to attend the Annual Meeting of Shareholders of Bristol-Myers Squibb Company on Wednesday, May 29, 2019, at 10:30 a.m. at our offices located in Lawrence Township, New Jersey. I hope that you will be able to attend.

During the meeting, we will cover a number of business items, including the election of directors, advisory vote to approve the compensation of our Named Executive Officers, ratification of the appointment of an independent registered public accounting firm, and consideration of one shareholder proposal.

We will also use the meeting as an opportunity to look back on the past year, highlighting everything from our strong commercial and operational execution to our clinical advances to our progress against our Sustainability 2020 Goals and the important work of the BMS Foundation. We will also look ahead to the next steps in our announced acquisition of Celgene Corporation creating a leading focused specialty biopharma company well positioned to address the needs of patients facing serious diseases.

Last year, over 86% of the outstanding shares were represented at the Annual Meeting and earlier this year, over 75% of outstanding shares were represented at our Special Meeting on April 12, 2019. Whether or not you attend in person, I hope that your shares will be represented at the meeting. Your vote is very important.

I look forward to welcoming many of you to our 2019 Annual Meeting.

Giovanni Caforio, M.D.
Chairman of the Board and Chief Executive Officer

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To my fellow shareholders:

Bristol-Myers Squibb's Mission is "to discover, develop and deliver innovative medicines that help patients prevail over serious diseases." My fellow Directors and I believe in this Mission, and we strive to ensure from the boardroom that the company is successful in this important undertaking. In 2018, with the Board's independent oversight and effective guidance, our management team's focused execution of our strategy resulted in increased revenues and an increase in both our GAAP and non-GAAP earnings per share. These results were primarily driven by superior commercial execution for our prioritized brands, including *Opdivo* and *Eliquis* (two of the 10 largest selling drugs in the pharmaceutical industry in 2018).

Your Board and management team understand the importance of maintaining a robust pipeline for future growth as well as capitalizing on opportunities to create sustainable long-term growth for our shareholders. To that end, following a comprehensive strategic review and extensive due diligence, we decided to acquire Celgene Corporation ("Celgene"). Together with Celgene, our combined company will be a global biopharma leader, with the #1 oncology franchise, a top 5 immunology and inflammation franchise, best-in-class cardiovascular franchise, significant near-term launch opportunities, and a deep and broad pipeline. We are very pleased that this transaction has been approved by both companies' shareholders and we look forward to closing the transaction later this year following regulatory approval.

Each year, your Board evaluates and re-asserts its commitment to sound corporate governance. Over the last year, we have focused in particular on the following key areas:

Setting the company strategy for sustainable long-term value creation. My fellow Directors and I firmly believe in the importance of a strong partnership between management and the Board to set the company strategy our long-term success as a company is inextricably linked to the Board's proactive, independent, and constructive engagement with management. This partnership proved critical in 2018 as we embarked on a robust strategic review process of numerous business development opportunities, with thorough Board oversight that ultimately led to the decision to acquire Celgene in early 2019. Our Board met eight times between June 2018 and January 2019 to discuss the risks and merits of the Celgene opportunity and oversaw all aspects of the process. Our Board will continue to provide critical oversight of our management team as they execute our strategy to create long-term shareholder value and support the pursuit of our Mission.

Constructive dialogue with shareholders. Shareholder engagement remains a top priority and we are committed to this because of the valuable insights we gain. In 2018, management and members of the Board, including me, met with some of our shareholders and had productive discussions on a number of topics, including board composition, company strategy and execution, sustainability and risk oversight, as well as executive compensation. More recently, our Board and members of management engaged with shareholders extensively about the Celgene transaction. We believe the support of over 75% of shareholders for the transaction is an important endorsement of the value it brings to the company. We recognize, however, that some shareholders have expressed concerns about the deal. We are committed to continuing an open and constructive dialogue with all our shareholders as we focus on executing a successful integration and delivering the value of the combined company.

Focus on Board effectiveness and composition. We are at an important inflection point for the company. As we look ahead to the unique opportunities and challenges presented by the integration of Celgene and continued execution of our strategy and Mission, we recognize the importance of having an effective Board with the right skill sets for this time. We are focused on Board composition to ensure that your Board has highly qualified members with diverse backgrounds and the best mix of skill sets, including leadership and vision, industry and company-specific knowledge, and experience integrating large-scale acquisitions, among others, to provide important insights, guidance and oversight as we move into the next chapter for Bristol-Myers Squibb as a company.

As we look ahead, I can report that the Board will continue to advance its commitment to excellence in serving you, our shareholders. On behalf of the Board of Directors, I thank you for your continued support.

Vicki L. Sato, Ph.D.
Lead Independent Director

Chair, Committee on Directors and Corporate Governance

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PROXY STATEMENT SUMMARY

2019 Annual Meeting of Shareholders

Date: May 29, 2019
Time: 10:30 a.m.
Place: 3401 Princeton Pike, Lawrence Township, New Jersey

For additional information about the Annual Meeting, see "Frequently Asked Questions" beginning on page 76.

Voting Matters

Item	Proposal	Board Vote Recommendation	Required Vote	Page Number
1	Election of Directors	**FOR ALL**	Majority of votes cast	9
2	Advisory vote to approve the compensation of our Named Executive Officers	**FOR**	Majority of shares voted	67
3	Ratification of the appointment of an independent registered public accounting firm	**FOR**	Majority of shares voted	68
4	Shareholder proposal on shareholder right to act by written Consent	**AGAINST**	Majority of shares voted	71

2018 Performance Highlights

In 2018, we exceeded our financial goals in key areas, including continued growth across our core prioritized brands, and had important scientific advancement of clinical assets, including some high value targets, that continue to diversify our pipeline. Management's continued execution of our strategic priorities in 2018 resulted in increased revenues of 9%. Our strong operating performance resulted in an increase of our GAAP earnings per share by 393% and our non-GAAP earnings per share by 32%. Our 2018 operating results were primarily driven by outstanding commercial execution, which yielded strong performance for our prioritized brands, particularly *Opdivo* and *Eliquis*, important scientific advances that continue to diversify our R&D pipeline, a disciplined approach to expense management, and a strong balance sheet.

$ amounts in millions, except per share amounts	**Full Year**		
	2018	**2017**	**Change**
Total Revenues	$22,561	$20,776	9%
GAAP Diluted EPS (1)	3.03	0.61	393%
Non-GAAP Diluted EPS (2)	3.98	3.01	32%

(1) The increase in GAAP EPS in 2018 was primarily due to 2017 tax charges attributed to tax reform. After excluding the impact of tax reform and other specified items due to their significant and/or unusual nature, the increase in non-GAAP EPS in 2018 was primarily due to higher revenues. The exclusion of such specified items for 2018 is consistent with the company's current policies and procedures, as well as our past practices.

(2) Our non-GAAP financial measures, including non-GAAP earnings and related EPS information, are adjusted to exclude specified items, which represent certain costs, expenses, gains and losses and other items impacting the comparability of financial results. For a detailed listing of all specified items and further information, including reconciliations of non-GAAP financial measures, please refer to " Non-GAAP Financial Measures" in our Annual Report on Form 10-K for the year ended December 31, 2018.

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Our overall philosophy to create sustainable shareholder value is primarily focused on strong year-to-year financial and operational performance and on the development and advancement of our pipeline over the long-term. Our strong performance in 2018 continued to deliver on our strategy and positions us well for potential growth opportunities that will create sustainable long-term shareholder value. Our acquisition of Celgene will position us to create a leading biopharma company, with best-in-class franchises, significant near-term launch opportunities and a deep and broad pipeline, creating an even stronger foundation for long-term sustainable growth.

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Director Nominees

Our Committee on Directors and Corporate Governance maintains an active and engaged Board, whose diverse skill sets benefit from both the industry and company-specific knowledge of our longer-tenured directors, as well as the fresh perspectives brought by our newer directors. We continually review our Board's composition with a focus on refreshing necessary skill sets as our business strategy and industry dynamics evolve.

Name	Occupation	Independent	Committee Memberships*	Other Public Company Boards
Giovanni Caforio, M.D. *Chairman of the Board* Age: 54 Director Since: 2014	Chairman of the Board and Chief Executive Officer	No		0
Vicki L. Sato, Ph.D. *Lead Independent Director* Age: 70 Director Since: 2006	Independent Chairman of the Board, Denali Therapeutics, Inc.; Former Professor of Management Practice and Molecular and Cell Biology at Harvard University	Yes	CDCG (c); S&T	3
Peter J. Arduini Age: 54 Director Since: 2016	President and Chief Executive Officer of Integra LifeSciences Holdings Corporation	Yes	Audit; CMDC	1
Robert Bertolini Age: 57 Director Since: 2017	Former President and Chief Financial Officer, Bausch & Lomb Incorporated; Former Chief Financial Officer, Schering Plough Corporation	Yes	Audit (c); CDCG	2
Matthew W. Emmens Age: 67 Director Since: 2017	Former Chairman and Chief Executive Officer, Shire PLC; Former Chairman, President and Chief Executive Officer, Vertex Pharmaceuticals Incorporated; Former Chief Executive Officer, Astra Merck	Yes	CMDC; S&T	0

Michael Grobstein Age: 76 Director Since: 2007	Former Vice Chairman, Ernst & Young LLP	Yes	Audit; CMDC (c)	0
Alan J. Lacy Age: 65 Director Since: 2008	Trustee, Fidelity Funds; Former Non-Executive Chairman, Dave & Buster's Entertainment, Inc.	Yes	Audit; CDCG	0
Dinesh C. Paliwal Age: 61 Director Since: 2013	President and Chief Executive Officer, Harman International, a wholly-owned subsidiary of Samsung Electronics Co., Ltd	Yes	CDCG; CMDC	2
Theodore R. Samuels Age: 64 Director Since: 2017	Former President, Capital Guardian Trust Company	Yes	Audit; CDCG	2
Gerald L. Storch Age: 62 Director Since: 2012	Chief Executive Officer, Storch Advisors; Former Vice Chairman, Target; Former Chairman and Chief Executive Officer; Toys "R" Us; Former Principal, McKinsey & Company	Yes	Audit; CMDC	0
Karen H. Vousden, Ph.D. Age: 61 Director Since: 2018	Chief Scientist, Cancer Research UK; Former Chief Executive Officer, Beatson Institute for Cancer Research	Yes	CMDC; S&T (c)	0

*** Committee memberships listed as of the date of the 2019 Annual Meeting**

Audit: **Audit Committee**

CDCG: **Committee on Directors and Corporate Governance**

CMDC: **Compensation and Management Development Committee**

S&T: **Science and Technology Committee**

(c): **Committee Chair**

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Board's Role in Strategic Planning

The Board and Board Committees regularly meet to discuss the strategic direction and the issues and opportunities facing our company. Our Board frequently provides guidance to management on strategy and has been instrumental in determining our next steps as a company. As part of its ongoing review and focus on strategy, the Board annually holds an in-depth meeting with senior management dedicated to discussing and reviewing our long-term operating plans and overall corporate strategy, which also includes a discussion of key risks and opportunities as well as risk mitigation plans and activities. In 2018, this in-depth strategy meeting was the start of a comprehensive strategic review process of numerous business development opportunities, which ultimately led to the decision to acquire Celgene. During this process, the Board was consistently involved, meeting 8 times between June 2018 and January 2019 to discuss the merits and risks of the Celgene opportunity. For a further discussion on the Board's role in strategic planning, please see "Board's Role in Strategic Planning and Risk Oversight" on page 19.

Board Refreshment and Leadership Transition

The Board continually reviews its composition with a focus on refreshing necessary skill sets as our business strategy and industry dynamics evolve. Five new independent directors have been added to the Board over the past 3 years, including Dr. Karen Vousden, our newest director who joined the Board in January 2018. These new independent directors bring fresh perspectives and important skills and experience that further strengthen and complement the Board.

In connection with our acquisition of Celgene, we have announced that two current Celgene directors will join our Board upon closing of the transaction.

Following the 2017 Annual Meeting, Dr. Giovanni Caforio became Chairman of the Board. The Board determined that Dr. Caforio's deep institutional knowledge and industry experience uniquely position him to serve as Chairman. The Board recognizes the importance of a Lead Independent Director, and Dr. Sato was elected to serve in this position. The Lead Independent Director responsibilities can be found on page 19.

Corporate Governance Highlights

We are committed to strong governance practices that protect the long-term interests of our shareholders and establish strong Board and management accountability. The "Corporate Governance and Board Matters" section beginning on page 18 describes our governance framework, which includes the following key governance best practices that we have adopted:

ü	Annual election of Directors	ü	Proxy access shareholder right
ü	Majority voting standard for election of Directors	ü	Limit on number of public company directorships Board members may hold (4)
ü	Shareholder right to call a special meeting (25%)	ü	Emphasis on board refreshment and effectiveness
ü	No supermajority voting provisions for common shareholders	ü	Clawback and recoupment policies
ü	Proactive shareholder engagement	ü	Share ownership and retention policy
ü	Robust related party transaction policies and procedures	ü	Prohibition of speculative and hedging transactions by all employees and directors
ü	Semi-annual disclosure of political contributions	ü	No shareholder rights plan

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Shareholder Engagement and Responsiveness

We continued to place a high priority on engagement with our shareholders in 2018, reaching out to over 50 of our top shareholders, representing nearly 50% of our shares outstanding. In 2018, management and members of the Board, including our Lead Independent Director, met with many of our shareholders and had a productive dialogue on a number of topics, including board composition, company strategy and execution, sustainability and risk oversight, as well as executive compensation. The feedback received was generally positive and was shared with the entire Board and members of senior management. In addition, we continued to engage with shareholders, seeking active feedback and offering additional insights on shareholder proposals included in our most recent proxy statements, including those related to drug pricing and executive compensation and the threshold to call special shareholder meetings. For a discussion of the company's response to shareholder proposals, please see "Responsiveness to Shareholder Feedback" on page 22.

More recently, we engaged extensively with our shareholders ahead of our Special Meeting on April 12, 2019 to approve the issuance of shares in connection with the Celgene acquisition.

We encourage our registered shareholders to use the space provided on the proxy card to let us know your thoughts about BMS or to bring a particular matter to our attention. If you hold your shares through an intermediary or received the proxy materials electronically, please feel free to write directly to us.

2018 Compensation Plan Structure

Our compensation program design reflects our compensation philosophy and aligns well with our strategy, market practice and our shareholders' interests.

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Executive Compensation

The Compensation and Management Development Committee firmly believes in pay-for-performance and has structured the executive compensation program to align our executives' interests with those of our shareholders.

In line with our commitment to a highly performance-based compensation structure, approximately 90% of Dr. Caforio's target total compensation (and approximately 82% of the target total compensation for our other Named Executive Officers) is variable and at risk, based on the financial, operational, strategic and share price performance of the company.

Additional detail on our executive compensation program is provided in the "Compensation Discussion and Analysis" beginning on page 33.

2018 Target Total CEO Compensation

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ITEM 1 ELECTION OF DIRECTORS

Our Board of Directors has nominated 11 current directors, Peter J. Arduini, Robert Bertolini, Giovanni Caforio, M.D., Matthew W. Emmens, Michael Grobstein, Alan J. Lacy, Dinesh C. Paliwal, Theodore R. Samuels, Vicki L. Sato, Ph.D., Gerald L. Storch and Karen H. Vousden, Ph.D., to serve as directors of Bristol-Myers Squibb. The directors will hold office from election until the 2020 Annual Meeting.

Majority Vote Standard and Mandatory Resignation Policy

A majority of the votes cast is required to elect directors. Any current director who does not receive a majority of votes cast must tender his or her resignation as a director within 10 business days after the certification of the shareholder vote. The Committee on Directors and Corporate Governance, without participation by any director tendering his or her resignation, will consider the resignation offer and recommend to the Board whether to accept it. The Board, without participation by any director tendering his or her resignation, will act on the Committee's recommendation at its next regularly scheduled meeting to be held within 60 days after the certification of the shareholder vote. We will promptly disclose the Board's decision and the reasons for that decision in a broadly disseminated press release that will also be furnished to the U.S. Securities and Exchange Commission (SEC) on Form 8-K. If any nominee is unable to serve, proxies will be voted in favor of the remainder of those nominated and may be voted for substitute nominees, unless our Board of Directors provides for a lesser number of directors.

Criteria for Board Membership

As specified in our Corporate Governance Guidelines, members of our Board should be persons with broad experience in areas important to the operation and long-term success of our company. These include areas such as business, science, medicine, finance/accounting, law, business strategy, crisis management, corporate governance, education or government. Board members should possess qualities reflecting integrity, independence, leadership, good business judgment, wisdom, an inquiring mind, vision, a proven record of accomplishment and an ability to work well with others. The Corporate Governance Guidelines also express the Board's belief that its membership should continue to reflect a diversity of gender, race, ethnicity, age, sexual orientation and gender identity.

All Director Nominees Possess:

Director Orientation and Continuing Education

Director education is an ongoing, year-round process, which begins when a director joins our Board. Upon joining our Board, new directors are provided with a comprehensive orientation to our company, including our business, strategy and governance. New directors participate in an orientation program with senior business and functional leaders from all areas of the company, during which there is discussion on strategic priorities and key risks and opportunities, and participate in site visits to one or more of our locations. On an ongoing basis, directors receive presentations on a variety of topics related to their work on the Board and within the biopharmaceutical industry, both from senior management and from experts outside of the company. We also encourage directors to enroll in continuing education programs sponsored by third parties at our expense.

Director Independence

10 of our 11 director nominees are currently independent

Our Corporate Governance Guidelines provide that a substantial majority of Board members be independent from management, and the Board has adopted independence standards that meet the listing standards of the New York Stock Exchange. Our Board has determined that, except for Giovanni Caforio, M.D. who is our Chief Executive Officer, each of our directors and each director nominee for election at this Annual Meeting is independent of Bristol-Myers Squibb and its management.

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Process for Determining Independence

In accordance with our Corporate Governance Guidelines, our Board undertakes an annual review of director independence. In February 2019, the Board considered all commercial and charitable relationships of our independent directors and director nominees, including the following relationships, which were deemed immaterial under our categorical standards (see Exhibit A):

Messrs. Arduini, Bertolini, Lacy and Samuels are directors of companies that received payment from the company for property or services in an aggregate amount that did not exceed the greater of $1 million or 2% of such other company's consolidated gross revenues. For each transaction, the Board determined that the director did not initiate or negotiate the transaction and that the transaction was entered into in the ordinary course of business.

Drs. Sato and Vousden, Messrs. Arduini, Grobstein, Lacy and Storch, or one of their immediate family members, are employed by, or serve as directors of, businesses or educational or medical institutions with which we engage in ordinary course business transactions. The directors did not initiate or negotiate any transaction with such institutions and the payments made did not exceed the greater of $1 million or 2% of such institutions' respective consolidated gross revenues.

Dr. Sato, Messrs. Grobstein and Samuels are directors of charitable or nonprofit organizations to which the Bristol-Myers Squibb Foundation made charitable contributions, which, in the aggregate, did not exceed the greater of $1 million or 2% of such organizations' respective consolidated gross revenues.

The Board determined that none of these relationships impair the independence of these directors under the New York Stock Exchange's independence standards or otherwise.

Director Succession Planning and Identification of Board Candidates

Regular Assessment of our Board Composition

The Committee on Directors and Corporate Governance regularly assesses the appropriate size and composition of our Board. This assessment incorporates the results of the Board's annual evaluation process, which was recently enhanced in 2017 as described more fully under "Annual Evaluation Process" beginning on page 21. The Committee also considers succession planning for its directors.

Identification and Selection of Director Nominees

Director Tenure

In connection with the Board's ongoing director identification process, the Committee on Directors and Corporate Governance, in consultation with the Chairman, conducts an initial evaluation of prospective nominees against the established Board membership criteria discussed above. The Committee also reviews the skills of the current directors and compares them to the particular skills of potential candidates, keeping in mind the Board's commitment to maintain members of diverse experience and background. In particular, the Board is committed to identifying and evaluating highly qualified women and under-represented ethnic group candidates as well as candidates with other diverse backgrounds, industry experience and other unique characteristics. Candidates may come to the attention of the Committee on Directors and Corporate Governance through current Board members, third party search firms, management, shareholders or others. Search firms together with management and directors develop a candidate profile that includes the relevant skills and experiences being sought at that time and

incorporates the Board membership criteria. Prospective candidates are identified based on the profile. Additional information relevant to the qualifications of prospective nominees may be requested from third party search firms, other directors, management or other sources. After this initial evaluation, prospective nominees may be interviewed by telephone or in person by the members of the Committee on Directors and Corporate Governance, the Chairman, the Lead Independent Director and other directors, as applicable. After completing this evaluation and interview process, the Committee on Directors and Corporate Governance makes a recommendation to the full Board as to the persons who should be nominated by our Board, and the full Board determines the nominees after considering the recommendation and any additional information it may deem appropriate.

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Shareholder Nominations for Director

The Committee on Directors and Corporate Governance considers and evaluates shareholder recommendations of nominees for election to our Board of Directors in the same manner as other director nominees. Shareholder recommendations must be accompanied by disclosure, including written information about the recommended nominee's business experience and background with consent in writing signed by the recommended nominee that he or she is willing to be considered as a nominee and, if nominated and elected, he or she will serve as a director. Shareholders should send their written recommendations of nominees accompanied by the required documents to: Bristol-Myers Squibb Company, 430 East 29th Street 14th Floor, New York, New York 10016, Attention: Corporate Secretary.

Proxy Access Shareholder Right

Following extensive engagement with our shareholders, our Board determined to adopt proxy access in 2016, permitting a shareholder or group of up to 20 shareholders holding 3% of our outstanding shares of common stock for at least three years to nominate a number of directors constituting the greater of two directors or 20% of the number of directors on our Board, as set forth in detail in our Bylaws. If you wish to propose any action pursuant to our proxy access bylaw provision, you must deliver a notice to BMS containing certain information set forth in our Bylaws, not less than 120 but not more than 150 days before the anniversary of the prior year's filing of the proxy materials. For our 2020 Annual Meeting, we must receive this notice between December 2, 2019 and January 1, 2020. Shareholders should send their notices to: Bristol-Myers Squibb Company, 430 East 29th Street 14th Floor, New York, New York 10016, Attention: Corporate Secretary.

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2019 Director Nominees

The following biographies of our director nominees reflect their Board Committee membership and Chair positions as of the date of this year's Annual Meeting.

Giovanni Caforio, M.D.

Chairman and Chief Executive Officer of the Company

DIRECTOR SINCE: 2014

AGE: 54

OTHER CURRENT PUBLIC BOARDS: None

Chairman of the Board since May 2017 and Chief Executive Officer of Bristol-Myers Squibb since May 2015. He was Chief Operating Officer from June 2014 until May 2015 and was Executive Vice President and Chief Commercial Officer from November 2013 until June 2014. From October 2011 until November 2013, he served as President, U.S. He held the position of Senior Vice President, Global Commercialization and Immunology from May 2010 until October 2011. Previously, he served as Senior Vice President, Oncology, U.S. and Global Commercialization from March 2009 until May 2010. From January 2007 until March 2009 he served as Senior Vice President, U.S. Oncology, and from May 2004 until January 2007, he served as Senior Vice President, European Marketing and Brand Commercialization.

He is a member of the Board of Trustees of Hun School of Princeton, and a member of Business Roundtable, CEO Roundtable on Cancer, the Pharmaceutical Research and Manufacturers of America and The Prium.

KEY SKILLS & EXPERIENCE: Dr. Caforio brings over 30 years of pharmaceutical industry experience, including more than 18 years at the company. He has overseen the creation of a fully integrated worldwide commercial organization as part of our evolution into a diversified specialty biopharmaceutical company. A physician by training, Dr. Caforio has worked across many businesses within the company, in Europe and in the U.S., and has a proven record of developing talented leaders with the diverse experiences and competencies needed for the continued success of the company.

Vicki L. Sato, PH.D.

Dr. Sato serves as the independent Chairman of the Board of Denali Therapeutics, Inc. Retired in 2005 as President of Vertex Pharmaceuticals Incorporated, a global biotechnology company, where she was responsible for research and development, business and corporate development, commercial operations, legal and finance. She also served as Chief Scientific Officer, Senior Vice President of Research and Development and Chair of the Scientific Advisory Board at Vertex before being named President in 2000. She previously served as a professor of management practice at the Harvard Business School

KEY SKILLS & EXPERIENCE: Dr. Sato has more than 30 years of extensive and distinctive experience in business, academia and science. She brings to the Board a valuable perspective on the biotech industry. Dr. Sato has a strong background in research and development, positioning her well to serve as a member of our Science & Technology Committee. Her experience serving on the Board of other healthcare companies and her knowledge and keen understanding of the issues facing public companies, in particular healthcare companies, position her well to serve as our Lead Independent Director.

from July 2005 until June 2017. From July 2005 until October 2014 she served as professor of the practice of molecular and cell biology at Harvard University. She serves as Chairman of VIR Biotechnology, Inc. She serves as Co-Chair on the Task Force on Science and Engineering at Harvard University and Co-Chair on the Advisory Council of LifeSci NYC. During the last five years, Dr. Sato was a Director of PerkinElmer Corporation.

Lead Independent Director

DIRECTOR SINCE: 2006

AGE: 70

BOARD COMMITTEES:

Committee on Directors and Corporate Governance (Chair)

Science & Technology Committee

OTHER CURRENT PUBLIC BOARDS:

Denali Therapeutics, Inc.

BorgWarner, Inc.

Syros Pharmaceuticals

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Peter J. Arduini

President and Chief Executive Officer at Integra LifeSciences Holdings Corporation, a global medical technology company since January 2012 and currently serves as a member of Integra's Board of Directors. He served as President and Chief Operating Officer of Integra from November 2010 to January 2012. Before joining Integra, Mr. Arduini was Corporate Vice President and President of Medication Delivery, Baxter Healthcare from 2005 until 2010. Prior to joining Baxter, he worked for General Electric Healthcare, where he spent much of his 15 years in a variety of management roles for domestic and global businesses, culminating in leading the global functional imaging business. Mr. Arduini also serves on the Board of Directors of ADVAMED (the Advanced Medical Technology Association), the Board of Directors of MDIC (the Medical Device Innovation Consortium), and the Board of Directors of the National Italian American Foundation. He also serves on the Board of Trustees of Susquehanna University.

KEY SKILLS & EXPERIENCE: With over 25 years in the healthcare industry, Mr. Arduini brings to the Board extensive leadership, business and operational experience, particularly with respect to manufacturing and sales of medical technology and devices. In addition, his experience serving as a public company chief executive officer and former chief operational officer positions him well to serve as a member of our Audit Committee and our Compensation and Management Development Committee.

DIRECTOR SINCE: **2016**

AGE: **54**

BOARD COMMITTEES:

Audit Committee

Compensation and Management Development Committee

OTHER CURRENT PUBLIC BOARDS:

Integra LifeSciences Holding Corporation

Robert Bertolini

Served as President and Chief Financial Officer of Bausch & Lomb Incorporated from February 2013 until August 2013 (until its acquisition by Valeant Pharmaceuticals). Previously, he served as Executive Vice President and Chief Financial Officer at Schering-Plough Corp. from November 2003 until November 2009 (through its merger with Merck & Co.) with responsibility for tax, accounting and financial asset management. Prior to joining Schering-Plough, Mr. Bertolini spent 20 years at PricewaterhouseCoopers LLP, ultimately leading its global pharmaceutical industry practice.

KEY SKILLS & EXPERIENCE: Mr. Bertolini brings to the Board extensive expertise in our industry, particularly in building world-class finance and information technology functions and in leading business development and strategy. In addition, as a former chief financial officer who also has over 20 years experience at a major auditing firm, he has extensive knowledge and background related to accounting and financial reporting rules and regulations as well as the evaluation of financial results, internal controls and business processes and this positions him well to serve as Chair of our Audit Committee and a member of our Committee on Directors and Corporate Governance.

DIRECTOR SINCE: **2017**

AGE: **57**

BOARD COMMITTEES:

Audit Committee (Chair)

Committee on Directors and Corporate Governance

OTHER CURRENT PUBLIC BOARDS:

Charles River Laboratories International, Inc.

Idorsia Ltd.

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Matthew W. Emmens

Served as Chief Executive Officer of Shire PLC from 2003 until 2008 and Chairman of the Board from 2008 until 2014. He also served as a Director of Vertex Pharmaceuticals Incorporated from 2004 until 2009, Chairman, President and Chief Executive Officer from 2009 until 2012 and Director from 2012 until 2013. Mr. Emmens served as President, Worldwide Pharmaceuticals of Merck KGaA from 1999 until 2003, as Chief Executive Officer, Commercial Operations of Astra Merck Inc. from 1992 until 1999 and in Sales, Marketing and Administration positions for Merck & Co., Inc. from 1974 until 1991.

KEY SKILLS & EXPERIENCE: With over 40 years in the biopharmaceutical industry, Mr. Emmens brings to the Board significant expertise in management, business development, business and operations, particularly with respect to strategy and team effectiveness. Mr. Emmens' strong leadership qualities and industry knowledge position him well to provide valuable insights to both management and his fellow Board members on issues facing our company and to serve as a member of our Compensation and Management Development Committee and a member of our Science and Technology Committee.

DIRECTOR SINCE: 2017

AGE: 67

BOARD COMMITTEES:

Compensation and Management Development Committee

Science & Technology Committee

OTHER CURRENT PUBLIC BOARDS: None

Michael Grobstein

Retired as Vice Chairman of Ernst & Young LLP, an independent registered public accounting firm. He worked with Ernst & Young from 1964 until 1998, and was admitted as a partner in 1975. Mr. Grobstein served as a Vice Chairman International Operations from 1993 until 1998, as Vice Chairman Planning, Marketing and Industry Services from 1987 until 1993, and as Vice Chairman Accounting and Auditing Services from 1984 until 1987. He serves on the Board of Trustees and Executive Committee and is the Treasurer of the Central Park Conservancy. He

KEY SKILLS & EXPERIENCE: With over 30 years of experience at a major auditing firm, and 20 years as a director of public companies with global operations, Mr. Grobstein has extensive knowledge and background relating to accounting and financial reporting rules and regulations as well as the evaluation of financial results, internal controls and business processes. Mr. Grobstein's depth and breadth of financial expertise and his experience handling complex financial issues position him well to serve as Chair of our

also serves on the Board of Directors of the Peer Health Exchange, Inc. During the last five years, Mr. Grobstein was a Director of Mead Johnson Nutrition Company and Given Imaging Ltd.

Compensation and Management Development Committee and a member of our Audit Committee.

DIRECTOR SINCE: **2007**

AGE: **76***

BOARD COMMITTEES:

Compensation and Management Development Committee (Chair)

Audit Committee

OTHER CURRENT PUBLIC BOARDS: **None**

*

As disclosed in the 2018 Proxy Statement, after extensive consideration and discussion of specific facts and special circumstances, following input from several of our top shareholders, and upon the recommendation of our Committee on Directors and Corporate Governance, our Board determined that it is in the best interest of the company and its shareholders to waive the mandatory retirement age for Mr. Michael Grobstein for up to two years to maintain Board continuity during a period of transition. In reaching this determination, the Board also carefully considered the recent addition of five new independent directors to the Board in the last three years, Mr. Grobstein's extensive knowledge of the company and industry; his leadership as Compensation and Management Development Committee Chairman; his key role as a member and former Chair of our Audit Committee; his desire and ability to continue to guide and serve the company in executing its mission and strategy; the low average tenure of the Board (5.8 years compared to 9 for the S&P 500) and the robust Board evaluation process, among other things. The waiver will expire at the 2020 Annual Meeting.

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Alan J. Lacy

Served as the Non-Executive Chairman of Dave & Buster's Entertainment Inc. from 2014 until 2017. He served as the Vice Chairman and Chief Executive Officer of Sears, Roebuck and Co. and the Vice Chairman and Chief Executive Officer of its successor, Sears Holdings Corporation, from 2000 until 2005. Mr. Lacy also served as Vice Chairman of Sears Holdings Corporation from 2005 until 2006. Mr. Lacy served as Senior Advisor to Oak Hill Capital Partners, L.P., a private equity investment firm, from 2007 until 2014. He is a Trustee of Fidelity Funds and the California Chapter of The Nature Conservancy. Mr. Lacy is a Director of the Center for Advanced Study in the Behavioral Sciences at Stanford University. During the last five years, Mr. Lacy was a Director of The Hillman Companies.

KEY SKILLS & EXPERIENCE: Mr. Lacy is a highly respected business leader with a proven record of accomplishment. He brings to the Board extensive business understanding and demonstrated management expertise having served in key leadership positions at Sears Holdings Corporation, including Chief Executive Officer. In addition, his experience as a senior financial officer of three large public companies provides him with a comprehensive understanding of the complex financial, legal and corporate governance issues facing large companies and positions him well to serve as a member of our Audit Committee and our Committee on Directors and Corporate Governance.

DIRECTOR SINCE: 2008

AGE: 65

BOARD COMMITTEES:

Committee on Directors and Corporate Governance

Audit Committee

OTHER CURRENT PUBLIC BOARDS: None

Dinesh C. Paliwal

Served as President and Chief Executive Officer at Harman International, the connected technologies company for automotive, consumer and enterprise markets since 2007. Mr. Paliwal also served as Chairman of the Harman Board of Directors from July 2008 until March 2017 until its acquisition by Samsung Electronics Co., Ltd. Today, Harman operates as a wholly-owned subsidiary of Samsung. Prior to joining Harman, Mr. Paliwal served as a member of the Group Executive Committee of ABB Ltd., a provider of industrial automation, power transmission systems and services from January 2001

KEY SKILLS & EXPERIENCE: Mr. Paliwal brings to the Board extensive leadership, business and governance experience having served as a public company chief executive officer and a senior executive officer of various divisions of a multi-national corporation. His engineering and financial background, together with his worldwide experience, particularly in emerging markets, provide him with a heightened understanding of the complex issues which arise in the global marketplace. In addition, Mr. Paliwal's experience and his prior service on Boards of other public

until June 2007. He also served as President of Global Markets and Technology of ABB Ltd. from January 2006 until June 2007, as Chairman and Chief Executive Officer of ABB North America from January 2004 until June 2007, and as President and Chief Executive Officer of ABB Automation Technologies Division from October 2002 until December 2005. Mr. Paliwal is a member of the CEO Business Roundtable and the advisory board of the Woodrow Wilson Center.

He also serves on the Boards of Directors of the Business Advisory Council of Farmer School of Business, Miami University of Ohio and the U.S. Indian Business Council. During the last five years, Mr. Paliwal was a Director of ADT Corporation.

companies position him well to serve as a member of our Committee on Directors and Corporate Governance and our Compensation and Management Development Committee.

DIRECTOR SINCE: 2013

AGE: 61

BOARD COMMITTEES:

Committee on Directors and Corporate Governance

Compensation and Management Development Committee

OTHER CURRENT PUBLIC BOARDS:

Nestlé S.A.

Raytheon Company

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Theodore R. Samuels

DIRECTOR SINCE: 2017

AGE: 64

BOARD COMMITTEES:

Committee on Directors and Corporate Governance

Audit Committee

OTHER CURRENT PUBLIC BOARDS:

Perrigo Company, PLC

Stamps.com

Served with Capital Group Companies from 1981 until 2016. He was President of the Capital Guardian Trust Company from 2010 until 2016 and was the Capital Group representative for Focusing Capital on the Long Term from 2014 until 2015. He was a portfolio manager from 1990 until 2016, and while at Capital Group, he served on numerous management and investment committees. He also served as a board member of Capital Group Foundation and as Chair of Capital Group Foundation Investment Committee and the Capital International (North America) Proxy Committee. Mr. Samuels served on the Capital Group Finance Committee from 2013 until 2016 and previously served on the Capital Group Board and the Capital Group Audit Committee. He also serves as Co-chair of Tuft's President's Council and the Harvard West Coast Council. Mr. Samuels is a Director of Children's Hospital Los Angeles, where he served as Co-chair of the Board of Trustees from 2012 until 2015, the Edward Mallinckrodt, Jr. Foundation and The Fund for Partnership for Success!, where he also serves as an advisor. He is also a trustee of the John Burroughs School.

KEY SKILLS & EXPERIENCE: With over 35 years in the financial industry, Mr. Samuels brings to the Board extensive business and operational experience, particularly with respect to economics and investment decision making. His experience and the investor perspective he brings to the Board position him well to serve as a member of our Audit Committee and our Committee on Directors and Corporate Governance.

Gerald L. Storch

Has served as Chief Executive Officer of Storch Advisors since November 2017, a position he had also held from November 2013 until January 2015. He served as Chief Executive Officer of Hudson's Bay Company from January 2015 until November 2017, a leading owner and operator of department stores, including Saks Fifth Avenue, Lord & Taylor, Hudson's Bay Department Stores, Home Outfitters, Sakes OFF 5th, Kaufhof, Inno and the e-commerce business Gilt. He also served as Chairman of Toys "R" Us, Inc. from February 2006 until November 2013 and Chief Executive Officer of Toys "R" Us from February 2006 until May 2013. Prior to joining Toys "R" Us, Mr. Storch served as Vice Chairman of Target Corporation. He joined Target in 1993 as Senior Vice President of Strategy and served in roles of increasing seniority over the next 12 years. Prior to joining Target, Mr. Storch was a partner at McKinsey & Company. He is a director of Fanatics, Inc. During the last five years, Mr. Storch was a Director of Supervalu, Inc.

KEY SKILLS & EXPERIENCE: A retail veteran with more than 20 years of experience, Mr. Storch provides the Board with valuable business, leadership and management insight, including expertise leading an organization with global operations, giving him a keen understanding of the issues facing a multi-national business. These qualities make him a valued member of our Audit Committee. Additionally, his prior service on the compensation committee of another public company positions him well to serve as a member of our Compensation and Management Development Committee.

DIRECTOR SINCE: 2012

AGE: 62

BOARD COMMITTEES:

Compensation and Management Development Committee

Audit Committee

OTHER CURRENT PUBLIC BOARDS: None

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Karen H. Vousden, Ph.D.

DIRECTOR SINCE: 2018

AGE: 61

BOARD COMMITTEES:

Science & Technology Committee (Chair)

Compensation and Management Development Committee

OTHER CURRENT PUBLIC BOARDS: None

Dr. Vousden has been a Senior Group Leader at the Francis Crick Institute in London since February 2017 and Chief Scientist of Cancer Research UK since July 2016. From 2002 until 2016 she served as the Director of the Cancer Research UK (CRUK) Beatson Institute in Glasgow, prior to which she held leadership roles at the National Cancer Institute in Maryland from 1995 until 2002. She serves as a member of the Science Advisory Board of Oncode Institute, the Gurdon Institute, The Netherlands Cancer Institute, University Cancer Center Frankfurt, Grail, Inc., Ludwig Institute for Cancer Research, PMV Pharma, Raze Therapeutics and Swiss Institute for Experimental Cancer Research. Dr. Vousden is a Council member of the European Molecular Biology Organization and President of the British Association of Cancer Research. She is also a Fellow of the Royal Society and a Foreign Associate of the National Academy of Sciences.

KEY SKILLS & EXPERIENCE: With over 30 years of experience leading ground-breaking cancer research, Dr. Vousden brings to the Board important perspective and knowledge on a variety of healthcare related issues, including the inherent challenges facing our R&D organization in discovering and developing new medicines. Her strong background in research and development, expertise in oncology, experience with international healthcare systems and extensive experience in the medical field position her well to serve as Chair of our Science and Technology Committee.

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CORPORATE GOVERNANCE AND BOARD MATTERS

Active Board Oversight of Our Governance

Our business is managed under the direction of our Board of Directors pursuant to the Delaware General Corporation Law and our Bylaws. The Board has responsibility for establishing broad corporate policies and for the overall performance of our company. The Board keeps itself informed of company business through regular written reports and analyses and discussions with the Chief Executive Officer and other officers of Bristol-Myers Squibb; by reviewing materials provided to Board members by management and by outside advisors; and by participating in Board and Board Committee meetings.

The Committee on Directors and Corporate Governance continually reviews corporate governance issues and is responsible for identifying and recommending the adoption of corporate governance initiatives. In addition, our Compensation and Management Development Committee regularly reviews compensation issues and recommends adoption of policies and procedures that strengthen our compensation practices. The "Compensation Discussion and Analysis" beginning on page 33 discusses many of these policies and procedures.

The Board of Directors has adopted Corporate Governance Guidelines that govern its operation and that of its Committees. Our Board annually reviews the Corporate Governance Guidelines and, from time to time, our Board revises them in response to changing regulatory requirements, evolving best practices and the concerns of our shareholders and other constituents. Our Corporate Governance Guidelines may be viewed on our website at www.bms.com/ourcompany/governance.

Board Leadership Structure

The company's governance documents provide the Board with flexibility to select the appropriate leadership structure for the company. They establish well-defined responsibilities with respect to the Chairman and Lead Independent Director roles, including the requirement that the Board have a Lead Independent Director if the Chairman is not an independent director. This information is set forth in more detail on our website at www.bms.com/ourcompany/governance.

Our Board has dedicated significant consideration to our leadership structure, particularly in connection with the election of Dr. Caforio as the Chairman of the Board at the 2017 Annual Meeting. The Board's analysis of our leadership structure took into account many factors, including the specific needs of the Board and the company, the strong role of our Lead Independent Director, our Corporate Governance Guidelines (including our governance practices that provide for independent oversight of management), the acquisition of Celgene and integration of Celgene businesses into our company, the challenges specific to our company, and the best interests of our shareholders. After thoughtful and rigorous consideration, the Board determined that combining the Chairman and Chief Executive Officer positions and electing Dr. Caforio as the Chairman of the Board continues to be in the best interest of the company and our shareholders and is the best leadership for the company and its shareholders at this time. Specifically, our Board believes that to have Dr. Caforio serve in the combined role of Chairman and Chief Executive Officer confers distinct advantages at this time, including:

- having a Chairman who can draw on detailed institutional knowledge of the company and industry experience from serving as Chief Executive Officer, providing the Board with focused leadership, particularly in discussions about the company's strategy;
- a combined role ensures that the company presents its message and strategy to all stakeholders, including shareholders, employees and patients, with a unified voice; and
- the structure allows for efficient decision making and focused accountability.

The Board recognizes the importance of appointing a strong Lead Independent Director to maintain a counterbalancing structure to ensure that the Board functions in an appropriately independent manner. The Lead Independent Director is selected annually by the independent directors. The independent directors have elected Dr. Vicki Sato to serve in that position.

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The Lead Independent Director's responsibilities include, among others:

- ü Serving as liaison between the independent directors and the Chairman and Chief Executive Officer
- ü Reviewing and approving meeting agendas and sufficiency of time
- ü Calling meetings of the independent directors
- ü Presiding at all meetings of the independent directors and any Board meeting when the Chairman and Chief Executive Officer is not present, including executive sessions of the independent directors
- ü Engaging with major shareholders, as appropriate
- ü Approving the quality, quantity and timeliness of information sent to the Board
- ü Serving a key role in Board and Chief Executive Officer evaluations
- ü Responding directly to shareholder and stakeholder questions, as appropriate
- ü Providing feedback from executive sessions of the independent directors to the Chairman and Chief Executive Officer and other senior management
- ü Recommending advisors and consultants

The Board believes this structure provides an effective, high-functioning Board, as well as appropriate safeguards and oversight. Our Board will continue to evaluate its leadership structure in light of changing circumstances and will evaluate the Board's leadership structure on at least an annual basis and make changes at such times as it deems appropriate.

Board's Role in Strategic Planning and Risk Oversight

Our Board meets regularly to discuss the strategic direction and the issues and opportunities facing our company in light of trends and developments in the biopharmaceutical industry and general business environment. Our Board has been instrumental in determining our next steps as a company.

The Board plays a critical role in the determination of the types and appropriate levels of risk undertaken by the company.

Annual strategy deep-dive: Each year, typically during the second quarter, the Board holds an extensive meeting with senior management dedicated to discussing and reviewing our long-term operating plans and overall corporate strategy. A discussion of key risks to the plans and strategy as well as risk mitigation plans and activities is led by our Chief Executive Officer as part of the meeting.

Constant focus on strategy: Throughout the year, our Board provides guidance to management on strategy and helps to refine operating plans to implement the strategy. This was especially true in 2018. The Board was consistently involved and met 8 times between June 2018 and January 2019 to discuss the merits and risk of the opportunity to acquire Celgene.

Dedicated to oversight of risk management: Our Board is responsible for risk oversight as part of its fiduciary duty of care to monitor business operations effectively.

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Our Board administers its strategic planning and risk oversight function as a whole and through its Board Committees. The following are examples of how our Board Committees are involved in this process:

Regularly reviews and discusses with management our process to assess and manage enterprise risks, including those related to market/environmental, strategic, financial, operational, legal, compliance, cyber security and reputation.

Annually evaluates our incentive compensation programs to determine whether incentive pay encourages excessive or inappropriate risk-taking. In particular, the Committee evaluates the components of our executive compensation program that work to minimize excessive or inappropriate risk-taking, including, the use of different forms of long-term equity incentives, linking payout to each executive's demonstration of our BMS Behaviors, placing caps on our incentive award payout opportunities, following equity grant practices that limit potential for timing awards and having stock ownership and retention requirements.

Regularly considers and makes recommendations to the Board concerning the appropriate size, function and needs of the Board, determines the criteria for Board membership, provides oversight of our corporate governance affairs and reviews corporate governance practices and policies. Oversees the company's political activities and routinely considers matters relating to the company's responsibilities as a global corporate citizen pertaining to corporate social responsibility and corporate public policy and the impact on the company's employees and shareholders.

Regularly reviews our pipeline and potential business development opportunities to evaluate our progress in achieving our near-term and long-term strategic research and development goals and objectives and assures that we make well-informed choices in the investment of our research and development resources, among other things.

In addition, the Board has formed two ad hoc committees in 2019 in connection with the Celgene acquisition for additional oversight over the financing transactions and related matters (by the Board Finance Committee) and the integration (by the Celgene Integration Committee). A summary of each Committee's general responsibilities as well as the Committee members is noted below:

Oversee and approve additional acquisition finance-related matters, including, final terms of the notes issuance and debt exchange transactions contemplated by the Celgene transaction as well as future debt exchanges or other related financing transactions, among other things.

The Committee includes the following Board members: Peter J. Arduini, Giovanni Caforio, M.D., Alan J. Lacy, Theodore R. Samuels and Gerald L. Storch.

Oversee all aspects of the Celgene integration and provide advice and assistance to the management with respect to the integration.
Provide updates on the progress of the Celgene integration to the full Board at each regularly scheduled board meeting, and more frequently as the Committee deems appropriate.

The Committee will include the following Board members: Peter J. Arduini, Giovanni Caforio, M.D., Matthew W. Emmens, Dinesh C. Paliwal, Karen H. Vousden, Ph.D., and one current director of Celgene who will join the company's Board of Directors upon closing of the transaction.

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Risk Assessment of Compensation Policies and Practices

The Compensation and Management Development Committee annually conducts a worldwide review of our material compensation policies and practices. Based on this review, we have concluded that our material compensation policies and practices are not reasonably likely to have a material adverse effect on the company. On a global basis, our compensation programs contain many design features that mitigate the likelihood of inducing excessive or inappropriate risk-taking behavior. These features include:

- ü Balance of fixed and variable compensation, with variable compensation tied both to short-term objectives and the long-term value of our stock price
- ü Multiple metrics in our incentive programs that balance top-line, bottom-line and pipeline performance
- ü Caps in our incentive program payout formulas
- ü Reasonable goals and objectives in our incentive programs
- ü Payouts modified based upon individual performance, inclusive of assessments against our BMS Behaviors
- ü The Compensation and Management Development Committee's ability to exercise downward discretion in determining incentive program payouts
- ü Clawback and recoupment provisions and policies pertaining to annual incentive payouts and long-term incentive awards
- ü Share ownership and retention guidelines applicable to our senior executives
- ü Equity award policies that limit risk by having fixed annual grant dates
- ü Prohibition of speculative and hedging transactions by all employees and directors
- ü All non-sales managers and executives worldwide participate in the same annual incentive program that pertains to our Named Executive Officers and that has been approved by the Compensation and Management Development Committee
- ü Mandatory training on our Principles of Integrity: BMS Standards of Business Conduct and Ethics (the Principles of Integrity) and other policies that educate our employees on appropriate behaviors and the consequences of taking inappropriate actions

Annual Evaluation Process

Our Board recognizes the critical role Board and Committee evaluations play in ensuring the effective functioning of our Board. It also believes in the importance of continuously improving the functioning of our Board and committees. Under the leadership and guidance of our Lead Independent Director, the Committee on Directors and Corporate Governance continuously assesses the Board evaluation process. In 2017, following discussions with and input from the full Board of Directors, the Committee enhanced the Board assessment process to include a written questionnaire. The formal 2018 Board and Committee evaluation processes were as follows:

Board: Directors completed a written questionnaire on an unattributed basis responding to questions about the Board and Committee structure and responsibilities, Board culture and dynamics, adequacy of information to the Board, Board skills and effectiveness, and Committee effectiveness. The robust feedback and comments from the directors were anonymously compiled and then were presented by the Chairman and the Lead Independent Director to the full Board for discussion and action. The 2018 Board evaluation was completed in February 2019.

Committees: Committee chairs selected a list of topics for their respective committees to evaluate and discuss, covering both substantive and process-oriented aspects of committee performance. The list of discussion topics for each committee was distributed to committee members in advance for consideration. Committee chairs led discussions in executive session of their respective committees. Committee chairs then reported to the full Board the results of their respective committee's evaluation and any follow-up actions. The 2018 Committee evaluations were completed in the beginning of 2019 and reported to the Board in February 2019.

The formal annual Board and Committee evaluations are supplemented by regular informal one-on-one discussions between the Chairman and Chief Executive Officer and each director throughout the year. The Lead Independent Director actively conveys directors' feedback on an ongoing basis to our Chairman and Chief Executive Officer and has regular one-on-one discussions with the other members of the Board.

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Responsiveness to Shareholder Feedback

Through our outreach efforts, we actively solicited feedback from shareholders and offered additional insights on shareholder proposals that were included in our most recent proxy statements, including those related to drug pricing and executive compensation and the threshold to call special shareholder meetings. The results of these discussions are noted below:

Proposal	Proponent	Shareholder Outreach Feedback	Company Response
Lower threshold to call a special meeting of shareholders from 25% to 15%	James McRitchie	Most shareholders deferred to Board's determination of an appropriate threshold	The Board believes the current 25% threshold is reasonable, appropriate and aligned with our shareholder's interests
		Some shareholders inquired whether board would consider lowering threshold if proposal received substantial support	The current threshold is designed to strike a balance between assuring that shareholders have the ability to call a special meeting and protecting against the risk that a small minority of shareholders could trigger the expense and distraction of a special meeting to pursue maters that do not need immediate attention Board continues to evaluate the appropriateness of the current threshold, taking into account: (i) shareholder's interest, (ii) shareholder support for the proposal, and (iii) continued feedback from our shareholders
How risks related to public concern over drug pricing strategies are integrated into the Company's incentive compensation policies, plans and programs for senior executives	UAW Retiree Medical Benefits Trust, Trinity Health and multiple other co-filers	Robust engagement with proponents and other shareholders; proponents requested additional disclosure, including related to (i) key drivers for pricing and (ii) governance around price increases and Board's oversight of pricing	Company collaborated with the proponents to include additional disclosure that was responsive to the proponents' feedback and consistent with our shared desired outcome, which is included in this proxy statement beginning on page 28

Meetings of our Board

Our Board meets on a regularly scheduled basis during the year to review significant developments affecting Bristol-Myers Squibb and to act on matters requiring Board approval. It also holds special meetings when important matters require Board action between scheduled meetings. Members of senior management regularly attend Board meetings to report on and discuss their areas of responsibility. In 2018, the Board met 10 times. The average aggregate attendance of directors at Board and committee meetings was over 98%. No director attended fewer than 75% of the aggregate number of Board and committee meetings during the period he or she served, except for Dr. Baselga who resigned from the Board in September 2018. In addition, our independent directors met 9 times during 2018 to discuss such topics as our independent directors determined, including the evaluation of the performance of our current Chief Executive Officer.

Annual Meeting of Shareholders

Directors are strongly encouraged, but not required, to attend the Annual Meeting of Shareholders. All of the 2018 nominees for director attended our 2018 Annual Meeting of Shareholders.

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Committees of our Board

Our Bylaws specifically provide for an Audit Committee, Compensation and Management Development Committee, and Committee on Directors and Corporate Governance, which are composed entirely of independent directors. Our Bylaws also authorize the establishment of additional committees of the Board and, under this authorization, our Board of Directors established the Science and Technology Committee. Our Board has appointed individuals from among its members to serve on these four standing committees and each committee operates under a written charter adopted by the Board, as amended from time to time. These charters are published on our website at http://bms.com/ourcompany/governance/Pages/board_committees_charters.aspx. Each of these Board Committees has the necessary resources and authority to discharge its responsibilities, including the authority to retain consultants or experts to advise the committee.

The table below indicates the current members of our standing Board Committees and the number of meetings held in 2018:

Director	Audit(1)	Committee on Directors and Corporate Governance	Compensation and Management Development	Science and Technology(2)
Peter J. Arduini	X		X	
Robert Bertolini	C	X		
Giovanni Caforio, M.D.				
Matthew W. Emmens			X	X
Michael Grobstein	X		C	
Alan J. Lacy	X	X		
Dinesh Paliwal		X	X	
Theodore R. Samuels	X	X		
Vicki L. Sato, Ph.D.		C		X
Gerald L. Storch	X		X	
Karen H. Vousden, Ph.D.(3)				C
Number of 2018 Meetings	**7**	**3**	**7**	**7**

"C" indicates Chair of the committee.

(1) Our Board of Directors has determined, in its judgment, that all members of the Audit Committee are financially literate and that all members of the Audit Committee meet additional, heightened independence criteria applicable to directors serving on audit committees under the New York Stock Exchange listing standards. In addition, our Board has determined that Messrs. Arduini, Bertolini, Grobstein, Lacy, Samuels and Storch each qualify as an "audit committee financial expert" under the applicable SEC rules.

(2) Dr. Thomas J. Lynch Jr., our Executive Vice President and Chief Scientific Officer, is a member of the Science and Technology Committee but he is not a member of our Board.

(3) Dr. Karen H. Vousden will become a member of the Compensation and Management Development Committee effective May 29, 2019.

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The following descriptions reflect each standing Board Committee's membership and Chair effective as of May 29, 2019.

Committee Chair:	***Key Responsibilities***
Robert Bertolini	Overseeing and monitoring the quality of our accounting and auditing practices, including, among others, reviewing and approving the internal audit charter, audit plan, audit budget and decisions regarding appointment and replacement of Chief Audit Officer
	Appointing, compensating and providing oversight of the performance of our independent registered public accounting firm for the purpose of preparing or issuing audit reports and related work regarding our financial statements and the effectiveness of our internal control over financial reporting
Additional Members:	Assisting the Board in fulfilling its responsibilities for general oversight of (i) compliance with legal and regulatory requirements, (ii) the performance of our internal audit function and (iii) enterprise risk assessment and risk management policies and guidelines
Peter J. Arduini Michael Grobstein Alan J. Lacy Theodore R. Samuels Gerald L. Storch	Reviewing our disclosure controls and procedures, periodic filings with the SEC, earnings releases and earnings guidance
	Producing the required Audit Committee Report for inclusion in our Proxy Statement
	Overseeing the implementation and effectiveness of our compliance and ethics program
	Reviewing our information security and data protection program

Committee Chair:	***Key Responsibilities***
Vicki L. Sato, Ph.D.	Providing oversight of our corporate governance affairs and reviewing corporate governance practices and policies, including annually reviewing the Corporate Governance Guidelines and recommending any changes to the Board

	Identifying individuals qualified to become Board members and recommending that our Board select the director nominees for the next annual meeting of shareholders
	Reviewing and recommending annually to our Board the compensation of non-employee directors
	Considering questions of potential conflicts of interest involving directors and senior management and establishing, maintaining and overseeing related party transaction policies and procedures
Additional Members:	
Robert Bertolini	Evaluating and making recommendations to the Board concerning director independence and defining specific categorical standards for director independence
Alan J. Lacy	
Dinesh C. Paliwal	Providing oversight of the company's political activities
Theodore R. Samuels	
	Considering matters relating to the company's responsibilities as a global corporate citizen pertaining to corporate social responsibility and corporate public policy and the impact on the company's employees and shareholders
	Overseeing the annual evaluation process of the Board and its Committees

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Committee Chair:	***Key Responsibilities***
Michael Grobstein	Reviewing, approving and reporting to our Board on our major compensation and benefits plans, policies and programs
	Reviewing corporate goals and objectives relevant to CEO compensation, evaluating the CEO's performance in light of those goals and objectives and recommending for approval by at least three-fourths of the independent directors of our Board the CEO's compensation based on this evaluation
Additional Members:	Reviewing and evaluating the performance of senior management; approving the compensation of executive officers and certain senior management
Peter J. Arduini	
Mathew W. Emmens	Overseeing our management development programs, performance assessment of our most senior executives and succession planning
Dinesh C. Paliwal	
Gerald L. Storch	Reviewing and discussing with management the Compensation Discussion and Analysis and related disclosures required for inclusion in our Proxy Statement, recommending to the Board whether the Compensation Discussion and Analysis should be included in our Proxy Statement, and producing the Compensation and Management Development Committee Report required for inclusion in our Proxy Statement
Karen H. Vousden	
	Establishing and overseeing our compensation recoupment policies
	Reviewing incentive compensation programs to determine whether incentive pay encourages inappropriate risk-taking throughout our business

Committee Chair:	*Key Responsibilities*
Karen H. Vousden, Ph.D.	Reviewing and advising our Board on the strategic direction of our research and development (R&D) programs and our progress in achieving near-term and long-term R&D objectives
	Reviewing and advising our Board on our internal and external investments in science and technology
	Identifying and discussing significant emerging trends and issues in science and technology and considering their potential impact on our company
Additional Members:	Providing assistance to the Compensation and Management Development Committee in setting any pipeline performance metric under the company's incentive compensation programs and reviewing the performance results
Matthew W. Emmens	
Thomas J. Lynch, Jr., M.D.	
Vicki L. Sato, Ph.D.	

Codes of Conduct

The Principles of Integrity adopted by our Board of Directors set forth important company policies and procedures in conducting our business in a legal, ethical and responsible manner. These standards are applicable to all of our employees, including the Chief Executive Officer, the Chief Financial Officer and the Controller.

In addition, the Audit Committee has adopted the Code of Ethics for Senior Financial Officers that supplements the Principles of Integrity by providing more specific requirements and guidance on certain topics. The Code of Ethics for Senior Financial Officers applies to the Chief Executive Officer, the Chief Financial Officer, the Controller, the Treasurer and the heads of major operating units.

Our Board has also adopted the Code of Business Conduct and Ethics for Directors that applies to all directors and sets forth guidance with respect to recognizing and handling areas of ethical issues.

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The Principles of Integrity, the Code of Ethics for Senior Financial Officers and the Code of Business Conduct and Ethics for Directors are available on our website at www.bms.com/ourcompany/governance. We will post any substantive amendments to, or waivers from, applicable provisions of our Principles, our Code of Ethics for Senior Financial Officers, and our Code of Business Conduct and Ethics for Directors on our website at www.bms.com/ourcompany/governance within two days following the date of such amendment or waiver.

Employees are required to report any conduct they believe in good faith to be an actual or apparent violation of our Codes of Conduct. In addition, as required under the Sarbanes-Oxley Act of 2002, the Audit Committee has established procedures to receive, retain and treat complaints received regarding accounting, internal accounting controls, or auditing matters and the confidential, anonymous submission by company employees of concerns regarding questionable accounting or auditing matters.

Related Party Transactions

The Board has adopted a written policy and procedures for the review and approval of transactions involving the company and related parties, such as directors, executive officers and their immediate family members. The policy covers any transaction or series of transactions (an "interested transaction") in which the amount involved exceeds $120,000, the company is a participant, and a related party has a direct or indirect material interest (other than solely as a result of being a director or less than 10% beneficial owner of another entity). All interested transactions are subject to approval or ratification in accordance with the following procedures:

Management will be responsible for determining whether a transaction is an interested transaction requiring review under this policy, in which case the transaction will be disclosed to the Committee on Directors and Corporate Governance (the "Governance Committee").

The Governance Committee will review the relevant facts and circumstances, including, among other things, whether the interested transaction is on terms no less favorable than terms generally available to an unaffiliated third party under the same or ordinary circumstances and the related party's interest in the transaction.

If it is impractical or undesirable to wait until a Governance Committee meeting to complete an interested transaction, the Chair of the Governance Committee, in consultation with the General Counsel, may review and approve the transaction, which approval must be ratified by the Governance Committee at its next meeting.

In the event the company becomes aware of an interested transaction that has not been approved, the Governance Committee will evaluate all options available to the company, including ratification, revision or termination of such transaction and take such course of action as the Governance Committee deems appropriate under the circumstances.

No director will participate in any discussion or approval of the interested transaction for which he or she is a related party, except that the director will provide all material information concerning the interested transaction to the Governance Committee.

If an interested transaction is ongoing, the Governance Committee may establish guidelines for management to follow in its ongoing dealings with the related party and will review and assess such ongoing relationships on at least an annual basis.

Certain types of interested transactions are deemed to be pre-approved or ratified by the Governance Committee, as applicable, even if the amount involved will exceed $120,000, including the employment of executive officers, director compensation, certain transactions with other companies or charitable contributions, transactions where all shareholders receive proportional benefits, transactions involving competitive bids, regulated transactions and certain banking-related services.

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BlackRock, Inc. (BlackRock), Wellington Management Group, LLP (Wellington) and The Vanguard Group (Vanguard) are each considered a "Related Party" under our related party transaction policy because they each beneficially own more than 5% of our outstanding common stock. The Governance Committee ratified and approved the following related party transactions in accordance with our policy and Bylaws:

- Certain of our retirement plans use BlackRock and its affiliates to provide investment management services. In connection with these services, we paid BlackRock approximately $1.1 million in fees during 2018.

- Certain of our retirement plans use Wellington and its affiliates to provide investment management services. In connection with these services, we paid Wellington approximately $1.2 million in fees during 2018.

- Vanguard acts as an investment manager with respect to certain investment options under our savings and thrift plans. Participants in the plans pay Vanguard's investment management fees if they invest in investment options managed by Vanguard; neither the plans themselves nor the company pays fees directly to Vanguard. In connection with these services, Vanguard received approximately $488,012 in fees during 2018.

The Governance Committee ratified the above relationships on the basis that these entities' ownership of our stock plays no role in the business relationship between us and them, and that the engagement of each entity was on terms no more favorable to them than terms that would be available to unaffiliated third parties under the same or similar circumstances.

Dr. José Baselga resigned from the Board in September 2018. Before this, he served as Physician-in-Chief of Memorial Sloan-Kettering Cancer Center (MSKCC) from January 2013 until September 2018. The company has made both business and charitable payments to MSKCC for many years, including for research studies and grants led by principal investigators affiliated with the hospital. The company paid MSKCC approximately $8.2 million in 2018, which accounted for less than 2% of MSKCC's revenues for the 2018 fiscal year.

Disclosure Regarding Political Activities

We provide semi-annual disclosure on our website of all political contributions to political committees, parties or candidates on both state and federal levels that are made by our employee political action committee, as well as annual disclosure of the portion of our dues or other payments made to trade associations to which we give $50,000 or more that can be attributed to lobbying expenditures.

Global Corporate Citizenship & Sustainability

Patients are at the center of everything we do, and our work is focused on the development of innovative medicines that deliver value to patients and the broader society. To do so in a sustainable manner requires continued investment in research and development (R&D) that seeks to uncover transformative approaches to treating serious diseases. At the same time, we aim to broaden access to medicines by collaborating with various facets of healthcare systems globally to build capacity to care for patients, including creative approaches to address affordability. Over the past 20 years, Bristol-Myers Squibb has embraced its responsibility to grow in a manner that respects the environment, encourages social progress and contributes to long-term economic viability that supports our employees and communities. Our Sustainability 2020 Goals are:

- **Accelerate innovation to develop transformative medicines** By 2020, enable Speed to Patients by optimizing development timelines such as R&D processes, regulatory review and data packaging. The goal also focuses on improving clinical trial patient diversity and satisfaction.

- **Enhance patient access to medicines** Use existing approaches such as tiered pricing, voluntary licensing, reimbursement support, patient assistance programs and our Bristol-Myers Squibb Foundation partnerships to provide greater access to our medicines in global markets. For example, all marketed products will have access plans.

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Be the employer of choice and the champion of safety Empower and engage our people by improving safe behaviors and building a more globally diverse and inclusive workforce; being a recognized employer of choice. For example, by 2020, establish a new safety culture survey and improve results.

Drive supply chain leadership on quality and integrity Ensure reliable supply, engaging with our critical suppliers and assessing those in high-risk countries for conformance with labor and integrity standards. As an example, all critical manufacturing suppliers will be assessed for risk and risk mitigation performance, with results incorporated in sourcing decisions.

Innovate to support a green, healthy planet Continue to improve our environmental footprint with greenhouse gas and water reduction goals and integrate green design and reduce waste throughout our product portfolio. Among Bristol-Myers Squibb's Sustainability 2020 Goal targets is to reduce water use and greenhouse gas emissions by 5 percent (absolute) or more from the 2015 baseline.

We remain actively engaged with our shareholders and other key stakeholders on our environmental, social and governance performance relative to our financial results. Our Board remains actively engaged on these issues with direct oversight by our Committee on Directors and Corporate Governance. For more information and to provide feedback, please see the company's website at https://www.bms.com/about-us/sustainability.html under "Sustainability."

Responsible Drug Pricing Strategy & Transparency

Our Commitment

We firmly believe that prescription medicines are such a vital part of human healthcare that everyone who needs them should have access to them. We have been, and remain, committed to facilitating access to our medicines, and to furthering our Mission to help patients prevail over serious diseases. We price our medicines based on a number of factors, including, among others, the value of scientific innovation for patients and society in the context of overall healthcare spend; economic factors impacting the healthcare systems' capacity to provide appropriate, rapid and sustainable access to patients; and the necessity to sustain our research and development (R&D) investment in innovative platforms to continue to address serious unmet medical needs.

At Bristol-Myers Squibb, we believe in the value our medicines bring to patients and society and our role in transforming care to help patients live longer, healthier and more productive lives. We focus on medicines that meaningfully change patient outcomes and improve quality of life, and over the last 30 years, we have made significant contributions in areas such as HIV, hepatitis, cardiovascular disease and, most recently, immuno-oncology. Many of our medicines are breakthroughs in innovation, truly differentiated medicines that have changed the standard of care and help patients live longer and healthier lives. For example, in melanoma, prior to the availability of immuno-oncology treatment options, 25% of patients diagnosed with metastatic melanoma survived 1 year. This increased to 74% with immuno-oncology therapies. We are making real progress towards the goal of shifting cancer from a death sentence to a chronic disease that can be managed and controlled. Collectively, we have delivered eight (8) new products in the past eight (8) years, including 14 major market approvals in 2018. These breakthrough medicines are possible because of our consistent investment in research and development. Over the last several years, we have emerged as an industry leader in R&D investment, investing approximately $6 billion annually, roughly 30% of our revenue. Therefore, our goal is to ensure access to currently approved medicines while continuing to fuel the development of medicines for the future.

Governance/Transparency

We take a thoughtful approach to pricing our products and have internal processes and controls in place to ensure that pricing decisions are thoroughly and appropriately vetted prior to implementation with involvement from the highest levels of management. This process includes routine presentations to the Board on drug pricing strategies. In addition, on balance, over the last few years, our revenue growth has been primarily attributable to increased volume arising from increased demand for our products rather than price increases. We have and continue to disclose in our annual report on Form 10-K and our quarterly reports on Form 10-Q, the average net selling price increase for our products. Our average net selling price increase for 2015, 2016, 2017 and 2018 was approximately, 3%, 5%, 2% and 0%, respectively. We believe we have the appropriate governance mechanisms and internal controls and processes in place to ensure that pricing decisions are made in line with our values and commitment.

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In addition, the Compensation Management and Development Committee ("Committee") annually completes a thoughtful and rigorous evaluation of our executive compensation program to ensure that the program is aligned with our Mission and delivers shareholder value, while not encouraging excessive or inappropriate risk-taking by our executives. When setting incentive plan targets each year, the Committee is aware of the risks associated with drug pricing, among other things, and ensures our plans do not incentivize risky behavior in order to meet targets.

Access/Regulatory Reform

We remain committed to working with policymakers, thought leaders, patient advocates and other stakeholders to shape a comprehensive system that provides accessible and affordable health care with the goal of achieving universal coverage and quality patient care, while continuing to fuel innovation. We support efforts to make medicines more affordable, from access assistance to innovative ways to address costs more directly. Individuals who cannot afford our medicines and have no other means of coverage, public or private, may be eligible to be provided with our medicines, at no charge, through a number of programs, including various independent charitable organizations, including the Bristol-Myers Squibb Patient Assistance Program Foundation, Inc. (an independent 501(c)(3) charitable organization) and other company sponsored patient assistance programs. We estimate that in 2018 alone, we provided more than $1.2 billion worth of medicines to more than 98,000 patients in the United States at no cost to these patients.

Increasing access to patients is one of our 2020 Sustainability Goals. In addition to our patient assistance programs in the U.S. and outside of the U.S., we have different mechanisms of patient assistance programs, rebates and co-pay assistance programs in each country. For example, we support the use of tiered pricing between distinct groups of countries, in instances of disproportionate disease impact. For instance, for over a decade, Bristol-Myers Squibb has maintained a policy of tiered pricing and voluntary licensing for our HIV and HCV medicines in an attempt to reduce barriers that delay broad and accelerated access to treatment for patients around the world. In addition, as part of our commitment to helping patients prevail over serious diseases, we also drive and support a number of programs designed to build capacity, raise patient awareness, including prevention and diagnosis and access to treatment and care. Several examples are: *SECURE THE FUTURE; Delivering Hope*; and the U.S. Patient Assistance Program.

As a company, we have made remarkable improvements in delivering life-saving medicines to patients and also offering creative solutions for access; however, we understand concerns that our healthcare system as a whole is too expensive, and we are interested in finding ways to improve our system. Therefore, we re-assert our commitment to proactively work with governments, payers, health care providers and other stakeholders to develop sustainable solutions that will better assist patients in need.

Communications with our Board of Directors

Our Board has created a process for anyone to communicate directly with our Board, any committee of the Board, the non-management directors of the Board collectively or any individual director, including our Chairman and Lead Independent Director. Any interested party wishing to contact our Board may do so in writing by sending a letter to Bristol-Myers Squibb Company, 430 East 29th Street 14th Floor, New York, New York 10016, Attention: Corporate Secretary.

Any matter relating to our financial statements, accounting practices or internal controls should be addressed to the Chair of the Audit Committee. All other matters should be addressed to the Chair of the Governance Committee.

Our Corporate Secretary or her designee reviews all correspondence and forwards to the addressee all correspondence determined to be appropriate for delivery. Our Corporate Secretary periodically forwards to the Governance Committee a summary of all correspondence received. Directors may at any time review a log of the correspondence we receive that is addressed to members of the Board as well as copies of any such correspondence. Our process for handling communications to our Board has been approved by the independent directors.

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Compensation of Directors

Director Compensation Program

We aim to provide a competitive compensation program to attract and retain high quality directors. The Committee on Directors and Corporate Governance annually reviews our directors' compensation practices, including a review of the director compensation programs at our executive compensation peer group. Furthermore, for 2018 we again engaged an outside consultant, Frederic W. Cook & Co., Inc. (FWC), to review market data and competitive information on director compensation. FWC recommended that our executive compensation peer group should be the primary source for determining director compensation.

Based on this analysis, the Committee determined to make no further changes to the director compensation program for service as a director in 2018. The Committee previously determined, in light of the fact that our director compensation program has been unchanged since 2016, and was between the 25th percentile and median of our peer group, among other reasons, to increase the annual equity award for service as a director for 2018 by $15,000. The Committee submitted its recommendations for director compensation to the full Board for approval. Our employee directors do not receive any additional compensation for serving as directors.

The Committee believes the total compensation package for directors we offered in 2018 was reasonable, and appropriately aligned the interests of directors with our shareholders by ensuring directors have a proprietary stake in our company.

The Components of our Director Compensation Program

In 2018, non-management directors who served for the entirety of 2018 received:

Component		Value of Award
Annual Retainer		$100,000
Annual Equity Award		Deferred Share Units valued at $185,000
Committee Chair Retainer		$25,000
Committee Member (not Chair) Retainer	Audit, Compensation and Management Development, and Science and Technology Committees	$15,000
Committee Member (not Chair) Retainer	Committee on Directors and Corporate Governance	$7,500

Annual Equity Award

On February 1, 2018, all non-management directors serving on the Board at that time received an annual award of deferred share units valued at $185,000 under the 1987 Deferred Compensation Plan for Non-Employee Directors. These deferred share units are non-forfeitable at grant and are settleable solely in shares of company common stock. A new member of the Board who is eligible to participate in the Plan receives, on the date the director joins the Board, a pro-rata number of deferred share units based on the number of share units payable to participants as of the prior February 1.

Compensation of our Lead Independent Director

Our Lead Independent Director receives an additional retainer of $35,000. Our Board has determined to award this retainer in light of the increased duties and responsibilities demanded by this role, which duties and responsibilities are described in further detail on page 19.

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Share Retention Requirements

We significantly increased the share retention requirements for non-management directors in 2016. All non-management directors are required to acquire a minimum of shares and/or units of company stock valued at not less than five times their annual cash retainer within five years of joining the Board and to maintain this ownership level throughout their service as a director. We require that at least 25% of the annual retainer be deferred and credited to a deferred compensation account, the value of which is determined by the value of our common stock, until a non-management director has attained our share retention requirements.

Deferral Program

A non-management director may elect to defer payment of all or part of the cash compensation received as a director under our company's 1987 Deferred Compensation Plan for Non-Employee Directors. The election to defer is made in the year preceding the calendar year in which the compensation is earned. Deferred funds for compensation received in connection with service as a Director in 2018 were credited to one or more of the following funds: a United States total bond index, a short term fund, a total market index fund or a fund based on the return on our common stock. Deferred portions are payable in a lump sum or in a maximum of ten annual installments. Payments under the Plan begin when a participant ceases to be a director or at a future date previously specified by the director.

Charitable Contribution Programs

Each director who joined the Board prior to December 2009 participates in our Directors' Charitable Contribution Program. Upon the death of a director, we will donate up to an aggregate of $500,000 to up to five qualifying charitable organizations designated by the director. Individual directors derive no financial or tax benefit from this program since the tax benefit of all charitable deductions relating to the contributions accrues solely to us. In December 2009, the Board eliminated the Charitable Contributions Program for all new directors.

In addition, each director was able to participate in our company wide matching gift program in 2018. We matched dollar for dollar a director's contribution to qualified charitable and educational organizations up to $30,000. This benefit was also available to all company employees. In 2018, each of the following non-employee directors participated in our matching gift programs as indicated in the Director Compensation Table below: Drs. Sato and Baselga and Messrs. Arduini, Bertolini, Emmens, Grobstein, Lacy, Samuels and Storch.

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Director Compensation Table

The following table sets forth information regarding the compensation earned by our non-employee directors in 2018.

Name	Fees Earned or Paid in Cash(1)	Stock Awards(2)	Option Awards(3)	All Other Compensation(4)	Total
P. J. Arduini	$ 130,000	$ 185,000	$ 0	$ 17,750	$ 332,750
J. Baselga, M.D., Ph.D.(5)	$ 62,462	$ 170,808	$ 0	$ 5,000	$ 238,270
R. Bertolini	$ 129,161	$ 185,000	$ 0	$ 10,000	$ 324,161
M. W. Emmens	$ 130,000	$ 185,000	$ 0	$ 30,000	$ 345,000
M. Grobstein	$ 140,000	$ 185,000	$ 0	$ 30,000	$ 355,000
A. J. Lacy	$ 125,812	$ 185,000	$ 0	$ 30,000	$ 340,812
D. C. Paliwal	$ 122,500	$ 185,000	$ 0	$ 0	$ 307,500
T. R. Samuels	$ 122,500	$ 185,000	$ 0	$ 30,000	$ 337,500
V. L. Sato, Ph.D.	$ 178,312	$ 185,000	$ 0	$ 25,000	$ 388,312
G. L. Storch	$ 130,000	$ 185,000	$ 0	$ 10,000	$ 325,000
K.H. Vousden, Ph.D.	$ 121,661	$ 199,438	$ 0	$ 0	$ 321,099

(1) Includes the annual retainer, committee chair retainers, committee membership retainers and Lead Independent Director retainer, as applicable. All or a portion of the cash compensation may be deferred until retirement or a date specified by the director, at the election of the director. The directors listed in the below table deferred the following amounts in 2018, which amounts are included in the figures above.

Name	Dollar Amount Deferred	Percentage of Deferred Amount Allocated to U.S. Total Bond Index	Percentage of Deferred Amount Allocated to Short Term Fund	Percentage of Deferred Amount Allocated to Total Market Index Fund	Percentage of Deferred Amount Allocated to Deferred Share Units	Number of Deferred Share Units Acquired
P. J. Arduini	$ 130,000	0%	0%	0%	100%	2,250
J. Baselga, M.D., Ph.D.(5)	$ 62,462	0%	0%	0%	100%	1,060
R. Bertolini	$ 129,161	0%	0%	0%	100%	2,238
M. W. Emmens	$ 130,000	0%	0%	0%	100%	2,250
M. Grobstein	$ 70,000	0%	0%	0%	100%	1,211
A. J. Lacy	$ 125,812	0%	0%	0%	100%	2,174

D. C. Paliwal	$ 122,500	0%	0%	0%	100%	2,120
T. R. Samuels	$ 122,500	0%	0%	0%	100%	2,120
G. L. Storch	$ 130,000	0%	0%	0%	100%	2,250
K. H. Vousden, Ph.D.	$ 30,415	0%	0%	0%	100%	527

(2)

Represents aggregate grant date fair value under FASB ASC Topic 718 of deferred share unit and common stock awards granted during 2018. On February 1, 2018, each of the non-management directors then serving as a director received a grant of 2,945.860 deferred share units valued at $185,000 based on the fair market value on the day of grant of $62.80. On January 1, 2018, in connection with her appointment to the Board, Dr. Karen H. Vousden received a pro-rated grant of 235.613 deferred share units valued at $14,438 based on the fair market value on the day of grant of $61.28. On March 1, 2018, in connection with his appointment to the Board, Dr. José Baselga received a pro-rated grant of 2,600.220 deferred share units valued at $170,808 based on the fair market value on the day of grant of $65.69. The aggregate number of deferred share units held by each of these directors as of December 31, 2018 is set forth below. In some cases, these figures include deferred share units acquired through elective deferrals of cash compensation.

Name	# of Deferred Share Units
P. J. Arduini	14,961
J. Baselga, M.D., Ph.D.(5)	3,731
R. Bertolini	10,100
M. W. Emmens	10,197
M. Grobstein	75,479
A. J. Lacy	65,590
D. C. Paliwal	22,606
T. R. Samuels	9,102
V. L. Sato, Ph.D.	61,108
G. L. Storch	44,743
K. H. Vousden, Ph.D.	3,786

(3)

There have been no stock options granted to directors since 2006 and no non-employee Director had stock options outstanding as of December 31, 2018.

(4)

Amounts include company matches of charitable contributions under our matching gift program.

(5)

Dr. José Baselga resigned from the company in September 2018.

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COMPENSATION DISCUSSION AND ANALYSIS

This Compensation Discussion and Analysis (CD&A) is intended to explain how our compensation program is designed and how it operates for our Named Executive Officers (NEOs). The below table includes a list of our 2018 NEOs.

Name	Principal Position
Giovanni Caforio, M.D.	Chairman & Chief Executive Officer
Charles Bancroft	Chief Financial Officer and EVP, Global Business Operations
Thomas J. Lynch, Jr., M.D.	EVP and Chief Scientific Officer
Sandra Leung	EVP and General Counsel
Louis S. Schmukler	SVP and President, Global Product Development and Supply

EXECUTIVE SUMMARY

A. Introduction

Overview. Bristol-Myers Squibb Company continues to recognize that aligning pay to the achievement of both our short-term and long-term goals, engagement of our employees, the achievement of our Mission and the delivery of value to our shareholders is a cornerstone of our compensation philosophy and program structure. In 2018, we exceeded our financial goals in key areas, including continued growth across our core prioritized brands, and although we did not meet some of our targeted pipeline goals, we had important scientific advancement of clinical assets that continue to diversify our pipeline.

Received strong shareholder support for executive compensation with 95% in favor of our 2018 "Say on Pay" vote

Key 2018 performance highlights

- Total revenues increased by 9%
- GAAP and non-GAAP earnings per share increased by 393% and 32%, respectively
- Our strong commercial and operational execution as well as continued investment in R&D supports the right framework for delivering value to shareholders over the long-term

Maintained superior commercial execution across the company in 2018

- We sustained significant growth across our prioritized brands, led by our two largest brands, *Opdivo*, an oncology product, and *Eliquis*, a cardiovascular product, which had sales growth of 36% and 32%, respectively
- *Eliquis* is the leading oral anticoagulant in the U.S., with a best in class profile
- We continued to grow and advance our immuno-oncology portfolio in additional launched indications, including: (i) approval of *Opdivo/Yervoy* combination in first-line renal cell carcinoma (RCC) in U.S., and approval by the European Medicines Agency (EMA) in January 2019 for first-line RCC in EU; (ii) *Opdivo* approval for adjuvant treatment in melanoma in EU and Japan (both quickly becoming standards of care within their approved settings); and (iii) *Opdivo* approval for non-small cell lung cancer in China (the first immuno-oncology product approved in China)
- Advanced early pipeline with encouraging phase II data for our TYK-2 inhibitor compound for treatment of moderate-to-severe plaque psoriasis; advanced compound to phase III as part of a robust development plan for TYK-2 across psoriasis, crohn's disease and lupus

Continued to advance our long-term business strategy

- Strong foundation for growth in 2019 and beyond, with a diversified portfolio of innovative medicines
- We made the strategic decision to acquire Celgene Corporation ("Celgene"), which was announced on January 3, 2019, following a robust strategic review and extensive due diligence completed in 2018

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- We executed other important business development transactions both divesting non-core assets and supplementing our innovative pipeline, including a collaboration with Janssen (JNJ) for our Factor Xla inhibitor program (for treatment of major thrombotic conditions) and advanced assets into phase II trials, the announced sale of the company's UPSA consumer health business to Taisho Pharmaceutical Holdings Co., Ltd., and other research and clinical collaborations with entities such as, Boston Medical, Eisai Co., Ltd., Vedanta Biosciences, and Infinity Pharmaceuticals, Inc.
- Although we made significant progress in advancing our innovative medicines pipeline in 2018 and our pending acquisition of Celgene's portfolio strengthens our strategic position, we recognize that there is still more work to be done our clinical programs remain focused on expanding the benefits of our immuno-oncology, cardiovascular, fibrosis and immunoscience portfolios. The Company's overall pipeline performance and key pipeline milestones are described in more detail on page 43

Our Compensation & Management Development Committee's (the "Committee") ongoing review of our business strategy and our extensive shareholder engagement efforts have allowed our executive compensation program to maintain close alignment with our strategic focus and the perspectives of our shareholders. This executive summary includes an overview of the key components of our executive compensation program and recent changes designed to support our company's strategy as a diversified specialty biopharmaceutical company.

B. Expanded Shareholder Engagement

In 2018, we reached out to over 50 of our top shareholders, representing nearly 50% of our shares outstanding. We engaged with our investors on many important aspects of our executive compensation program, including disclosure trends and structural changes to the compensation program that became effective in 2016, as well as other corporate governance topics covering, among other things, board composition, tenure, board assessment, risk oversight, and board and company-wide diversity and other sustainability items.

The feedback received from shareholders was generally positive and was discussed by the Committee and Board. We are committed to ongoing shareholder engagement and consideration of feedback as we continually evaluate our executive compensation program. For example, after a review of our compensation program practices as well as engagement with our shareholders, the Committee adopted a compensation policy to exclude the impact of share repurchases from both target and achieved financial results. For a discussion of this new compensation policy, please see "Compensation Program Changes for 2019" on page 37.

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C. 2018 Executive Compensation Program at a Glance

Our compensation program design reflects our compensation philosophy and aligns well with our strategy, market practice and our shareholders' interests.

D. 2018 Pay Decisions Align with Company Performance and Ongoing Evolution

Key Considerations

Each year, when evaluating company and senior management performance and making its compensation decisions, the Committee considers our compensation philosophy and program structure, which underscores competitive compensation and pay for performance, striking the appropriate balance among (i) directly aligning executives' compensation with the fulfillment of our Mission and the delivery of shareholder value, (ii) making a substantial portion of our executives' compensation variable and at risk based on operational, financial, strategic and share price performance and (iii) attracting, retaining and engaging executives who are capable of leading our business in a highly competitive, complex, and dynamic business environment.

For 2018, after reviewing our financial and operational performance, our share price performance, and the individual performance of our executives, our Committee determined that the compensation of our executives under the program design continues to be appropriate.

The Committee looked at how all the elements of our compensation program design worked together, noting the balance between short-term and long-term compensation and performance; top-line and bottom-line results; absolute and relative factors; and internal and market-based performance metrics. In evaluating 2018 performance, the Committee determined that the compensation of our executives appropriately reflects:

our **financial and operational results**,

the execution and **advancement of company's long-term strategy** in 2018, and

the Committee's holistic assessment of the **individual performance** of our executives.

We believe that the execution of our strategy will continue to create sustainable long-term value for shareholders.

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Other Key Factors Considered

As noted, our compensation program is guided by our compensation philosophy and principles and this is illustrated through the following elements of our program:

Balance of incentives emphasizes long-term performance.

Long-term equity incentive program aligns executive compensation with shareholder value over the relevant period:

- Long-term compensation emphasized in our overall pay mix (*i.e.*, over 60% for our NEOs);
- 34% of the 2018 PSU grant is tied to 3-year total shareholder return (TSR) vs. our peer group; and
- MSUs are also highly responsive to changes in our share price.

Robust share ownership and retention guidelines further the alignment of management and shareholders.

E. 2018 Annual Incentive Program Results & Incentive Plan Target Setting Considerations

Annual Incentive Program Results

Annual awards are determined based on a Company Performance Factor, which is calculated based on pre-defined financial and pipeline goals, and an Individual Performance Factor, which is calculated based on individual achievements against pre-defined strategic and operational goals. When determining the individual component of our annual incentive awards, the Committee considers each executive's contributions to the company's strategic achievements and financial and operational performance. In addition, the Committee considers how each executive demonstrates our BMS Behaviors, including among others, accountability, and his or her contributions to our company's culture of diversity and inclusion, business integrity, ethics and compliance.

Target Setting Considerations

At the beginning of each year, the Committee undertakes an incentive goal setting process to establish targets that it believes will motivate our executives appropriately to deliver the performance that drives shareholder value creation in both the short and longer term.

The Committee set incentive targets in the first quarter of 2018 after considering our budget, operational priorities, long-term strategic plans, historical performance, product pipeline and external factors, among other things. The Committee also set targets in line with guidance provided to the market in early 2018. When it became clear that the Company would exceed the financial targets, we revised our sales and earnings guidance to the market.

Further detail on annual target setting considerations for each of our NEOs is included beginning on page 42, under "Financial and Pipeline Metric Target Setting Considerations".

Year over Year Comparison of Financial and Pipeline Achievements for Company Performance Factor

	2017			2018		
Performance Measure	**Target**	**Actual**	**% of Target**	**Target**	**Actual**	**% of Target**

Non-GAAP Diluted Earnings Per Share(1)	$ 2.76	$ 2.94	106.5%	$ 3.22	$ 3.87	120.2%
Total Revenues, Net of Foreign Exchange ($=MM)(1)	$ 19,991	$ 20,683	103.5%	$ 21,447	$ 22,564	105.2%
Pipeline Score	3	3.5	116.7%	3	2.5	83.3%

(1) Consistent with the company's past practice, non-GAAP diluted earnings per share and total revenues, net of foreign exchange, were each adjusted $0.11 and $63 million, respectively, due to unanticipated favorable budget variances for *Sprycel* performance in Europe and the impact of tax reform in the U.S. The Committee determined that it was appropriate to exclude the impact of these unanticipated favorable budget variances because these events favorably impacted performance in an amount that was not determinable when the target was set in the first quarter of 2018.

The Individual Performance Factors applied to our NEOs for 2018 ranged between 100% and 135%. Disclosure of our NEOs individual performance goals and achievements are detailed below beginning on page 43, under "2018 Individual Performance Assessment". Further detail on annual incentive awards for each of our NEOs is included on page 45, under "2018 Annual Incentive Awards".

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F. Compensation Program Changes for 2019

Key Integration Metrics Built into Compensation Program

Our acquisition of Celgene will position us to create a leading biopharma company, with best-in-class franchises, significant near-term launch opportunities and a deep and broad pipeline, creating an even stronger foundation for long-term sustainable growth. To enhance the structural alignment between our incentive program and the successful execution of our integration strategy and value creation, the Committee will adjust performance metrics on outstanding PSUs awarded to our NEOs in 2018 and 2019 to incorporate key integration metrics, subject to the closing of the Celgene transaction. Key integration execution metrics include:

Our short-term annual incentive program will include assessment of the following key integration execution metrics:

- Near-term pipeline delivery milestones
- Human capital management, and
- Synergy savings

For our long-term incentive program, outstanding PSU awards will include the following indicators of post-merger progress:

- Multi-year progress against key integration execution metrics
- Combined company revenue goals, and
- Relative TSR

Compensation Policy Regarding Share Repurchases

Following shareholder engagement, the Committee has decided to adopt a policy to neutralize the impact of share repurchases in financial performance metrics. The Committee will exclude the impact of share repurchases from both target and achieved financial results.

Our Compensation Governance Reflects Market Best Practices

We maintain a number of compensation governance best practices which support our overarching compensation philosophy and are fully aligned with our compensation principles, as discussed in the following section. Our compensation practices also align with input we have received from shareholders.

	What We Do:	What We Don't Do:
ü	100% performance-based annual and long-term incentives	Generally no perquisites to our Named Executive Officers
ü	Caps on the payouts under our annual and long-term incentive award programs	Prohibition on speculative and hedging transactions
ü	Robust share ownership and share retention guidelines	No employment contracts with our Named Executive Officers
ü	Robust recoupment and clawback policies	Prohibition on re-pricing or backdating of equity awards
ü	Proactive shareholder engagement	No guaranteed incentives with our Named Executive Officers

ü	"Double-trigger" change-in-control agreements	No tax gross-ups

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Executive Compensation Philosophy and Principles

Our executive compensation philosophy focuses on two core elements:

Based on this philosophy, our compensation program is designed with the following principles in mind:

- ü to pay our employees equitably based on the work they do, the capabilities and experience they possess, and the performance and behaviors they demonstrate (including passion, innovation, speed and accountability);
- ü to promote a non-discriminatory and inclusive work environment that enables us to benefit from and to use as a competitive advantage the diversity of thought that comes with a diverse and inclusive workforce;
- ü to motivate our executives and all our employees to deliver high performance with the highest integrity; and
- ü to implement best practices in compensation governance, including risk management and promotion of effective corporate policies.

Benchmarking Analysis and Peer Group

Benchmarking Approach

In general, our executive compensation program seeks to provide total direct compensation at the median of our primary peer group (as defined below) when targeted levels of performance are achieved. In any given year, however, we may target total direct compensation for a particular executive above or below the median of our primary peer group due to multiple factors, including competencies, qualifications, experience, responsibilities, contribution, individual performance, role criticality and/or potential. We may also target total direct compensation above the median of our primary peer group to attract and retain talent within the competitive biopharmaceutical industry marketplace. We define total direct compensation as base salary plus target annual incentive award plus the grant date fair value of annual long-term equity incentive awards.

Paying at competitive levels when targeted levels of performance are achieved allows us to attract and retain the talent we need to continue driving performance, while enabling us to maintain a competitive cost base with respect to compensation expense.

Benchmarking Process

The Committee's independent compensation consultant annually conducts a review of the compensation for our Named Executive Officers, including compensation information compiled from publicly filed disclosures of our primary and extended peer groups. Pay levels of our peers are used as a reference point, among other factors, when determining individual pay decisions (i.e., base salary levels, the size of salary adjustments, if any, target annual incentive levels and long-term equity incentive award size).

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2018 Peer Groups

We regularly monitor the composition of our peer groups and make changes when appropriate. Our peer groups in 2018 remained unchanged and consisted of the following companies:

Primary Peer Group		Extended Peer Group(1)
AbbVie Inc.	Gilead Sciences Inc.	AstraZeneca PLC
Amgen Inc.	Johnson & Johnson	GlaxoSmithKline PLC
Biogen Inc.	Merck & Co.	Roche Holding AG
Celgene Corporation	Pfizer, Inc.	Novartis AG
Eli Lilly and Company		Sanofi

(1) Our extended peer group includes the primary peer group plus these five companies based outside the U.S. Following the closing of the company's acquisition of Celgene, Celgene will be removed from the list of peer companies.

Primary Peer Group: The Committee believes the companies included in our 2018 primary peer group are appropriate given the unique nature of the biopharmaceutical industry. These companies represent our primary competitors for executive talent and operate in a similarly complex regulatory and research driven environment.

In determining our primary peer group, we believe emphasis should be placed on whether a company competes directly with us for the specialized talent necessary to further drive our success as a diversified specialty biopharmaceutical company. We also consider company size in determining our peer group. The companies in our primary peer group all had annual revenues of at least $10 billion. In 2018, BMS approximated the 25th percentile in revenue and market capitalization amongst our primary peer group.

Extended Peer Group: We also review an extended peer group, which is comprised of the nine companies in our primary peer group plus five companies based outside the U.S. This extended peer group serves as an additional reference point for compensation practices, including understanding of the competitive pay environment as it relates to the global nature of both our business and the competition for talent.

2018 Target Compensation Benchmarks

Target compensation for Dr. Caforio was at approximately the median of Chief Executive Officers within our current proxy peer group. The Committee believes Dr. Caforio's compensation package positions him appropriately among his peers when taking multiple factors into consideration. On average, our other Named Executive Officers were also at approximately the median of our current proxy peer group, with some variation by position.

Components of Our 2018 Compensation Program

Core components of our 2018 executive compensation program:

- Base Salary
- Annual Incentive Award
- Long-Term Equity Incentives, comprised of:
  - Performance Share Units
  - Market Share Units

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The Committee believes this structure aligns with a continued commitment to emphasizing variable, or "at risk," compensation for our Named Executive Officers. The following charts provide an overview of the 2018 executive compensation components for the CEO and other NEOs, and highlights the percentage of target compensation that is variable and at risk.

This target mix supports the core elements of our executive compensation philosophy by emphasizing long-term, stock based incentives while providing competitive annual cash components, thus aligning our executive compensation program with our business strategy.

The following sections discuss the primary components of our executive compensation program and provide detail on how specific pay decisions were made for each NEO in 2018.

Base Salary

Base salaries are used to help us attract talent in a highly competitive labor market. The salaries of our executives are primarily established on the basis of the specialized qualifications, experience and criticality of the individual executive and/or his or her role and the pay levels of comparable positions within our primary peer group. Salary increases for our executives are determined based on both the performance of an individual and the size of our annual increase budget in a given year, which is based in part on an assessment of market movement related to salary budgets for our peer companies and broader general industry trends. Therefore, we typically set our annual salary increase budgets based on the median of such forecasts. There may be adjustments to salary from time to time to recognize, among other things, when an executive assumes significant increases in responsibility and/or is promoted, and to reflect competitive pay based on market data for individual executive roles.

In 2018, in accordance with our company wide merit review process, employees, including the Named Executive Officers, were eligible for a merit increase provided their performance fully met or exceeded expectations on both Results and Behaviors. Employees who are determined to be below the fully-performing level typically receive either a reduced merit increase or no salary increase depending on the extent to which they are below the fully-performing level. Effective April 1, 2018, Dr. Caforio received an increase of 3.1%, and each of Mr. Bancroft, Dr. Lynch, Ms. Leung and Mr. Schmukler received an increase of 3%.

Annual Incentive Program

Our annual incentive program is designed to reward performance that supports our business strategy as a diversified specialty biopharmaceutical company and our Mission to help patients prevail over serious diseases. The annual plan aligns with our business strategy and Mission by sharpening management's focus on key financial and pipeline goals, as well as by rewarding individual performance (both Results and Behaviors), consistent with our pay-for-performance philosophy.

Each NEO's target annual incentive is expressed as a percentage of base salary, which is set at a level to ensure competitive total direct compensation. Annual incentive awards for each NEO are determined by evaluating both company performance (as measured by the Company Performance Factor) and individual performance (as measured by the Individual Performance Factor). The maximum incentive opportunity for each NEO is 200% of target.

The Company Performance Factor can range from 0% to 152%, based on financial achievements and pipeline results, and the Individual Performance Factor can range from 0% to 165%, based on individual performance (both Results and Behaviors), subject to a 200% of target maximum payout. The graphic below illustrates the calculation used to determine annual incentive plan awards.

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Annual Incentive Award Calculation for Named Executive Officers

Performance Metrics Underlying the Company Performance Factor

Our 2018 incentive plan design has the following corporate-wide measures, which apply to all employees eligible to participate in the annual incentive plan, including our Named Executive Officers:

2018 Metric and Weighting	What It Is	Why It's Important
Earnings Per Share (EPS) *(50%)*	**Non-GAAP Diluted EPS** (Net Income *divided* by outstanding shares of common stock)	A critical **measure of annual profitability** aligning our employees' interests with those of our shareholders
Total Revenues *(25%)*	**Total Revenues, net of foreign exchange** (Total revenues *minus* reserves for returns, discounts, rebates and other adjustments)	**A measure of topline growth** that creates a foundation of long-term sustainable growth and competitive superiority
Pipeline *(25%)*	**Near-Term Value** (Submissions and approvals) **Long-Term Growth Potential**	**Increases BMS-wide focus on delivery of our late-stage pipeline and continued development of a robust pipeline** through both internal efforts and business development

Our pipeline metric highlights the importance of pipeline delivery to the near-term and long-term success of the company. This metric measures the sustainability and output of our R&D pipeline portfolio and is comprised of goals in two categories, Near-Term Value and Long-Term Growth Potential with a Qualitative Overlay on the entire metric:

Metric	What It Is	Why It's Important
Near-Term Value (50%)	Regulatory submissions and approvals for new medicines and new indications and formulations of key marketed products in the U.S., EU, China and Japan	**Recognizes delivery of the late-stage pipeline**, which drives near-term value
Long-Term Growth Potential (50%)	Development Candidates First in Human Registrational Study Starts	**Recognizes the progression and successes of the R&D pipeline** at various stages of development, including internally and externally-sourced compounds
Qualitative Overlay	Reflects management's, the Science & Technology Committee's (S&T) and the Committee's holistic evaluation of our pipeline performance, including such considerations as the performance of high value assets and the integration of acquired assets, among other factors.	

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Financial and Pipeline Metric Target Setting Considerations

At the beginning of each year, the Committee undertakes an incentive target setting process to establish targets that it believes will motivate our executives appropriately to deliver the high performance that drives shareholder value creation in both the short and longer term.

Financial and strategic performance targets are:

- Predefined;
- Stretch goals that aligned with earnings guidance;
- Tied to the key financial objectives of the company; and
- Aligned with industry benchmarks on speed of commercial launch and expected market adoption.

Pipeline performance targets are:

- Set in collaboration with the Science and Technology Committee (the "S&T Committee");
- Aligned with the company's strategic plan and key value drivers;
- Aligned with industry benchmarks on typical clinical study duration and regulatory approval timelines;
- Separated into two performance categories, "Near-Term Value" and "Long-Term Growth Potential" subject to a qualitative overlay; and
- Reflects annual milestones that link short-term outcomes to long-term strategic R&D priorities (milestones for higher value assets are emphasized in goal setting to provide a framework that assesses not only quantity, but also quality and impact of milestones).

The S&T Committee also identifies those highest value assets and the integration of acquired assets, among other factors, the importance of which will inform the application of a qualitative overlay.

In establishing targets and goals each year, the Committee considers budget, operational priorities, long-term strategic plans, historical performance, product pipeline and external factors, including external expectations, competitive developments, and the regulatory environment, among other things.

The Committee set incentive targets in the first quarter of 2018 in consideration of anticipated performance, in line with guidance provided to the market in early 2018 and in line with commercial and pipeline expectations. Later in the year, we met, or exceeded financial and operational goals in certain key areas, including growth of both revenues and non-GAAP earnings, earlier-than-expected regulatory approvals, important business development activities, and disciplined expense management, resulting in a revision of guidance to the market for the year.

2018 Company Performance Factor Achievements

The table below shows the performance and resulting payout percentage of the performance measures used for our 2018 annual incentive plan:

Performance Measure	Target	Actual	% of Target	Resulting Payout Percentage
Non-GAAP Diluted Earnings Per Share(1)	$ 3.22	$ 3.87	120.2%	152.1%
Total Revenues, Net of Foreign Exchange ($=MM)(1)	$ 21,447	$ 22,564	105.2%	152.17%
Pipeline Score	3	2.5	83.3%	73.26%
Total			107.2%	132.44%

(1) Consistent with the company's past practice, non-GAAP diluted earnings per share and total revenues, net of foreign exchange, were each adjusted $0.11 and $63 million, respectively, due to unanticipated favorable budget variances for *Sprycel* performance in Europe and the impact of tax reform in the U.S. The Committee determined that it was appropriate to exclude the impact of these unanticipated favorable budget variances because these events favorably impacted performance in an amount that was not determinable when the target was set in the first quarter of 2018.

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For the pipeline metric, the S&T Committee reviews our performance in the categories identified above, including a qualitative assessment of results, and determines a performance score using a scale of one to five, with three being target. We did not meet our target goal range, but we advanced a number of important programs and achieved many high value milestones in 2018. From a qualitative perspective, the S&T Committee considered the specific milestones that were achieved and those that were not achieved and determined that no additional qualitative adjustment was required. For 2018, the S&T Committee recommended, and the Committee approved, a pipeline score of 2.5 based on the following results:

Individual Performance Factor

Our executive compensation program is designed to reward executives for financial, operational, strategic, share price and individual performance while demonstrating high integrity and ethical standards. We believe this structure appropriately incentivizes our executives to focus on our long-term business strategy, to achieve our Mission to help patients prevail over serious diseases, and to attain sustained long-term value creation for our shareholders.

When determining individual award levels, the Committee considers (i) individual performance against strategic, financial and operational objectives that support our long-term business strategy and shareholder value creation ("Results") and (ii) an executive's demonstration of the behaviors defined in the BMS Behaviors ("Behaviors") identified in the box to the right.

The Role of Risk Assessment in our Incentive Program

Also embedded in the determination of individual award levels is the ongoing assessment of enterprise risk, including reputational risk stemming from the dynamic external environment. In particular, we evaluate how each of our executives demonstrate our BMS Behaviors in the execution of their day-to-day decisions. This evaluation is one input into the determination of payouts under both the annual incentive and long-term equity incentive programs. Therefore, given the direct link between Behaviors that impact payout and our executive compensation

program's emphasis on sustainable long-term value, we minimize and appropriately reduce the possibility that our executive officers will make excessively or inappropriately risky decisions that could maximize short-term results at the expense of sustainable long-term value creation for our shareholders.

2018 Individual Performance Assessment

When determining the individual component of the annual incentive awards, the Committee considered each executive's contributions to our company's strategic achievements and financial and operational performance as well as his or her demonstration of our BMS Behaviors. The Committee evaluated our NEO's performance against clear and pre-defined objectives established at the beginning of the year and tied to the company's key strategic objectives.

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For the CEO, the Committee evaluated the following in determining his individual performance modifier:

2018 CEO PERFORMANCE EVALUATION

STRATEGIC OBJECTIVE	EVALUATION
Drive enterprise performance: Achieve budgeted financial targets established at the beginning of the year, including revenues, non-GAAP EPS and operating margin, and increase competitiveness as a diversified Specialty BioPharma company, including ensuring supply chain reliability, achieving predefined customer service metrics for all products and accelerating strategic plan deliverables. Execute on-time completion of 2018 deliverables against company transformation plan.	Exceeded target for revenues, operating margin and non-GAAP EPS, as a result of strong commercial execution.
	Exceeded all customer service metrics.
	Met target for supply chain reliability and manufacturing capacity and achieved 100% of the target enterprise supply chain transformation.
	Completed 54 transactions in furtherance of strategic plan, including strategic partnerships with Nektar and Janssen, translational medicines partnerships and an agreement to divest the UPSA business, among others, and positioned the Company to announce an agreement to acquire Celgene on January 3, 2019.
	Significant progress on transformation deliverables, exceeding savings goal in 2018; plan remains on track.
Enhance the value of the portfolio and diversify for long-term growth: Maximize portfolio value of brands/assets and advance pipeline portfolio, including through combinations, next-generation agents and innovating delivery solutions. Achieve budgeted revenue targets for core products, key product approvals, regulatory submissions, regulatory study starts, and other key pipeline milestones.	Exceeded revenue targets for *Opdivo*, *Yervoy and Eliquis* and grew net sales of prioritized brands compared to 2017.
	Exceeded or met U.S. new patient share objectives, including *Opdivo* in second-line lung cancer, first- and second-line kidney cancer, and adjuvant melanoma, among other indications.
	Additional indications approved for *Opdivo*, including first-line kidney cancer in the U.S. and Japan and a positive opinion by an advisory board to the European Medicines Agency in the EU; adjuvant melanoma in the EU and Japan; and second-line non-small cell lung cancer in China.

	Orencia approved for juvenile idiopathic arthritis in Japan
	Overall pipeline performance and key pipeline milestones are described in more detail on page 43.
Evolve our culture and execute our People Strategy: Continue to deepen employee engagement, cultivate great managers and leaders, and build talent, delivering measureable improvements in key areas of focus, including, among others, diversity and inclusion, and continuing to set a firm "tone at the top" on a culture of business integrity and ethics and compliance.	Continued comprehensive approach to deepen engagement of global leadership team and cultivate great managers.
	New performance management approach implemented, with survey results showing significant year over year improvement in employee engagement and articulated development goals.
	Continued to reinforce integrity and ethics in all key employee communications, and updated Principles of Integrity.
	Progress made on diversity and inclusion with representation of women globally and underrepresented ethnic groups in the U.S.
	Successfully managed succession for certain key roles and continued robust management development and succession planning for critical positions.

Individual Performance Modifier Based on CMDC Evaluation: **125%**

In addition, the Committee noted the following with respect to each of our other NEOs:

For Mr. Bancroft, the Committee considered: (i) his significant leadership in the achievement of strong operational results, including Total Revenues increasing by 9% and GAAP and non-GAAP EPS increasing by 393% and 32% respectively, maintaining a strong balance sheet, and optimized U.S. tax reform impacts, with significant impact on our effective tax rate; (ii) critical support of key business development activities, both divesting non-core assets and supplementing our innovative pipeline, including a collaboration with Janssen (JNJ) for our Factor Xla inhibitor program (for treatment of major thrombotic conditions), the announced sale of the company's UPSA consumer health business to Taisho Pharmaceutical Holdings Co., Ltd., and other research and clinical collaborations with entities such as, Boston Medical, Eisai Co., Ltd., Vedanta Biosciences, and Infinity Pharmaceuticals, Inc.; (iii) his critical advice and guidance in connection with the acquisition of Celgene; and (iv) his continued leadership in driving the evolution of our operating model while ensuring a balanced approach to capital allocation and returning capital to shareholders in dividends.

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For Dr. Lynch, the Committee considered: (i) Dr. Lynch's leadership of our R&D organization by strengthening capabilities in our Translational Medicine, Medical, Global Clinical Operations and Quality organizations through key leadership appointments; (ii) pipeline performance namely (a) 23 regulatory submissions and approvals, (b) approval of *Opdivo* combination with *Yervoy* for first-line kidney cancer in U.S., (c) approval of *Opdivo* for adjuvant melanoma in EU and Japan, as well as for lung cancer in China, and (d) 25 pipeline projects meeting transitions milestones, and achieving high value milestones such as the registrational study start for TYK2 inhibitor, first-in-human for LPA1 and NLRP3, among others; (iii) his critical advice and guidance in connection with the acquisition of Celgene; (iv) his leadership in driving the evolution of our operating model within the R&D organization; and (v) his continued partnership with our commercial and global manufacturing organizations, which has resulted in increasingly seamless transitions.

For Ms. Leung, the Committee considered: (i) her role in providing consistently sound legal advice to senior management and the Board of Directors; (ii) her leadership in enforcing and enhancing our immuno-oncology intellectual property position; (iii) her leadership in obtaining significant royalties from competitors; (iv) her successful management of multiple, significant legal issues across all teams and functions, including among others, successful execution of robust commercial defense, intellectual property and patent strategies; (v) her role in supporting multiple business development transactions, including innovative partnerships and worldwide licensing agreements, as well as providing critical advice and guidance on the evaluation, negotiation and signing of the acquisition of Celgene; (vi) her contributions and performance as a trusted and respected senior leader who provides valuable strategic advice and whose impact spans across all teams and functions; and (vii) her strong advocacy and sponsorship of diversity and inclusion both internally and externally.

For Mr. Schmukler, the Committee considered: (i) strong operational performance in our Global Product Development and Supply organization, including exceeding important metrics such as gross inventory and CapEx; (ii) strong achievement against customer service metrics at a time of increased commercial growth; (iii) achieving key development pipeline milestones and reducing cycle time; (iv) his critical advice and guidance in connection with the acquisition of Celgene; (v) his focus on the on-going development and succession planning of talent; and (vi) his strong advocacy for diversity and inclusion, including his executive sponsorship of the Veterans Community Network (VCN), our people and business resource group focused on the development and advancement of U.S. veterans.

2018 Annual Incentive Awards

The actual annual incentive awards paid to our Named Executive Officers are shown in the table below and can also be found in the Summary Compensation Table under the Non-Equity Incentive Plan Compensation column:

Executive	Target Incentive Award	Applying Company Performance Factor(1)	Actual Payout(2)
Giovanni Caforio, M.D.	$ 2,456,250	$ 3,253,058	$ 4,066,322
Charles Bancroft	$ 1,232,655	$ 1,632,528	$ 2,203,913
Thomas J. Lynch, Jr., M.D.	$ 1,227,000	$ 1,625,039	$ 1,625,039
Sandra Leung	$ 975,861	$ 1,292,430	$ 1,680,159
Louis Schmukler	$ 643,680	$ 852,490	$ 1,065,613

(1) Adjusted to reflect Company Performance Factor (financial and pipeline performance) earned at 132.44%.

(2) Adjusted to reflect individual performance.

As set forth in the table above, the Company Performance Factor of 132.44% was applied to each Named Executive Officer's target incentive award. Then, an individual performance payout factor was applied to determine the actual payout. The Committee can approve an Individual Performance Factor up to 165% of the adjusted incentive, subject to 200% of target maximum payout. Based on the performance highlighted the Committee approved Individual Performance Factors ranging between 100% and 135% for our Named Executive Officers.

Long-Term Incentive Program

Like our annual incentive plan, our long-term equity incentive program is designed to reward performance that supports our strategic objectives and creates value for our shareholders. A significant percentage of our Named Executive Officers' compensation is in the form of equity that vests over several years, which is designed to closely tie the interests of our Named Executives Officers' to the interests of our shareholders. Our long-term equity incentive program also is designed to promote retention through multi-year vesting.

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In 2018, we continued to offer two long-term award vehicles, each of which served a different purpose:

Performance Share Unit Awards: rewards the achievement of key financial goals and the value created for shareholders as measured by relative TSR over a three-year period ending in the first quarter of the applicable year.

Market Share Unit Awards: rewards the creation of incremental shareholder value over a long-term period.

We believe our long-term equity incentive program serves the best interests of our shareholders by focusing the efforts of our executives on key drivers of both short and long-term success and on shareholder value. Key aspects of the long-term equity incentive program include:

100% of executives' long-term equity incentive awards are performance-based;

The design of our long-term equity incentive program applies to all our executives, not just our most senior, thus promoting organizational alignment with our recruitment and business strategy; and

Our long-term equity incentive program serves as a retention lever, through vesting and payout over several years.

2018 Equity Incentive Program Summary

Proportion of Annual Grant	60%	40%
Metrics & Weighting	Non-GAAP Operating Margin: 33% Total Revenues (ex-fx): 33% 3-Year Relative TSR: 34%	Share Price Performance
Min / Max Payout (% of Target Units)	0% / 200%	0% / 200%*
Vesting	3-year, cliff vesting	4-year, ratable vesting

** The number of shares earned from Market Share Units (MSUs) can increase or decrease, in proportion to the change in our share price over the one-, two-, three and four-year performance periods. The minimum share price achievement required to earn any shares from MSUs is 60% of the grant date stock price. Accordingly, if 60% is not achieved, zero shares will vest.*

Our Long-term Incentive Program Design Promotes the Creation of Sustainable Long-term Value for Shareholders

Our overall philosophy to create sustainable shareholder value is primarily focused on strong year-to-year financial and operational performance and on the development and advancement of our pipeline over the long-term. Additionally, as noted, our long-term equity incentive program is tied directly to our stock price performance to closely align the interest of our executives with the interests of our shareholders. Namely, 100% of our executives' long-term equity incentive awards are performance based, which results in a significant portion of their total compensation being tied to our stock price performance and the creation of value for our shareholders.

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In addition, the design of our long-term equity incentive program generally magnifies the impact of changes in our stock price and relative TSR performance. When our stock price declines, the value of MSU awards decreases in two ways: (i) the number of shares earned goes down in proportion to the change in stock price and (ii) the value of those shares is less because of the lower stock price. Similarly, the value of PSU awards decreases in two ways: (i) the relative TSR metric reduces the number of shares earned (assuming our stock price declines more than our peers) and (ii) the value of those shares is also less.

Target values of performance share units and market share units reflect target number of units granted in 2018 using BMS' stock price of $67.92 on the date of grant.

Realizable value of performance share units reflects number of units expected to vest based on actual relative TSR performance as of 12/31/18 for the 34% of the award that vests based on relative TSR (i.e., 0% of the target number of units). For the remaining 66% of the award, realizable value reflects target number of shares.

Realizable value of market share units reflects number of units expected to vest based on BMS' 10-day average stock price on 12/31/18 (i.e., 75.63% of the target number of units).

Realizable values of both performance share units and market share units reflect BMS' stock price of $51.98 on 12/31/18 a 47% decline from the grant date value versus a 22% decline in TSR over the same period.

2018 Performance Share Unit Awards

Following extensive engagement with shareholders and an in-depth review of our compensation program in the context of our strategic goals and product portfolio, the Committee made a number of changes to the PSU program that became effective in 2016, with the first three-year performance cycle under the new design scheduled to be paid, if earned, in 2019. The key elements of the re-design are:

Three-year performance period of financial measures; and	
Financial performance measures that create alignment with our strategic goals. Specifically, total revenues (ex-fx), cumulative non-GAAP operating margin, and relative TSR expressed as a percentile rank relative to our peer group. TSR performance must be at median for target shares to be earned.	

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For PSUs awarded in 2018, the structure of our 2018 financial metrics and three-year relative TSR modifier in our PSU program are detailed below.

	2018-2020 Cumulative Operating Margin (33%)		2018-2020 Cumulative Total Revenues (ex-fx) (33%)		3-Year Relative TSR (34%)	
	Achievement	Payout	Achievement	Payout	TSR Percentile	Payout
Maximum	115%	200%	110%	200%	80%ile	200%
Target	100%	100%	100%	100%	50%ile	100%
Threshold	85%	50%	90%	50%	35%ile	50%
Below Threshold	<85%	0%	<90%	0%	<35%ile	0%

Market Share Unit Awards

MSUs comprise 40% of our executives' target long-term equity incentives. Each grant of MSUs vests 25% on each of the first four anniversaries of the grant date and the number of shares received by an executive upon payout is increased or decreased depending on the performance of our stock price during the one-, two-, three- and four-year performance periods.

Upon vesting, a payout factor is applied to the target number of MSUs vesting on a given date to determine the total number of units paid out. If our stock price increases during the performance period, both the number of units and value of shares that vest increases. If our stock price declines during the performance period, both the number of units and value of shares that are eligible to vest will be reduced. The payout factor is a ratio of the ten-day average closing price on the measurement date divided by the ten-day average closing price on the grant date. Beginning with our 2013 annual MSU award grant, the measurement date is the February 28 immediately preceding the vesting date. The minimum payout performance factor that must be achieved to earn any payout is 60% and the maximum payout factor is 200%. If our stock price performance is below 60%, then the portion of the award scheduled to vest will be forfeited. The following chart shows the performance periods for the MSU awards granted to our executives in March 2018:

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Performance Results

The following table summarizes the payout factors relating to the tranches that vested in the first half of 2018 for MSU awards outstanding at that time:

Grant Date	Vesting Date	# of Years in Performance Period	Payout Factor
March 10, 2014	March 10, 2018	4	122.71%
March 10, 2015	March 10, 2018	3	105.83%
May 5, 2015*	May 5, 2018	3	79.57%
March 10, 2016	March 10, 2018	2	104.26%
March 10, 2017	March 10, 2018	1	117.92%
April 3, 2017**	April 3, 2018	1	115.63%

*Reflects CEO grant on promotion to CEO.
**Reflects grant to Dr. Lynch on hire as Chief Scientific Officer.

Restricted Stock Units and Stock Options

Restricted stock units may be granted selectively to executives at other times of the year generally as inducement grants as part of an offer in attracting candidates to BMS, for retaining employees, or for providing special recognition, such as when an employee assumes significant increases in responsibility. During 2018, no special restricted stock unit awards were granted to any of our Named Executive Officers. We have not granted any stock options to our executives since 2009.

Process for Annual Equity Award Grants

Annual equity awards are typically approved on the date the Committee and full Board meet during the first week of March with a grant effective date of March 10. We believe that consistent timing of equity award grants is good corporate governance and reduces the risk of selecting a grant date with a preferential stock price.

Since March 2014, the Committee has established annual equity award guidelines for all executives at the company, including our Named Executive Officers other than the CEO, as a percentage of salary. The CEO's long-term equity incentive award level is assessed by the Committee annually.

Based upon individual performance, an executive other than the CEO may receive a long-term equity incentive award ranging from 0% to 150% of the target award. Once the grant value is established for each executive, 60% of the value is converted into PSUs and 40% into MSUs.

In determining the size of the individual long-term equity incentive awards granted to our Named Executive Officers in March 2018, the Committee considered the prior year's performance (both Results and Behaviors) of each executive as well as ways to motivate our Named Executive Officers to focus on the company's long-term performance over the next three years and beyond. Each Named Executive Officer, other than the CEO, had a target value for their long-term equity incentive award granted in March 2018. The Committee approved individual awards ranging between 125% and 135% of the target value for these Named Executive Officers. The CEO's long-term equity incentive award is not based on a target value and is determined annually by the Committee based on competitive benchmarks and individual performance and contributions. Dr. Caforio's award took into account his strong performance as CEO during 2017 and a long-term equity incentive opportunity that was commensurate with his role as CEO and the competitive market pay for that position.

Other Elements of 2018 Compensation

In addition to the components set forth above, our senior executives, including all of our Named Executive Officers, were entitled to participate in the following plans or arrangements in 2018:

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Other Elements of 2018 NEO Compensation

- Post-Employment Benefits
  - Change-in-Control- Arrangements
  - Severance Plan
  - Qualified and Non-Qualified- Pension Plans (Frozen; applicable only to Mr. Bancroft and Ms. Leung. In October of 2018, the Committee approved termination of the qualified Pension Plan, effective February 1, 2019)
  - Qualified and Non-Qualified Savings Plans
- Other Compensation

Post-Employment Benefits

We offer certain plans which provide compensation and benefits to employees who have terminated their employment. These plans are periodically reviewed by the Committee to ensure that they are consistent with competitive practice. The plans offered are common within our primary peer group and enhance our ability to attract and retain key talent.

Change-in-Control Arrangements

We have entered into change-in-control agreements with certain executives including the CEO and other Named Executive Officers. These agreements enable management to evaluate and support potential transactions that might be beneficial to shareholders even though the result would be a change-in-control of BMS. Additionally, the agreements provide for continuity of management in the event of a change-in-control. Our agreements require a "double-trigger" before any payments are made to an executive. This means that payments are only made in the event of a change-in-control and subsequent involuntary termination or termination for good reason of the employee within either 36 months or 24 months after a change-in-control.

We do not gross up compensation on excess parachute payments for any of our executives, including all of our Named Executive Officers.

If a change-in-control occurs during the term of the agreement, the agreement will continue in effect for either 36 months or 24 months beyond the month in which such change-in-control occurred, as applicable. The value of this benefit for our Named Executive Officers is provided in the "Post-Termination Benefits" section beginning on page 61.

Severance Plan

The Bristol-Myers Squibb Senior Executive Severance Plan provides a competitive level of severance protection for certain senior executives (including the Named Executive Officers) to help us attract and retain key talent necessary to run our company. The value of this benefit for our Named Executive Officers is shown in the "Post-Termination Benefits" section beginning on page 61.

Defined Benefit Pension Plans

Our frozen defined benefit pension plans provide retirement income for U.S. employees who joined the company and were U.S. employees prior to December 31, 2009 following their retirement. The Retirement Income Plan is a tax-qualified plan, as defined under IRS regulations, and the Benefit Equalization Plan relating to the Retirement Income Plan is a non-qualified plan that provides pension benefits above those allowed under the contribution limits for tax-qualified plans. The Summary Compensation Table reflects the annual increase in the actuarial value of these benefits. Current accrued benefits for each of the participating Named Executive Officers are provided in the Pension Benefit Table. As of December 31, 2009, we discontinued service accruals under our qualified and nonqualified pension plans in the U.S. and Puerto Rico for active plan participants, including all of our Named Executive Officers, and closed the plans to new participants. For active plan participants at year-end 2009, we allowed five additional years of pay growth in our pension plans. Accordingly, 2014 was the last year of pay growth under our pension plans. These actions were taken to align our retirement program with our new biopharmaceutical business strategy and

culture, to mitigate volatility risk to the company, to respond to the competitiveness of a changing industry, and meet the mobility and career expectations of an evolving workforce. In December 2018, the Company announced it will terminate the U.S. Retirement Income Plan ("US-RIP") in 2019 and transfer $3.8 billion of U.S.

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pension obligations through a full termination of its U.S. Retirement Income Plan (the "Plan"). The obligations will be distributed through a combination of lump sums to Plan participants who elect such payments, and the purchase of a group annuity contract from Athene Annuity and Life Company, a wholly-owned insurance subsidiary of Athene Holding, Ltd, for all remaining liabilities. For a further discussion on the termination of the US-RIP, please see "Retirement Plan" beginning on page 58.

Savings Plans

Our savings plans allow U.S. employees to defer a portion of their total eligible cash compensation and to receive matching contributions from BMS to supplement their savings and retirement income. The Savings and Investment Program is a tax-qualified 401(k) plan, as defined under IRS regulations, and the Benefit Equalization Plan for the Savings and Investment Program is a nonqualified deferred compensation plan that allows a select group of management and highly compensated employees to defer a portion of their total eligible cash compensation and to receive matching contributions from BMS in excess of the contributions allowed under the Savings and Investment Program. The savings plans are designed to allow employees to accumulate savings for retirement on a tax-advantaged basis. The company matching contribution under our savings plans equals 100% of the employee's contribution on the first 6% of eligible compensation that an employee elects to contribute. Employees are eligible for an additional automatic company contribution that is based on a point system of an employee's age plus service as follows: below 40 points, the automatic contribution is an additional 3% of total cash; between 40 and 59 points, the contribution is 4.5%; and at 60 points and above, the contribution is 6%. For those employees with 60 or more points who had 10 or more years of service at year-end 2009, we provided an additional automatic contribution of 2% for a five-year period. Accordingly, 2014 was the last year for this additional 2% automatic contribution for this group. As of December 31, 2009, Mr. Bancroft and Ms. Leung had earned over 60 points and had more than ten years of service. All U.S. employees are eligible to participate in the Savings Plan. The Summary Compensation Table reflects company contributions to these plans during 2018 in the "All Other Compensation" column. The Non-Qualified Deferred Compensation Table provides more detail on the Benefit Equalization Plan for the Savings and Investment Program.

Other Compensation

We generally do not provide perquisites or other personal benefits to our Named Executive Officers that are not otherwise available to all salaried employees. However, in 2018, our Named Executive Officers were provided benefits intended for business purposes that were in addition to the benefits offered to all salaried employees. In certain exigent circumstances, these benefits were used for personal use, which then became part of the Named Executive Officer's total compensation and treated as taxable income under the applicable tax laws. We did not reimburse the Named Executive Officers for any taxes paid on such income. Additionally, all perquisites for each of our Named Executive Officers during 2018 did not exceed $10,000; therefore, "All Other Compensation" for 2018 does not include disclosure of any perquisite amounts as permitted under SEC rules.

Our Compensation Program Design Process

Compensation and Management Development Committee

The Committee is responsible for providing oversight of our executive compensation program for the Named Executive Officers as well as other members of senior management. The Committee is responsible for setting the compensation of the Chief Executive Officer and approving the compensation of all of the other Named Executive Officers and certain other members of senior management.

The Committee annually reviews and evaluates the executive compensation program to ensure that the program is aligned with our compensation philosophy and with our performance. See page 25 for a discussion of the duties and responsibilities of the Committee in more detail.

Independent Compensation Consultant

The Committee has retained Compensation Advisory Partners, LLC (CAP) on an annual basis as its independent compensation consultant to provide executive compensation services to the Committee. CAP reports directly to the Committee, and the Committee directly oversees the fees paid for services provided by CAP. The Committee instructs CAP to give advice to the Committee independent of management and to provide such advice for the benefit of our company and shareholders. CAP does not provide any consulting services to BMS beyond its role as consultant to the Committee.

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In 2018, CAP provided the following services:

- reviewed and advised on the composition of the peer group used for competitive benchmarking;
- participated in the review of our executive compensation program;
- provided an assessment of BMS senior executive pay levels and practices relative to peers and other competitive market data;
- provided an annual analysis of industry trends among the peers and best practices related to pay program design and other program elements;
- reviewed and advised on all materials provided to the Committee for discussion and approval; and
- attended all of the Committee's regularly-scheduled meetings in 2018 at the request of the Committee, and also met with chairman without management present.

The Committee reviews the independence of CAP annually in accordance with its charter, applicable SEC rules and NYSE listing requirements. After review and consultation with CAP, the Committee has determined that CAP is independent, and there is no conflict of interest resulting from retaining CAP currently or during the year ended December 31, 2018.

Role of Company Management

The CEO makes recommendations to the Committee concerning the compensation of Named Executive Officers other than the CEO, as well as other members of senior management. In addition, the CEO, CFO and, in the case of our pipeline performance metric, the Chief Scientific Officer, are involved in recommending for the Committee's approval the performance goals for the annual and long-term incentive plans, as applicable. The Chief Human Resources Officer works closely with the Committee, its independent compensation consultant and management to (i) ensure that the Committee is provided with the appropriate information to make its decisions, (ii) propose recommendations for Committee consideration, and (iii) communicate those decisions to management for implementation.

Executive Compensation Governance Practices

Share Ownership and Retention Policy

In order to preserve the link between the interests of our Named Executive Officers and those of shareholders, executives are expected to use the shares acquired upon the vesting of (i) restricted stock unit awards, if any, (ii) market share unit awards and (iii) performance share unit awards, after satisfying the applicable taxes, to establish and maintain a significant level of direct ownership. This same expectation applies to shares acquired upon the exercise of their previously granted stock options. We continue to maintain long-standing share ownership expectations for our senior executives. Our current Named Executive Officers must comply with the following ownership and retention requirements:

Stock Ownership	Share Retention Policy applied to all shares acquired, net of	2018 Compliance

Executive	Guideline as a Multiple of Salary	taxes Prior to Achieving Guideline	After Achieving Guideline	with Share Ownership and Retention Policy
Giovanni Caforio, M.D.	6 x	100%	75% for 1 year	Yes
Charles Bancroft	3 x	100%	75% for 1 year	Yes
Thomas J. Lynch, Jr., M.D.	3 x	100%	75% for 1 year	Yes
Sandra Leung	3 x	100%	75% for 1 year	Yes
Louis Schmukler	2 x	100%	75% for 1 year	Yes

Recoupment of Compensation

We maintain clawback provisions relating to stock options, restricted stock units, performance share units and market share units. Under these clawback provisions, executives that violate noncompetition or non-solicitation agreements, or otherwise act in a manner detrimental to our interests, forfeit any outstanding awards, as of the date such violation is discovered and have to return any gains realized in the twelve months prior to the violation. These

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provisions serve to protect our intellectual property and human capital, and help ensure that executives act in the best interest of BMS and our shareholders.

In 2005, the Board adopted a policy wherein the Board will seek reimbursement of annual incentive awards paid to an executive if such executive engaged in misconduct that caused or partially caused a restatement of financial results. In such an event, we will seek to claw back the executive's entire annual incentive for the relevant period, plus a reasonable rate of interest. This policy may be viewed on our website at www.bms.com.

In December 2012, the Board adopted a policy that BMS will seek recoupment of any incentive and/or other compensation paid to executives and certain other employees where:

- the executive or other employee engaged in misconduct, or failed to appropriately supervise an employee who engaged in misconduct, that resulted in a material violation of a BMS policy relating to the research, development, manufacturing, sales or marketing of pharmaceutical products; and

- the Committee determines that this material violation of a BMS policy resulted in a significant negative impact on our results of operations or market capitalization.

In any instance where the employee misconduct occurred in a prior year, the Committee may elect to reduce a current or future incentive and/or other compensation award in lieu of requiring reimbursement of past compensation previously paid to such executive or other employee. This policy may be viewed on our website at www.bms.com.

Equity Grant Policy

The Committee's policy covering equity grants for the Named Executive Officers is as follows:

Approval of Awards

Awards granted to the CEO must be approved by the Committee and recommended by the Committee to, and approved by at least 75% of, the independent directors of the Board.

The Committee must approve awards to all Named Executive Officers.

Grant Effective Date

Annual Awards

Our regularly scheduled annual equity awards are approved on the date the Committee and full Board meet during the first week of March with a grant effective date of March 10.

All Other Awards

For awards granted to current employees at any other time during the year, the grant effective date is the first business day of the month following the approval date, except that if the approval date falls on the first business day of a given month, the grant effective date is the approval date.

For awards granted to new hires, the grant effective date is the first business day of the month following the employee's hire date, except that if the employee's hire date falls on the first business day of a given month, the grant effective date is the employee's hire date.

In no case whatsoever will the grant effective date precede the approval date of a given award.

Grant Price

The grant price of awards is a ten-day average closing price (i.e., an average of the closing price on the grant date plus the nine prior trading days). For stock options that may be granted under special circumstances (none have been granted since 2009), the grant price will be the closing price on the date of grant.

Policy Against the Repricing of Stock Options

We have always maintained a consistent policy against the repricing of stock options. We believe this is a critical element in maintaining the integrity of the equity compensation program and ensuring alignment of senior executives' interests with the interests of shareholders. The Board of Directors has adopted a formal policy prohibiting

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the repricing of stock options. This policy may be viewed on our website at www.bms.com. As noted, we have not granted any stock options to our executives since 2009.

Policy Regarding Shareholder Approval of Severance

The Board has approved a policy that requires shareholder approval of any future agreements that provide for cash severance payments in excess of 2.99 times the sum of an executive's base salary plus annual incentive award. "Cash severance payments" exclude accrued incentive payments, the value of equity acceleration, benefits continuation or the increase in retirement benefits triggered by severance provisions or tax gross-up payments. This policy may be viewed on our website at www.bms.com.

Risk Assessment of Executive Compensation

The Committee annually reviews the compensation programs from a risk perspective. Based on that review of our executive compensation arrangements as detailed beginning on page 21, the Committee believes that our compensation program does not encourage executives to take excessive or inappropriate risks that could maximize short-term results at the expense of sustainable long-term value creation that may harm shareholder value. Our compensation program achieves this by striking an appropriate balance between short-term and long-term incentives, using a diversity of metrics to assess performance and payout under our incentive programs, placing caps on our incentive award payout opportunities, following equity grant practices that limit potential for timing awards and having stock ownership and retention requirements. For example, our current long-term equity incentive program (60% performance share units (PSUs) and 40% market share units (MSUs)) incorporates the company's stock price into its performance measures and generally magnifies the impact of changes in our stock price as well as relative total shareholder return (TSR) performance over the mid and longer-term. Also embedded in the Committee's annual review is the ongoing assessment of enterprise risk, including reputational risks stemming from the dynamic external environment. In addition, we evaluate the performance of each of our executives based on a number of factors, including how they demonstrate our BMS Behaviors in the execution of their day-to-day decisions. Those behaviors include, among others, accountability. This evaluation is one input into the determination of payouts under both the annual incentive and long-term equity incentive programs. Therefore, given the direct link between payout and our executive compensation program's emphasis on sustainable long-term value, we minimize and appropriately reduce the possibility that our executive officers will make excessively or inappropriately risky decisions that could maximize short-term results at the expense of sustainable long-term value creation for our shareholders.

Tax Implications of Executive Compensation Program

Section 162(m) of the Internal Revenue Code includes general limits on the deductibility of compensation in excess of $1 million paid to our Named Executive Officers. Based on changes implemented to Section 162(m), all compensation paid or awarded in 2018 to our Named Executive Officers will be subject to this limitation. To the extent that compensation paid or awarded in 2018 to our Named Executive Officers exceeds $1 million in the aggregate, we will not be able to deduct such excess for federal income tax purposes.

Compensation and Management Development Committee Report

The Compensation and Management Development Committee of Bristol-Myers Squibb Company has reviewed and discussed with management the "Compensation Discussion and Analysis" on pages 33 to 54 of this Proxy Statement as required under Item 402(b) of Regulation SK. Based on its review and discussions with management, the Committee recommended to the full Board that the Compensation Discussion and Analysis be included in this Proxy Statement.

Compensation and Management Development Committee

Michael Grobstein, Chair
Peter J. Arduini
Mathew W. Emmens
Dinesh C. Paliwal
Gerald L. Storch

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Summary Compensation Table

The following tables and notes present the compensation provided to Giovanni Caforio, M.D., Chairman of the Board and Chief Executive Officer, Charles A. Bancroft, Chief Financial Officer and Executive Vice President, Head of Global Business Operations and the three other most highly compensated Executive Officers.

Summary Compensation Table
for Fiscal Years Ended December 31, 2018, 2017, and 2016

					Change in Pension Value and Non-Qualified Deferred Compensation Earnings		
		Bonus (3)	Stock Awards (4)	Non-Equity Incentive Plan Compensation (5)		All Other Compensation (7)	
		0	$ 13,011,542	$ 4,066,322	$ 0	$ 664,391	
		0	$ 12,650,528	$ 3,899,094	$ 0	$ 550,001	
		0	$ 11,823,808	$ 2,995,839	$ 0	$ 601,134	
		0	$ 4,313,576	$ 2,203,913	$ 0	$ 349,706	
		0	$ 4,321,014	$ 1,887,005	$ 1,307,641	$ 303,354	
		0	$ 4,013,210	$ 1,530,654	$ 110,329	$ 351,385	
		0	$ 4,075,218	$ 1,625,039	$ 0	$ 311,366	
		00,000	$ 4,425,587	$ 1,576,706	$ 0	$ 113,522	
		0	$ 3,290,794	$ 1,680,159	$ 0	$ 296,370	
		0	$ 3,047,660	$ 1,493,890	$ 794,983	$ 259,448	
		0	$ 2,883,253	$ 1,214,632	$ 103,886	$ 320,085	

As of , 2007, the last reported sales price of DMGI s common stock on the Nasdaq
number of holders of record was . Because many of DMGI s shares of common stoc
behalf of stockholders, DMGI is unable to estimate the total number of stockholders represe

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SUBMISSION OF FUTURE DMGI STOCKHOLDER

Management of DMGI knows of no other matters which may be brought before the special s
proposed merger or related matters should properly come before the special meeting, howev
vote proxies in accordance with their judgment on those matters.

Under Delaware law, only business stated in the notice of special meeting may be transacted

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WHERE YOU CAN FIND MORE INFORMA

DMGI is subject to the informational requirements of the Securities Exchange Act of 1934, any proxy statements and other information with the SEC. You can read any reports, statem SEC over the Internet at the SEC web site at http://www.sec.gov. You may also read and co public reference facility at 450 Fifth Street, N.W., Washington, D.C. 20549. You may also o by writing to the Public Reference Section of the SEC at 450 Fifth Street, N.W., Washingto 1-800-SEC-0330 for further information on the operation of the public reference facilities.

DMGI has not authorized anyone to provide you with information that differs from that con statement is dated , 2007. You should not assume that the information contained in t other than that date, and neither the mailing of this proxy statement to DMGI stockholders n in the merger shall create any implication to the contrary. This proxy statement does not con to buy, any securities, or the solicitation of a proxy, in any jurisdiction to or from any perso or solicitation in such jurisdiction. Neither the delivery of this proxy statement nor any distri any circumstances, create an implication that there has been no change in the affairs of DM herein is correct as of any time subsequent to its date.

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DIGITAL MUSIC GROUP, INC.

REPORT OF INDEPENDENT REGISTERED PUBLIC AC

To the Board of Directors

Digital Music Group, Inc.

Sacramento, California

We have audited the consolidated balance sheet of Digital Music Group, Inc. and subsidiary 2005, and the related consolidated statements of operations, changes in shareholders equity period ended December 31, 2006 and for the period from February 26, 2004 (Inception) to D statements are the responsibility of the Company s management. Our responsibility is to ex statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounti standards require that we plan and perform the audits to obtain reasonable assurance about w material misstatement. An audit includes examining, on a test basis, evidence supporting the statements. An audit also includes assessing the accounting principles used and significant e evaluating the overall financial statement presentation. We believe that our audits provide a

In our opinion, the consolidated financial statements referred to above present fairly, in all m position of Digital Music Group, Inc. and subsidiary as of December 31, 2006 and 2005, and their cash flows for each of the two years in the period ended December 31, 2006 and for the December 31, 2004, in conformity with accounting principles generally accepted in the Unit

/s/ Perry-Smith LLP

Sacramento, California

March 29, 2007

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DIGITAL MUSIC GROUP, INC.

CONSOLIDATED BALANCE SHEETS

Assets	
Current assets:	
Cash and cash equivalents	
Accounts receivable	
Current portion of royalty advances	
Prepaid expenses and other current assets	
Total current assets	
Furniture and equipment, net	
Digital rights, net	
Master recordings, net	
Royalty advances, less current portion	
Goodwill	
Other assets	
Total assets	
Liabilities and Stockholders Equity	
Current liabilities:	
Accounts payable	
Accrued liabilities	
Royalties payable	
Accrued compensation and benefits	
Current portion of capital lease obligations	
Total current liabilities	
Capital lease obligations, less current portion	
Other long-term liabilities	
Total liabilities	
Commitments and contingencies	
Stockholders equity:	
Preferred stock, $.01 par value, 1,000,000 shares authorized: none issued and outstanding	
Common stock, $.01 par value, 30,000,000 shares authorized: 9,034,941 and 2,249,941 shar outstanding at December 31, 2006 and 2005	
Additional paid-in capital	
Subscriptions receivable	
Accumulated deficit	
Total stockholders equity	
Total liabilities and stockholders equity	

The accompanying notes are an integral part of these consolidate

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DIGITAL MUSIC GROUP, INC.

CONSOLIDATED STATEMENTS OF OPERA

	Year
	2006
Revenue	$ 5,564,9
Cost of revenue:	
Royalties and payments to content owners	3,329,6
Amortization of digital rights and master recordings	422,4
Write-down of non-productive assets	
Gross profit	1,812,7
Operating, general and administrative expenses	5,655,1
Loss from operations	(3,842,3
Interest income	1,251,3
Interest expense	(13,6
Other income (expense), net	(16,9
Loss before income taxes	(2,621,6
Income taxes	(8
Net loss	$ (2,622,4
Net loss per common share basic and diluted	$ (0
Weighted average common shares outstanding basic and diluted	8,071,3

The accompanying notes are an integral part of these consolidate

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DIGITAL MUSIC GROUP, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLI

For the period from February 26, 2004 (Inception) to De

	Common Stock		Additional Paid-in
	Shares	Amount	Capital
Shares owned by founders and investors in Digital Musicworks International, Inc. (inception on February 26, 2004)	2,249,941	$ 22,500	$ 4,630,706
Cash received upon issuance of equity securities by Digital Musicworks International, Inc.			
Stock-based compensation related to stock options and warrants issued to employees and consultants			1,281
Digital rights received in exchange for equity securities of Digital Musicworks International, Inc.			
Net loss for the period from February 26, 2004 (Inception) to December 31, 2004			
Balances, December 31, 2004	2,249,941	22,500	4,631,987
Stock-based compensation related to stock options and warrants issued to employees and consultants			8,304
Cash received upon issuance of equity securities by Digital Musicworks International, Inc.			
Net loss for the year ended December 31, 2005			
Balances, December 31, 2005	2,249,941	22,500	4,640,291
Merger with Digital Music Group, Inc. by the accounting acquiror, Digital Musicworks International, Inc.	2,425,000	24,250	(97,555)
Issuance of common stock in connection with acquisition of Rio Bravo Entertainment LLC digital rights	25,000	250	243,500
Cash received upon issuance of equity securities by Digital Musicworks International, Inc.			
Issuance of common stock in connection with initial public offering, net of cash offering costs of $4,792,397	3,900,000	39,000	33,193,603
Issuance of common stock in connection with acquisition of Digital Rights Agency, LLC	420,000	4,200	1,831,950
Stock-based compensation related to stock options and restricted stock issued to employees	15,000	150	326,495
Net loss for the year ended December 31, 2006			
Balances, December 31, 2006	9,034,941	$ 90,350	$ 40,138,284

The accompanying notes are an integral part of these consolidate

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DIGITAL MUSIC GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH

Cash flows from operating activities:	
Net loss	$
Adjustments to reconcile net loss to net cash used in operating activities:	
Non-cash charges to operations:	
Depreciation of furniture and equipment	
Amortization of digital rights and master recordings	
Recoupment of royalty advances	
Amortization of deferred rent	
Recognition of deferred revenue	
Loss on disposal of furniture and equipment	
Write-off of non-productive assets	
Share-based compensation related to stock options, warrants and restricted shares issued	
Interest expense related to conversion of subordinated notes payable	
Changes in operating assets and liabilities:	
Accounts receivable	
Prepaid expenses and other current assets	
Accounts payable	
Accrued liabilities	
Royalties payable	
Accrued compensation and benefits	
Net cash used in operating activities	
Cash flows from investing activities:	
Purchases of furniture and equipment	
Purchases of digital rights and master recordings	
Payments of advance royalties	
Acquisition of Digital Rights Agency, LLC, net of cash received	
Increase in other assets	
Net cash used in investing activities	(

The accompanying notes are an integral part of these consolidate

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DIGITAL MUSIC GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOW

Cash flows from financing activities:
Proceeds from the sale of common and preferred stock of Digital Musicworks International, Inc. prior to recapitalization, net of offering costs
Proceeds from the exercise of Digital Musicworks International, Inc. options and warrants prior to recapitalization
Proceeds from initial public offering of common stock of Digital Music Group, Inc., net of offering costs
Proceeds from issuance of restricted stock
Collection on behalf of (payments to) DMI Publishing, Inc.
Proceeds from the issuance of subordinated notes payable
Payments on capital lease obligations
Net cash provided by financing activities
Net increase (decrease) in cash and cash equivalents
Cash and cash equivalents, beginning of period
Cash and cash equivalents, end of period
Supplemental cash flow information:
Interest paid
Supplemental disclosure of non-cash investing and financing transactions:
Issuance of common stock and warrants in connection with the acquisition of Digital Rights Agency, LLC
Issuance of warrant to underwriters
Reduction in contract for digital rights
Purchase of furniture and equipment under capital lease obligations
Holdback for purchase of master recordings
Merger between Digital Music Group, Inc. and Digital Music Works International, Inc.
Issuance of shares of common stock in connection with purchase of digital rights
Conversion of notes payable and accrued interest into shares of preferred stock of Digital Musicworks International, Inc. prior to recapitalization

Future obligations under contracts to purchase digital rights

The accompanying notes are an integral part of these consolidate

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DIGITAL MUSIC GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STA

1. ORGANIZATION AND BASIS OF PRESENTATION

Digital Music Group, Inc. (DMGI) was incorporated in Delaware on April 11, 2005 and i video content. On February 7, 2006, DMGI completed its initial public offering (the IPO) acquired all of the outstanding common stock of Digital Musicworks International, Inc., a C Rio Bravo Entertainment LLC, a Delaware limited liability company doing business as Psyc Music Group, Inc. prior to February 7, 2006 are the financial statements of DMI, which has reporting purposes. The historical shareholders equity of DMI has been restated for all peri effect to the acquisition by DMGI. The results of operations from the assets acquired from R included in the financial statements beginning on February 7, 2006.

On September 8, 2006, DMGI acquired all the membership interest of Digital Rights Agenc (DRA), and DRA became a wholly-owned subsidiary of DMGI. The consolidated financ wholly-owned subsidiary from the date of acquisition. All intercompany accounts and transa

Certain reclassifications have been made to the prior period s financial statements in order t

2. ACCOUNTING POLICIES

Use of Estimates and Assumptions

The preparation of financial statements in conformity with accounting principles generally a management to make estimates and assumptions that affect the reported amounts of assets a and the reported amounts of revenues and expenses during the reporting period. Actual resu

Cash and Cash Equivalents

DMGI considers all highly liquid investments with an original maturity or remaining maturi to be cash equivalents. Based upon its investment policy, DMGI may invest its cash primari institutions, in highly rated commercial paper, United States treasury obligations, United Sta United States government sponsored enterprises, money market funds and highly liquid deb approximately $6,500,000 and $432,000 in cash equivalents at December 31, 2006 and 2005

DMGI maintains its cash and cash equivalents at financial institutions. The combined accou Deposit Insurance Corporation (FDIC) insurance coverage and, as a result, there is a conc in excess of FDIC insurance coverage. DMGI has not incurred losses on these deposits to da on the credit ratings of the financial institutions.

Significant Customers

One digital entertainment service accounted for approximately 77%, 87% and 93% of DMG 2006 and 2005 and for the period from February 26, 2004 (Inception) to

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NOTES TO CONSOLIDATED FINANCIAL STATEMI

December 31, 2004, respectively. At December 31, 2006 and 2005, this service accounted fo
DMGI s accounts receivable.

Allowance for Doubtful Accounts

DMGI establishes allowances for doubtful accounts based on credit profiles of its retailers, c
conditions and historical payment experience, as well as for known or expected events. DMG
inception. Accordingly, at December 31, 2006 and 2005, no allowance for doubtful accounts

Fair Value of Financial Instruments

The carrying value of cash, cash equivalents, accounts receivable, accounts payable and acc
approximates their fair value due to the short-term nature of these instruments.

Furniture and Equipment

Furniture and equipment are stated at cost and depreciated over the estimated useful lives of
using the straight-line method. Capital leases are recorded at the lower of fair market value o
payments. Each of DMGI s capital leases has a bargain purchase option at the end of the in
intends to exercise. Accordingly, assets under capital lease obligations are being depreciated
of the assets, which exceeds the lease terms.

Royalty Advances, Digital Rights and Master Recordings

DMGI capitalizes the cost of acquiring catalogs of digital rights and master recordings and p
include amounts paid to content owners and direct ancillary costs such as legal and finders f
by DMGI are amortized using the straight-line method over the shorter of the term of the rel
and ten years for master recordings, which management believes reasonably relates the amo
realized. Royalty advances will be recouped from DMGI s future royalty obligations resulti
entertainment services. DMGI classifies royalty advances as short-term or long-term based o
be recovered.

DMGI reviews the recoverability of its capitalized digital rights, master recordings and roya
changes in circumstances indicate that the carrying amount of an asset may not be recoverab
comparing the carrying value of individual catalogs or groups of catalogs of digital rights, m
advances to its undiscounted expected future cash flows. If such review indicates that the ca
expected future cash flows, the asset s carrying amount is written down to its estimated fair
developed discounted projected cash flow analysis of the asset. As a result of performing the
determined that no impairment existed as of December 31, 2006. During the year ended Dec
$295,356 relating to cash advances and the capitalized costs of producing and promoting ma
artists. During 2005, DMGI cancelled certain of these contracts and concluded that future ca
advances and costs that were capitalized under the remainder of the

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contracts. Management is no longer seeking to sign additional artists to record new material
strategy.

Goodwill

Goodwill represents the excess of the purchase price over the estimated fair value of the net
acquisition. Goodwill is deemed to have an indefinite life and is not amortized but is subject
of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (SFAS
on at least an annual basis using the two-step process prescribed in SFAS No. 142. The first
the second step measures the amount of the impairment, if any.

Income Taxes

Deferred income taxes result primarily from temporary differences between financial and ta
liabilities are determined based on the difference between the financial statement bases and
tax rates. A valuation allowance is established to reduce a deferred income tax asset to the a

Revenue Recognition

DMGI distributes its music and video content through agreements with digital entertainmen
consumers to purchase as a digital download or on a subscription basis. DMGI earns revenu
digital entertainment service s subscription revenue, as defined in DMGI s agreements wit
entertainment service reports DMGI s download revenue or proportionate share of subscrip
depending on the agreement, and pays DMGI at the same time. DMGI recognizes revenue r
month the transactions occur.

Industry Segments and Foreign Revenue

DMGI operates in one industry segment, acquisition, management and distribution of digita
December 31, 2006, revenue from digital entertainment services serving consumers in foreig
other countries. For the year ended December 31, 2005 and for the period from February 26
from digital entertainment services serving customers in foreign locations was 5% and 6%,

Foreign Currency Translation

DMGI receives revenue from digital entertainment services selling content owned or distrib
services collect cash from consumers and report sales to DMGI in their local currency. The
digital entertainment services is paid to DMGI in local currencies and converted to U.S. doll
time of receipt. DMGI converts the sales reported by digital entertainment services to U.S. d
based on published daily rates. The net difference represents a foreign currency gain or loss
the impact was not material for all periods presented in the accompanying Consolidated Stat

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Advertising Costs

DMGI expenses advertising costs as incurred. For the years ended December 31, 2006 and 2 (Inception) to December 31, 2004, advertising expense was $127,146, $84,448 and $26,886 administrative expenses in the accompanying Consolidated Statements of Operations.

Share-Based Compensation

DMGI elected early adoption of Statement of Financial Accounting Standards No. 123 (revi No. 123R), which requires entities to recognize compensation expense in an amount equal to and issuances, such as restricted stock, stock options and warrants granted to employees and employees are measured at estimated fair value at the issuance date and expensed in the peri received, which is generally the vesting period. Equity instruments issued to non-employees vested and non-forfeitable are measured at estimated fair value at the issuance date and expe are received.

Prior to January 1, 2006, DMGI utilized Black-Scholes, a standard option pricing model, to employees. While SFAS No. 123R permits entities to continue to use such a model, the stan Beginning in 2006, DMGI determined that the Trinomial Lattice Model was the best availab options because it accounts for changing employee behavior as the stock price changes and of exercise as the stock price increases.

The following weighted-average assumptions were used in estimating the fair value per shar assuming no dividends for the years ended December 31, 2006 and 2005:

Risk-free rate of return	
Expected volatility	
Expected life (in years)	
Suboptimal exercise factor	
Exit rate post-vesting	
Exit rate pre-vesting	

DMGI calculates the expected volatility for stock-based awards using the historical volatilit sufficient historical trading data does not yet exist for DMGI s stock. DMGI estimates the f historical data. The risk-free rate for stock options granted during the period is determined b period that coincides with the expected option terms.

Net Loss Per Share

Basic and diluted net loss per share have been computed using the weighted-average numbe years ended December 31, 2006 and 2005 and for the period from February 26, 2004 (Incep 2,249,941 and 2,249,941, respectively. As of December 31, 2006, common stock equivalent and non-vested restricted stock totaling 366,500, 423,000 and 10,000 shares, respectively, a

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These were excluded from the calculation of the weighted-average number of shares outstan stock vesting over two years which was issued to three executives in August 2005, of which 2006, were nominal issuances and are included in basic and diluted earnings per share for th

The weighted average number of shares of common stock used in the calculation of basic an December 31, 2005 and for the period from February 26, 2004 (Inception) to December 31, by DMGI in connection with the acquisition of DMI, DMGI s acquiror for accounting purp

Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpreta *Taxes* (FIN 48), an interpretation of Statement of Financial Accounting Standards No. 10 measurement attribute for the financial statement recognition and measurement of a tax posi FIN 48 also provides guidance on accounting for derecognition, interest, penalties, accounti of matters related to uncertainty in income taxes, and transitional requirements upon adoptio beginning after December 15, 2006. Management does not believe that the adoption of FIN financial statements of DMGI.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 which addresses how companies should measure fair value when they are required to use a f purposes under generally accepted accounting principles (GAAP). As a result of SFAS N value to be used throughout GAAP. The FASB believes that the new standard will make the comparable and improve disclosures about those measures. SFAS No. 157 is effective for fi Management is currently evaluating the impact of this statement on the consolidated financi

3. ACQUISITIONS AND INITIAL PUBLIC OFFERING

On February 7, 2006, DMGI completed its initial public offering of common stock, selling 3 net cash proceeds (after fees and expenses) of approximately $33,200,000. On the same date DMGI issued to the underwriters in the offering warrants to purchase an aggregate of 273,00 for $100. Each of the warrants has an exercise price of $12.1875 per share, and are exercisab February 6, 2011. The warrants had an estimated fair value at the date of issuance of $620,5 No. 123R, assuming a dividend yield of 0%, expected volatility of 35%, risk free rate of retu 4.6 years. The fair value of the warrants was recorded as an offering cost. Accordingly, the t approximately $32,600,000.

Also on February 7, 2006, DMGI concurrently acquired DMI and certain assets of Rio Brav and 25,000 shares, respectively, of DMGI s common stock. DMI has been deemed the acqu net liabilities and a stockholders deficit of $73,305 on the date of its acquisition of DMI. T Bravo

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Entertainment LLC on February 7, 2006 totaled $243,750, which has been allocated to digit
months, the estimated remaining life of the assets.

On September 8, 2006, DMGI acquired all of the ownership interests in DRA in exchange fo
Company common stock and a warrant issued to the former Managing Director of DRA to p
exercise price of $5.57 per share. The warrant had an estimated fair value at the date of issua
SFAS No. 123R, assuming a dividend yield of 0%, expected volatility of 35%, risk free rate
exercise of 4.75 years. The fair value of the warrant was recorded as acquisition considerati
installments beginning in September 2007, is fully exercisable by September 2009, and expi
were issued in a private placement under federal and state securities law and are subject to re
majority of the shares are subject to contractual restrictions on resale, short selling and other
one to two years from the acquisition date.

The purchase consideration for DRA was comprised of the following:

Cash consideration	
Common stock issued (420,000 shares at $4.14 per share)	
Liabilities assumed	
Acquisition costs	
Estimated fair value of common stock warrant issued	

The total purchase price was allocated to DRA s assets and liabilities based on their estimat
summary of the preliminary purchase price allocation, which is subject to finalization, is as

Cash	
Accounts receivable	
Other current assets	
Furniture and equipment	
Digital rights	
Goodwill	

DMGI is obligated to pay up to $1,155,000 in cash and to issue up to 87,000 shares of comm
financial targets are achieved through December 31, 2007. Any additional consideration obl
and will be allocated to goodwill.

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The unaudited pro forma combined statements of operations for the years ended December 3
the acquisitions of DMI, certain assets of Rio Bravo Entertainment LLC and DRA were com

Revenue	
Cost of revenue:	
Royalties and payments to content owners	
Amortization of digital rights and master recordings	
Write-down of non-productive assets	
Gross profit	
Operating, general and administrative expenses	
Loss from operations	
Interest income	
Interest expense	
Other income (expense), net	
Loss before income taxes	
Income taxes	
Net loss	
Net loss per common share basic and diluted	
Weighted average common shares outstanding basic and diluted	

Weighted average shares used in the calculation of the unaudited pro forma combined basic
December 31, 2006 and 2005 include the 2,249,941 shares attributable to DMI, the 2,425,00
the 25,000 shares issued on February 7, 2006 in connection with the acquisition of the Rio E
shares issued on September 8, 2006 in connection with the acquisition of DRA. In addition t
sentence, weighted average shares used in the calculation of the unaudited pro forma combi
year ended December 31, 2006 also included the 3,900,000 shares issued in DMGI s IPO, f

The adjustments and methodology used in allocating the purchase consideration for DRA ar
combined statements of operations are based on estimates, available information and certain
information becomes available. The pro forma financial data do not purport to represent wha
actually have been if such acquisitions had in fact occurred at the beginning of the periods, a
results of operations for any future period since the companies were not under common man

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NOTES TO CONSOLIDATED FINANCIAL STATEMI

4. FURNITURE AND EQUIPMENT

Furniture and equipment comprise the following at:

Computers and office equipment	
Furniture and fixtures	
Computer equipment under capital lease obligations	
Less accumulated depreciation and amortization	

Depreciation expense for DMGI s furniture and equipment totaled $156,839, $38,595 and $ 2005 and for the period from February 26, 2004 (Inception) through December 31, 2004, res related to equipment under capital lease obligations, respectively. Accumulated depreciation and $25,531 at December 31, 2006 and 2005, respectively.

5. ROYALTY ADVANCES

DMGI has the exclusive right to distribute certain music and video content in certain geogra the content owners. These distribution agreements have initial terms ranging from five to ten to extend the agreement for an additional term. Pursuant to these long-term agreements, DM recouped from the content owners share of future revenue which range from 25% to 57% o agreements.

Royalty advances comprise the following at:

Total royalty advances	
Less cumulative recoupment of royalty advances	
Current portion of royalty advances	

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DIGITAL MUSIC GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMI

6. DIGITAL RIGHTS

DMGI has acquired digital rights from record labels, artists and other owners of such rights addition, in connection with the acquisitions during 2006 of certain assets of Rio Bravo Ente in DRA, DMGI allocated $243,750 and $775,000, respectively, of the purchase price to the following at:

Digital rights	
Less accumulated amortization	

Amortization expense was $346,808, $22,518 and $3,040 for the years ended December 31, February 26, 2004 (Inception) to December 31, 2004, respectively.

7. MASTER RECORDINGS

DMGI has acquired master recordings, including all the rights (digital, physical and otherwi comprise the following at:

Master recordings	
Less accumulated amortization	

Amortization expense was $75,681 for the year ended December 31, 2006.

8. INCOME TAXES

Income taxes are comprised of the following:

20

Current:	
Federal	$
State	
Total current	
Deferred:	
Federal	(83
State	(13
Total deferred	(96
Valuation allowance	96
Total deferred	
Income taxes	$

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DIGITAL MUSIC GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMI

DMGI reports certain expenses for tax purposes in different periods than they are recorded f differences give rise to deferred income tax assets and liabilities. Net deferred income tax as at December 31, 2006 and 2005 and for the period from February 26, 2004 (Inception) to De offset by a valuation allowance due to the uncertainty of their ultimate realization.

The temporary differences that give rise to deferred income tax assets and liabilities compris

Deferred income tax assets:	
Net operating loss carryforwards	
Share-based compensation	
Depreciation and amortization	
Accrued expenses	
Deferred income tax liabilities:	
Depreciation and amortization	
Net deferred income tax assets	
Valuation allowance	
Net deferred income tax assets	

Beginning in 2006, DMGI will file a consolidated federal tax return including all merged en 2006, DMGI has federal and state net operating loss carryforwards estimated to be approxim available to reduce future taxable income. Such amounts include the net operating loss carry generated by DMI between its inception in 2004 and its merger with DMGI in 2006. Include 31, 2006 and 2005, are tax benefits of $270,000 and $17,000, respectively, attributable to th which will be recorded directly to additional paid in capital, when DMGI utilizes its net ope such dates, the federal net operating loss carryforwards begin to expire in 2024 and the state in 2014. In addition to potential expiration, there are other factors that could limit DMGI s carryforwards. Under Section 382 of the Internal Revenue Code of 1986 (Section 382), a carryforwards can be limited after an ownership change. DMGI s ability to fully utilize DM to limitation under Section 382 as a result of its merger with DMGI and other transactions, a of future sales of securities, if any. Accordingly, it is not certain how much of the existing n for use by DMGI. If DMGI generates taxable income in the future the use of net operating l have the effect of reducing DMGI s tax liability and increasing after-tax net income.

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Income taxes reported in the Consolidated Statements of Operations differ from the amount tax rate (34%) to loss before income taxes as follows:

	Ye
	2
Federal income tax benefit at statutory rate	$ (8
State income tax benefit, net of federal effect	(1
Change in valuation allowance	9
Other, net	
	$

9. LEASES

Operating Leases

DMGI leases its office facilities under non-cancelable operating leases for periods ranging f for the years ended December 31, 2006 and 2005 and for the period from February 26, 2004 $68,842 and $8,360, respectively.

As of December 31, 2006, future minimum payments under these leases, by calendar year, a

2007	
2008	
2009	
2010	

Capital Leases

DMGI leases certain of its technology and office equipment under capital leases with interes Future minimum lease payments for assets under capital lease obligations at December 31, 2

Year: 2007	
2008	

Less amount representing interest	
Total capital lease obligations	
Less current portion	
Long-term capital lease obligations	

10. COMMITMENTS AND CONTINGENCIES

Industry Conditions and Risks

DMGI operates in a new and rapidly changing and evolving industry - the digital distributio
early stages of its development and management is attempting to position it as

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a leader and first-mover in this emerging industry. As such, there are numerous risks involve of management s control, including potential changes in consumer tastes and preferences th structure and terms that DMGI receives from digital entertainment services and the formats deliver digital content for sale to consumers. DMGI has incurred losses throughout its limite achieve profitability depend upon a number of factors, including certain minimum levels of television catalogs that comprise the majority of the content that DMGI owns or distributes growth in consumer demand for digital music and video content.

Commitments for Content Acquisitions

At December 31, 2006, DMGI is contractually obligated to pay up to $5,433,000 over the ne digital rights and master recordings purchase consideration. These payments are due under v video recordings and related metadata and artwork are received from the content owners for obligated to pay a total of $360,000 in equal quarterly installments through February 2016 a under one long-term agreement.

Indemnification Agreements

In the ordinary course of business, DMGI enters into contractual arrangements with digital e provide indemnification of varying scope with respect to certain matters, including losses th agreements and out of intellectual property infringement claims made by third parties. Conv for losses that might arise out of any breach of their agreements to sell or provide music and any intellectual property infringement claims arising from the recordings they have sold or p terms of such indemnification provisions vary. Generally, a maximum obligation is not expl these indemnification obligations cannot be reasonably estimated. To date, DMGI has not in indemnifications in favor of digital entertainment services and has not accrued any liabilities financial statements.

In addition, DMGI has entered into standard indemnification agreements with its directors a other things, to indemnify them against certain liabilities that may arise by reason of their st never received a notice of claim under these agreements and maintains director and officer l and maximum aggregate amounts) that covers third-party claims against DMGI or against it capacity.

Employment Agreements

DMGI maintains employment agreements with its officers wherein duties and responsibilitie established for each officer. These agreements also include standard non- competition and c devote full-time to furthering the business of DMGI, provide that technology and inventions to DMGI, and contain other customary provisions. Officers are entitled to certain severance cause (as defined in the agreements) or under other circumstances, and DMGI recorded $ connection with the departure of two of its founding officers.

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Legal Matters

DMGI from time-to-time becomes involved in commercial and contractual disputes and disa
business, which management typically seeks to resolve through direct negotiations with the
As of December 31, 2006, DMGI was not a party to any legal proceedings.

11. CAPITAL STOCK

Recapitalization

DMI has been designated DMGI s acquiror for financial reporting purposes. The historic
all periods prior to February 7, 2006 to give retroactive effect to its merger with DMGI. DM
transactions have been restated as if they were issuances of DMGI s common stock as of Fe
merger agreement exchange ratios. The following table reconciles the restated February 26,
activity:

Original Equity Issuances	Co Share
Issuances of common stock in exchange for cash, services and digital rights and exercise of options and warrants for net proceeds of $57,963	709,3
Issuance of series A convertible preferred stock for net proceeds of $1,695,496	641,4
Issuance of series B convertible preferred stock for cash and conversion of subordinated notes and accrued interest for net proceeds of $2,899,747	899,1
Total	2,249,9

Founders shares in DMI, issued in exchange for services valued at $3,200, are included in
subscriptions receivable, as they were issued at the inception date.

Common Stock

DMGI completed its IPO on February 7, 2006 and issued 3,900,000 shares of its common st
shares to acquire certain assets of Rio Bravo Entertainment LLC and 2,249,941 shares to acq
stock of DMI. As a result of treating DMI as the accounting acquiror, the 2,425,000 shares o
which were outstanding at the time of the IPO were treated as issued on February 7, 2006. C
shares of its common stock in connection with its acquisition of the membership interests in

Restricted Stock Grant

In March 2006, DMGI issued to one of its senior executives a restricted stock grant of 15,00
price of $.01 per share, subject to a Company repurchase option at the

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original purchase price that lapsed with respect to 5,000 shares on September 22, 2006. The shares each on March 22, 2007 and 2008, so long as the executive remains a service provide at the date they were issued is being charged to operating, general and administrative expens included as outstanding for purposes of calculating basic earnings per share as the restriction

12. SHARE-BASED COMPENSATION

DMGI s accounting acquiror, DMI, had a 2004 Stock Plan under which it granted stock opt and 2005. In addition, during this period, DMI also issued warrants to purchase shares of its firm. The unvested options and warrants became fully exercisable pursuant to their terms im February 7, 2006. The options and warrants exercised in February 2006 generated net proce holders received shares of DMI and participated pro rata in the total merger consideration of and warrants were forfeited and the 2004 Stock Plan was terminated upon consummation of

DMGI has an Amended and Restated 2005 Stock Plan (the Plan) under which 1,200,000 issuance at December 31, 2006. The Plan provides for the grant of incentive stock options, v Revenue Code, to employees and for the grant of non-statutory stock options, stock appreci directors and consultants. The Compensation Committee of DMGI s Board of Directors adm under the Plan and establish vesting and other terms, but cannot grant options at less than fa previously granted. All options granted to employees since inception of the Plan have a four non-employee directors are automatic pursuant to a formula within the Plan which establish

Stock option activity under DMGI s Plan is summarized as follows:

	Number of Shares	Exer
Outstanding at December 31, 2005		
Granted	390,000	$ 4.0
Forfeited	(23,500)	$ 4.1
Outstanding at December 31, 2006	366,500	$ 4.0
Exercisable at December 31, 2006	63,000	$ 6.3

The weighted average estimated grant-date fair value per share for the 390,000 options gran $1.71. The weighted average estimated grant-date fair value per share for the 23,500 unveste

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NOTES TO CONSOLIDATED FINANCIAL STATEMI

Restricted stock activity is summarized as follows:

Nonvested at December 31, 2005	
Issued	
Vested	
Nonvested at December 31, 2006	

During the year ended December 31, 2006, 91,666 restricted shares became vested upon the
a former executive as required under the restricted stock agreement with such executive.

DMGI recorded a non-cash charge of $326,495, $8,304 and $1,281 as a component of opera
to share-based arrangements for the years ended December 31, 2006 and 2005 and for the pe
December 31, 2004, respectively. The non-cash charge for the year ended December 31, 200
accelerated vesting of the DMI stock options. As of December 31, 2006, the future pre-tax s
grants is $459,426 to be recognized in 2007 through 2010. Future pre-tax share-based comp
be recognized in 2007 through 2008.

As of December 31, 2006, a total of 818,500 shares remained available for grant under DMG
the shares available under the Plan are increased by the lesser of (i) 400,000 shares, (ii) 5% o
such date, or (iii) an amount determined by DMGI s Board of Directors. As a result, 1,218,
2007.

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DIGITAL MUSIC GROUP, INC.

CONDENSED CONSOLIDATED BALANCE S

Assets
Current assets:
Cash and cash equivalents
Accounts receivable
Current portion of advance royalties
Prepaid expenses and other current assets
Total current assets
Furniture and equipment, net
Digital rights, net
Master recordings, net
Royalty advances, less current portion
Goodwill
Other assets
Total assets
Liabilities and Stockholders Equity
Current liabilities:
Accounts payable
Accrued liabilities
Royalties payable
Accrued compensation and benefits
Current portion of capital lease obligations
Total current liabilities
Capital lease obligations, less current portion
Other long-term liabilities
Total liabilities
Commitments and contingencies
Stockholders equity:
Preferred stock, $.01 par value, 1,000,000 shares authorized: none issued and outstanding
Common stock, $.01 par value, 30,000,000 shares authorized: 9,121,939 shares issued and outstanding at June 30, 2007 and 9,034,941 issued and outstanding at December 31, 2006
Additional paid-in capital
Accumulated deficit
Total stockholders equity
Total liabilities and stockholders equity

The accompanying notes are an integral part of these unaudited condensed

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DIGITAL MUSIC GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF

Revenue
Cost of revenue:
Royalties and payments to content owners
Amortization of digital rights and master recordings
Gross profit
Operating, general and administrative expenses
Merger-related expenses
Loss from operations
Interest income
Interest expense
Other expense
Loss before income taxes
Income taxes
Net loss
Net loss per common share basic and diluted
Weighted average common shares outstanding basic and diluted

The accompanying notes are an integral part of these unaudited condensed

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CONDENSED CONSOLIDATED STATEMENTS OF

Cash flows from operating activities:
Net loss
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:
Non-cash charges to operations:
Depreciation of furniture and equipment
Amortization of digital rights and master recordings
Recoupment of royalty advances
Share-based compensation related to stock options, warrants and restricted shares issued
Loss on asset sales
Changes in operating assets and liabilities:
Accounts receivable
Prepaid expenses and other current assets
Accounts payable
Accrued liabilities
Royalties payable
Accrued compensation and benefits
Net cash used in operating activities
Cash flows from investing activities:
Purchases of furniture and equipment
Purchases of digital rights and master recordings
Payments of advance royalties
Proceeds from asset sales
Change in other assets and long-term liabilities, net
Net cash used in investing activities
Cash flows from financing activities:
Proceeds from initial public offering of common stock
Proceeds from the exercise of Digital Musicworks International, Inc. options and warrants p recapitalization
Proceeds from issuance of restricted stock
Payments on capital lease obligations
Net cash (used in) provided by financing activities
Net (decrease) increase in cash and cash equivalents
Cash and cash equivalents, beginning of period
Cash and cash equivalents, end of period
Supplemental cash flow information:

Interest paid	
Supplemental disclosure of non-cash investing and financing transactions:	
Increase in goodwill resulting from issuance of earn-out consideration for DRA acquisition	
Issuance of warrant to underwriters	
Purchase of certain assets of Rio Bravo Entertainment LLC through the issuance of commor	
Reduction in contract for digital rights	
Purchase of furniture and equipment under capital lease obligations	
Holdback for purchase of master recordings	
Merger between Digital Music Group, Inc. and Digital Musicworks International, Inc.	

The accompanying notes are an integral part of these unaudited condensed

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DIGITAL MUSIC GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIA

1. ORGANIZATION AND BASIS OF PREPARATION

Digital Music Group, Inc. (DMGI) was incorporated in Delaware on April 11, 2005 for th February 2006, DMGI completed its initial public offering (the IPO). Concurrent with the outstanding common stock of Digital Musicworks International, Inc., a California corporatio Entertainment LLC, a Delaware limited liability company doing business as Psychobaby (prior to February 7, 2006 are the financial statements of DMI, which has been designated as historical shareholders equity of DMI has been restated for all periods prior to February 7, DMGI. The results of operations of the Rio Bravo assets and of DMGI are included in the fi 2006.

On September 8, 2006, DMGI entered into an Agreement and Plan of Merger with Digital R company (DRA), and DRA became a wholly-owned subsidiary of DMGI. The consolidat DMGI and its wholly-owned subsidiary. All intercompany accounts and transactions have b

The accompanying unaudited condensed consolidated financial statements are presented pur States Securities and Exchange Commission in accordance with the disclosure requirements opinion of management of DMGI, the unaudited condensed consolidated financial statement recurring adjustments) necessary to fairly state the results for the interim periods presented. June 30, 2007 are not necessarily indicative of the results that may be expected for the year condensed consolidated financial statements should be read in conjunction with the audited DMGI included in DMGI s Annual Report on Form 10-K for the year ended December 31,

Certain reclassifications have been made to the prior period s balance sheet in order to conf interim periods, including June 30, 2007 and 2006, is unaudited.

2. ACQUISITIONS AND INITIAL PUBLIC OFFERING

On February 7, 2006, DMGI completed its initial public offering of common stock, selling 3 net cash proceeds (after fees and expenses) of approximately $33,200,000. On the same date DMGI issued to the underwriters in the offering warrants to purchase an aggregate of 273,00 warrants has an exercise price of $12.1875 per share, and is exercisable at any time from Fe underwriters paid an aggregate of $100 for the warrants. The warrants had an estimated fair determined in accordance with Statement of Financial Accounting Standards No. 123R, *Sha* yield of 0%, expected volatility of 35%, risk free rate of return of 4.52%, and an expected te warrants was recorded as an offering cost. Accordingly, the total net proceeds from DMGI

Also on February 7, 2006, DMGI concurrently acquired DMI and certain assets of Rio Brav respectively, of DMGI s common stock. DMI has been deemed the acquiror for financial re stockholders deficit of $73,305 on the date of its

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DIGITAL MUSIC GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL ST

acquisition of DMI. The purchase price of the Rio Bravo assets on February 7, 2006 totaled
rights. Such rights are being amortized over 24 months, the estimated remaining life of the a

On September 8, 2006, DMGI acquired all of the ownership interests in DRA in exchange fo
common stock and a warrant issued to the former Managing Director of DRA to purchase 1
exercise price of $5.57 per share. The warrant had an estimated fair value at the date of issua
Statement of Financial Accounting Standards No. 123R, assuming a dividend yield of 0%, e
of 4.7%, and an expected term to exercise of 4.75 years. The fair value of the warrant was re
is exercisable in various installments beginning in September 2007, is fully exercisable by S
upon a change in control of DMGI. The shares and warrant were issued in a private placeme
subject to restrictions on resale thereunder, and a substantial majority of the shares are subje
selling and other forms of hedging for varying terms ranging from one to two years from the

The estimated purchase price of DRA consisted of the following:

Cash consideration	
Common stock issued (420,000 shares at $4.14 per share)	
Common stock subsequently issued (56,998 shares at $4.05 per share)	
Liabilities assumed	
Acquisition costs	
Estimated fair value of common stock warrant issued	

The total purchase price was allocated to DRA s assets and liabilities based on their estimat
summary of the preliminary purchase price allocation, which is subject to finalization, is as

Cash	
Accounts receivable	
Other current assets	
Furniture and equipment	
Digital rights	
Goodwill	

On June 21, 2007, DMGI entered into an amendment to the DRA acquisition agreement wh
DRA $705,008 in cash and 56,998 shares of DMGI common stock in lieu of any payments t
earn-out provisions of the acquisition agreement, pursuant to which DMGI would have been
issue up to 87,000 shares of DMGI common stock if certain financial targets were achieved
resulted in an increase in goodwill of $935,850, with the cash portion recorded as a liability

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The unaudited pro forma combined statements of operations for the six months ended June 3
acquisitions of DMI, Rio Bravo and DRA were closed on January 1, 2006:

Revenue	
Cost of revenue	
Gross profit	
Operating, general and administrative expenses	
Loss from operations	
Interest income	
Interest and other income (expense)	
Loss before income taxes	
Income taxes	
Net loss	
Net loss per common share basic and diluted	
Weighted average common shares outstanding basic and diluted	

Weighted average shares used in the calculation of the unaudited pro forma combined basic
ended June 30, 2006 include the shares issued in connection with the acquisitions of DMI ar
issued in connection with the acquisition of DRA on September 8, 2006 and June 21, 2007,
January 1, 2006.

The adjustments used in the preparation of this unaudited pro forma combined statement of
information and certain assumptions, as they relate to DRA, which may be revised as additio
forma financial data do not purport to represent what DMGI s combined results of operatio
had in fact occurred at the beginning of the period, and are not necessarily representative of
since the companies were not under common management or control during the period prese

3. RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement
Value Measurements (SFAS No. 157), which addresses how companies should measure f
measure for recognition or disclosure purposes under generally accepted accounting princip
now a common definition of fair value to be used throughout GAAP. The FASB believes tha
fair value more consistent and comparable and improve disclosures about those measures. S
beginning after November 15, 2007. Management is currently evaluating the impact of this s

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *
Financial Liabilities Including an Amendment of FASB Statement No. 115 (SFAS No. 159
measure eligible assets and liabilities at fair value with changes in value recognized in earni
liabilities may be elected either prospectively upon initial recognition, or if an event triggers

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DIGITAL MUSIC GROUP, INC.

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existing asset or liability. SFAS No. 159 is effective for fiscal years beginning after Novemb
the impact of this statement on DMGI.

4. ACCOUNTING POLICIES

The accounting policies of DMGI are set forth in Note 2 of the Notes to Consolidated Finan
Form 10-K for the year ended December 31, 2006. There have been no changes to these pol
Interpretation 48, *Accounting for Uncertainty in Income Taxes*, on January 1, 2007. See Not

5. CASH AND CASH EQUIVALENTS

DMGI considers all highly liquid investments with an original maturity or remaining maturi
be cash equivalents. Based upon its investment policy, DMGI may invest its cash primarily
institutions, in highly rated commercial paper, United States treasury obligations, United Sta
United States government sponsored enterprises, money market funds and highly liquid deb
approximately $12,100,000 and $6,500,000 in cash equivalents at June 30, 2007 and Decem

DMGI maintains its cash and cash equivalents at financial institutions. The combined accou
Deposit Insurance Corporation (FDIC) insurance coverage and, as a result, there is a conc
in excess of FDIC insurance coverage. DMGI has not incurred losses on these deposits to da
on the credit ratings of the financial institutions.

6. DIGITAL RIGHTS

Digital rights comprise the following at:

Digital rights	
Less accumulated amortization	

Amortization expense was $299,596 and $124,396 for the six months ended June 30, 2007 a

7. MASTER RECORDINGS

Master recordings comprise the following at:

Master recordings	
Less accumulated amortization	

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL ST

Amortization expense was $94,855 and $10,452 for the six months ended June 30, 2007 and

8. ROYALTY ADVANCES

Royalty advances comprise the following at:

Total royalty advances	
Less cumulative recoupment of royalty advances	
Current portion of royalty advances	

9. INCOME TAXES

DMGI adopted FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes* (FIN comprehensive model for the financial statement recognition, measurement, presentation an expected to be taken in income tax returns. There was no impact on DMGI s consolidated f FIN 48.

DMGI has incurred net losses since its inception and has fully offset the deferred income tax due to the uncertainty of the ultimate realization of such tax benefits. DMGI has substantial reduce future taxable income for federal and state income tax reporting purposes. The federa in 2024 and the state net operating loss carryforwards begin to expire in 2014. In addition to could limit DMGI s ability to use these federal and state tax loss carryforwards. Under Sect (Section 382), as amended, use of prior net operating loss carryforwards can be limited a utilize DMI s net operating loss carryforward will be subject to limitation under Section 38 transactions, and may be subject to further limitations as a result of future sales of securities of the existing net operating loss carryforward will be available for use by DMGI. DMGI s have been fully offset by a valuation allowance due to the uncertainty of their ultimate realiz future, the use of net operating loss carryforwards that have not expired would have the effe after-tax net income.

10. CONCENTRATION OF CREDIT RISK

Accounts receivable from DMGI s largest digital entertainment service comprised approxi accounts receivable at June 30, 2007 and December 31, 2006, respectively. Based on its pre of the digital entertainment service, DMGI does not believe there is significant collection ris

11. COMMITMENTS AND CONTINGENCIES

At June 30, 2007, DMGI is contractually obligated to pay up to $3.4 million over the next tw
digital rights and master recordings purchase consideration. These payments are

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DIGITAL MUSIC GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL ST

due under various digital rights agreements as music and video recordings and related metad
owners for processing by DMGI. DMGI is also obligated to pay a total of $348,750 in equal
additional advances against future royalties under one long-term agreement.

12. SHARE-BASED COMPENSATION

DMGI recorded non-cash charges of $196,200 and $159,883 as a component of operating, g
share-based arrangements for the six months ended June 30, 2007 and 2006, respectively. Th
months ended June 30, 2006 included $38,834 associated with the accelerated vesting of DM
DMGI.

DMGI has an Amended and Restated 2005 Stock Plan (the Plan) under which 1,102,000
issuance at June 30, 2007. All options granted to employees since inception of the Plan have
to non-employee directors are automatic pursuant to a formula within the Plan which establi
grants.

In accordance with Statement of Financial Accounting Standards No. 123R, *Share-Based Co*
Model to measure the fair value of stock option grants. The following weighted-average assu
per share of the options granted under the Plan for the six months ended June 30, 2007 and 2

Risk-free rate of return	
Expected volatility	
Expected life (in years)	
Suboptimal exercise factor	
Exit rate post-vesting	
Exit rate pre-vesting	

DMGI calculates the expected volatility for stock-based awards using the historical volatility
sufficient historical trading data does not yet exist for DMGI s common stock. DMGI estim
based on historical data. The risk-free rate for stock options granted is determined by using a
that coincides with the expected option terms. It is further assumed that there are no dividen

Stock option activity for the six months ended June 30, 2007 is summarized as follows:

	Number of Shares	Exercise Pri

Outstanding at December 31, 2006	366,500	$ 4.02 - $9.
Granted	137,500	$ 4.02 - $4.
Exercised		
Forfeited	(51,000)	$ 4.13 - $9.
Outstanding at June 30, 2007	453,000	$ 4.02 - $9.
Exercisable at June 30, 2007	139,000	$ 6.38 - $9.

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DIGITAL MUSIC GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL ST

The aggregate intrinsic value shown in the table above was calculated as the difference betw
and the quoted price of DMGI s common stock for the 63,500 options that were in-the-mon
estimated grant-date fair value per share for the 1,354 vested and 49,646 unvested options fo
2007 was $1.17 per share.

Restricted stock activity is summarized as follows:

Nonvested at December 31, 2006	
Issued	
Vested	
Nonvested at June 30, 2007	

Subsequent to June 30, 2007, 16,666 non-vested restricted shares became vested upon the re
former executive as required under the restricted stock agreement with such executive.

As of June 30, 2007, the future pre-tax share-based compensation expense for stock option g
remainder of 2007 through 2011. Future pre-tax share-based compensation expense for restr
remainder of 2007 through 2008. However, in the event of a change in control as described
would become fully vested and all restrictions on restricted shares would lapse in accordanc
recognize all of the future share-based compensation expense.

13. NET LOSS PER SHARE

Basic and diluted net loss per share has been computed using the weighted-average number
months ended June 30, 2007 and 2006 of 9,030,880 and 7,266,804, respectively. As of June
outstanding stock options, warrants and non-vested restricted stock totaling 453,000, 423,00
equivalents have been excluded from the calculation of the weighted-average number of sha
their antidilutive effect. Restricted stock vesting over two years which was issued to three ex
and all such shares are included in basic and diluted weighted-average shares outstanding fo

14. SUBSEQUENT EVENT

On July 10, 2007, DMGI entered into a merger agreement with The Orchard Enterprises Inc
and marketer of music, under which Orchard will become a wholly-owned subsidiary of DM
its name to The Orchard Inc. The combined company will be headquartered in New York, N
amended and restated on September 13, 2007, obligate DMGI to issue in a private placemen
stock of DMGI and 448,833 shares of a newly created series of preferred stock in exchange

preferred stock of Orchard and all outstanding derivative instruments to acquire shares of Or
be convertible into, and will have voting rights equivalent to, ten shares of DMGI s commo
share.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL ST

Completion of the merger is subject to customary closing conditions, including, but not limi shareholders. DMGI is currently preparing a proxy statement that will be filed in preliminar finalized, it will be presented to shareholders with a request for approval of the merger. DM conditions to the merger with Orchard will be satisfied or that the merger will be consumma restrictions on the operation of the business of each of DMGI and Orchard through the closi DMGI and Orchard, and further provides that if the merger agreement is terminated under c required to pay the other a termination fee of up to approximately $1.6 million.

In connection with the merger, DMGI implemented a retention bonus plan for key employe total of $330,000 in one-time retention bonuses to eligible employees who remain continuou of the merger, which is expected to take place in the fourth calendar quarter of 2007.

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INDEPENDENT AUDITORS REPOR

To the Board of Directors and Stockholders of

The Orchard Enterprises Inc.:

We have audited the accompanying consolidated balance sheets of The Orchard Enterprises December 31, 2006 and 2005, and the related consolidated statements of operations, stockh three years in the period ended December 31, 2006. These consolidated financial statements management. Our responsibility is to express an opinion on these consolidated financial stat

We conducted our audits in accordance with auditing standards generally accepted in the Un that we plan and perform the audit to obtain reasonable assurance about whether the financia audit includes consideration of internal control over financial reporting as a basis for designi circumstances, but not for the purpose of expressing an opinion on the effectiveness of the C Accordingly, we express no such opinion. An audit also includes examining, on a test basis, in the financial statements, assessing the accounting principles used and significant estimate overall financial statement presentation. We believe that our audits provide a reasonable bas

In our opinion such consolidated financial statements present fairly, in all material respects, Enterprises Inc. and subsidiaries as of December 31, 2006 and 2005, and the results of its op the three year period ended December 31, 2006, in conformity with accounting principles ge

/s/ Deloitte & Touche LLP
New York, NY
July 30, 2007 (except for paragraphs 3, 4 and 5
of Note 15, as to which the date is
September 13, 2007)

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THE ORCHARD ENTERPRISES INC

CONSOLIDATED BALANCE SHEETS

ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	
Accounts receivable net (including amounts from related parties of $483,037 in 2006 and $ in 2005)	
Royalty advances	
Prepaid expenses and other current assets	
Total current assets	
PROPERTY AND EQUIPMENT Net	
OTHER ASSETS	
TOTAL	
LIABILITIES AND STOCKHOLDERS DEFICIENCY	
CURRENT LIABILITIES:	
Accounts payable	
Accrued royalties	
Accrued expenses	
Note payable	
Due to affiliated entities	
Deferred revenue	
Accrued interest payable (including amounts to related parties of $1,227,937 in 2006 and $7 in 2005)	
Convertible debt payable to a related party	
Total current liabilities	
COMMITMENTS AND CONTINGENCIES	
STOCKHOLDERS DEFICIENCY:	
Series A convertible preferred stock, $.001 par value 20,000,000 shares authorized, 7,931,0 issued and outstanding as of December 31, 2006; liquidation preference of $8,386,978	
Series B convertible preferred stock, $.001 par value 20,000,000 shares authorized, 7,931,0 issued and outstanding as of December 31, 2006; liquidation preference of $7,931,000	
Common stock, $.001 par value 40,000,000 and 5,000,000 shares authorized as of Decemb 2006 and 2005, respectively; 1,762,444 and 1,477,612 shares issued and outstanding as of December 31, 2006 and 2005, respectively	
Stock subscription receivable	
Paid-in capital	
Accumulated deficit	
Accumulated other comprehensive income	
Total stockholders deficiency	
TOTAL	

See notes to consolidated financial statemen

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THE ORCHARD ENTERPRISES INC

CONSOLIDATED STATEMENTS OF OPERA

REVENUES (including amounts from related parties of $1,783,140 in 2006, $1,007,814 in 2005, and $73,313 in 2004)
COSTS OF REVENUES (including amounts from related parties of $68,797 in 2006, $35,830 in 2005, and $11,759 in 2004)
GROSS PROFIT
OPERATING EXPENSES:
Product development (including amounts from related parties of $5,577 in 2006, $4,307 in 2005, and $3,152 in 2004)
Sales and marketing (including amounts from related parties of $128,274 in 2006, $53,128 in 2005, and $33,094 in 2004)
General and administrative (including amounts from related parties of $1,017,657 in 2006, $830,247 in 2005, and $612,946 in 2004)
Total operating expenses
LOSS FROM OPERATIONS
OTHER (INCOME) EXPENSE:
Other income
Interest income
Interest expense (including amounts from related parties of $520,084 in 2006, $464,261 in 2005, and $200,709 in 2004)
Total other (income) expense
NET LOSS

See notes to consolidated financial statemen

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THE ORCHARD ENTERPRISES INC

CONSOLIDATED STATEMENTS OF STOCKHOLDE

FOR THE YEARS ENDED DECEMBER 31, 2006, 20

	Series A Preferred		Series B Preferred		Common Stock			
	Shares	Amount	Shares	Amount	Shares	Amount	Stock Subscription Receivable	Paid-in Capital
BALANCE January 1, 2004		$		$	1,477,612	$ 1,478	$ (1,478)	$
Foreign currency translation adjustment								
Net loss								
BALANCE December 31, 2004					1,477,612	1,478	(1,478)	
Foreign currency translation adjustment								
Net loss								
BALANCE December 31, 2005					1,477,612	1,478	(1,478)	
Issuance of Common Stock					284,832	285		83,455
Issuance of Preferred Stock	7,931,000	7,931	7,931,000	7,931				7,915,138
Foreign currency translation adjustment								
Net loss								
BALANCE December 31, 2006	7,931,000	$ 7,931	7,931,000	$ 7,931	1,762,444	$ 1,763	$ (1,478)	$ 7,998,593

See notes to consolidated financial statemen

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THE ORCHARD ENTERPRISES INC

CONSOLIDATED STATEMENTS OF CASH

CASH FLOWS FROM OPERATING ACTIVITIES:
Net loss
Adjustments to reconcile net loss to net cash used in operating activities:
Depreciation and amortization
Bad debt expense
Net loss on sale/disposal of fixed assets
Gain on note payable and related accrued interest
Stock-based compensation
Changes in operating assets and liabilities:
Accounts receivable
Royalty advances
Prepaid expenses and other current assets
Other assets
Accounts payable
Accrued royalties
Accrued expenses
Due to affiliated entities
Deferred revenue
Accrued interest payable
Net cash used in operating activities
CASH FLOWS FROM INVESTING ACTIVITIES:
Purchases of property and equipment
Proceeds from the sale of fixed assets
Net cash used in investing activities
CASH FLOWS FROM FINANCING ACTIVITIES:
Proceeds from issuance of convertible debt payable to a related party
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS
INCREASE IN CASH AND CASH EQUIVALENTS
CASH AND CASH EQUIVALENTS Beginning of year
CASH AND CASH EQUIVALENTS End of year
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:
Interest paid
Non-cash financing activities:
Issuance of preferred stock upon conversion of convertible debt payable to a related party

See notes to consolidated financial statemen

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THE ORCHARD ENTERPRISES INC

NOTES TO CONSOLIDATED FINANCIAL STA

1. ORGANIZATION AND BUSINESS

The Orchard Enterprises Inc. (Orchard) was incorporated in New York in September 200 music content. Orchard is a global music marketing and distribution company, offering a sui create and sell product digitally across a worldwide network of digital entertainment service

On April 28, 2003, Dimensional Associates, LLC (Dimensional), an entity formed by a g invested in and acquired operating control of Orchard through the purchase of a convertible fundings under the same terms and conditions as the original convertible debt instrument (se

2. BASIS OF PRESENTATION

The accompanying consolidated financial statements have been prepared assuming Orchard incurred losses and negative cash flows from operations since its inception. Orchard incurre December 31, 2006, has incurred operating losses since inception, has a working capital def of $16,490,894 at December 31, 2006. Orchard s ability to continue operating as a going co generate operating cash flows through the execution of its business plan or to secure funding needs of its business. Until and unless Orchard s operations generate significant revenues a fund operations from cash on hand, through the issuance of debt and through the issuance of has committed to fund the operations of Orchard through at least July 31, 2008.

3. SIGNIFICANT ACCOUNTING POLICIES

Consolidation and Basis of Presentation The consolidated financial statements include the subsidiaries, Orchard Management, Inc., and Orchard EU, Limited. The consolidated accou revenues, expenses, and cash flows of Orchard and all entities in which Orchard has a contro consolidated in accordance with accounting principles generally accepted in the United Stat balances and transactions have been eliminated in consolidation.

Use of Estimates The preparation of consolidated financial statements and related disclosur management to make estimates and assumptions that affect the reported amounts of assets a and liabilities at the date of the financial statements, and revenues and expenses during the p those estimates. The most significant estimates relate to assessing the collectability of accou advances, the value of securities underlying stock based compensation, the realization of de allowances, and the useful lives and potential impairment of Orchard s property and equipm periodically and the effects of revisions are reflected in the period that they are determined t

Cash and Cash Equivalents Cash and cash equivalents include all short-term highly liquid amounts of cash and have maturities of three months or less when purchased.

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THE ORCHARD ENTERPRISES INC

NOTES TO CONSOLIDATED FINANCIAL STATEMI

Allowance for Doubtful Accounts Orchard establishes allowances for doubtful accounts ba economic and industry trends, contractual terms and conditions and historic payment experi Accordingly, at December 31, 2006 and 2005, Orchard had $70,000 and $0 recorded as an a

Fair Value of Financial Instruments The carrying value of Orchard s short-term financia accounts payable, accrued expenses, and accrued royalties approximates their fair value due no market value information available for Orchard s convertible debt and a reasonable estim costs (see Note 9).

Foreign Currency Translation Orchard has foreign operations where the functional curren The functional currency of Orchard s subsidiary in the United Kingdom has been determine local currency is the functional currency, assets and liabilities are translated using end-of-pe flows are translated using average rates of exchange. For these operations, currency translati component of stockholders deficiency. Transaction gains and losses are recognized in the c

Concentrations of Credit Risk Orchard s customers are primarily commercial organizatio receivable are generally unsecured.

The revenues from two of its customers, iTunes and eMusic, account for a significant portio iTunes were approximately 51%, 45% and 45% of total revenues and revenues from eMusic revenues for the years ended December 31, 2006, 2005, and 2004, respectively. Accounts re accounts receivable at December 31, 2006 and 2005, respectively. Accounts receivable from receivable at December 31, 2006 and 2005, respectively.

Due From Digital Service Providers At December 31, 2006 and 2005, accounts receivable related to reimbursements to Orchard by its customers, for digital encoding of Orchard s mu customer s retail website.

Royalty Advances and Digital Rights Orchard has paid advance royalties and the cost of ac artists. Orchard accounts for these advance royalty payments and digital rights acquisition co Financial Accounting Standards (SFAS) No. 50, *Financial Reporting in the Record and I* No. 50, certain advance royalty payments that are believed to be recoverable from future roy capitalized as assets. Royalty advances will be recouped from Orchard s future royalty obli digital entertainment services. Digital rights acquired by Orchard are amortized using the str Orchard classifies royalty advances as short-term or long-term based on the expectations of decision to capitalize an advance to an artist or songwriter as an asset requires significant ju The recoverability of these assets is assessed upon initial commitment of the advance, based from the sale of future and existing music and publishing-related products. In determining w evaluates the current and past popularity of the artist or songwriter, the initial or expected co and past popularity of the genre of music that the product is designed to appeal to, and other portion of such advances that is believed not to be recoverable is expensed. All advances an recoverability periodically, at minimum, on a quarterly basis.

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THE ORCHARD ENTERPRISES INC

NOTES TO CONSOLIDATED FINANCIAL STATEMI

Property and Equipment Property and equipment, consisting primarily of office equipmen are stated at cost less accumulated depreciation. Depreciation and amortization is determine useful lives of the assets. Leasehold improvements are stated at cost and are amortized using term of the lease or the estimated useful lives of the assets.

Major renewals and improvements are capitalized and minor replacements, maintenance and incurred. Upon retirement or disposal of assets, the cost and related accumulated depreciatio sheets and any gain or loss is reflected in the consolidated statements of operations.

Internal-Use Software Development Costs In accordance with AICPA Statement of Positio *Software Developed or Obtained for Internal Use*, Orchard capitalizes certain external and i the application development stage. The application development stage generally includes so and installation activities. Training and maintenance costs are expensed as incurred, while u probable that such expenditures will result in additional functionality. Capitalized software c of the underlying project on a straight-line basis, generally not exceeding five years. Orchard presented because in the opinion of management these costs were not considered capitalizab

Impairment of Long-Lived Assets Orchard reviews long-lived assets for impairment whene that the carrying value of the asset may not be recoverable. In connection with this review, C depreciation and amortization for these assets. Orchard assesses recoverability by determini will be recovered through the projected undiscounted future cash flows of the asset. If Orcha may not be recoverable, it measures any impairment based on the projected future discounte value. Through December 31, 2006, Orchard has not recorded any impairment charges on it

Revenue Recognition Orchard follows the provisions of Staff Accounting Bulletin (SAB (SAB 104), Emerging Issues Task Force (EITF) 00-21 Revenue Arrangements with *Revenue Gross as a Principal versus Net as an Agent*. In general, Orchard recognizes revenu arrangement, the fee is fixed or determinable, the product or services have been delivered an reasonably assured.

Orchard s distribution revenue from the sale of music recordings through digital distributio by the digital service providers, which provide Orchard with periodic notification of the sale

For arrangements with multiple obligations (*e.g.*, deliverable and undelivered music content services), Orchard allocates revenues to each component of the contract based on objective e revenues allocated to undelivered products when the criteria for product revenues set forth a the fair value of the undelivered obligations is not available, the arrangement consideration a amount allocable to the undelivered item(s) within the arrangement. Revenues are recognize Revenues from multiple element arrangements were not significant in any of the periods pre

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THE ORCHARD ENTERPRISES INC

NOTES TO CONSOLIDATED FINANCIAL STATEMI

In accordance with industry practice and as is customary in many territories, certain physica customers with the right to return unsold items. Net distribution revenues to Orchard from s by the retail distributor for the products that are shipped based on gross sales typically less a by distributor based on past historical trends. During 2006, 2005, and 2004, revenues from p revenues, respectively.

Reimbursements received by Orchard from its customers for encoding Orchard s music cor customer are recognized under the proportional performance method as revenue in the perio customer. Cash received in advance of providing the service is recorded as deferred revenue

Shipping and handling charges billed to customers are included in revenues and the costs as recorded as costs of revenues. The physical products are the property of the record labels an handling were not significant in 2006, 2005, or 2004.

Costs of Revenues Costs of revenues includes the royalty expenses owed to the artists and charges, and digital delivery costs. Royalties earned by labels, artists, songwriters, co-publis as an expense in the period in which the sale of the digital or physical music recordings take accompanying consolidated statements of operations.

Product Development Costs Costs incurred in connection with product development and te development costs for the years ended December 31, 2006, 2005, and 2004, were $118,943,

Income Taxes Orchard uses the asset and liability method to determine its income tax expe liabilities are recognized for the future tax consequences attributable to temporary difference amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets a expected to apply to taxable income in the years in which those temporary differences are ex deferred tax assets and liabilities of a change in tax rates is recognized in income in the perio allowances are established when realization of deferred tax assets is not considered more lik

Comprehensive Income SFAS No. 130, *Reporting Comprehensive Income*, requires the dis changes in equity that result from transactions and economic events from non-owner source and 2004 consisted of net loss and foreign currency translation adjustments.

Loss Contingencies Orchard accrues for costs relating to litigation, claims, and other conti and reasonably estimable. Such estimates may be based on advice from third parties or on m amounts paid may differ from amounts estimated, and such differences will be charged to op determination of the liability is made.

Recent Accounting Pronouncements In June 2006, the Financial Accounting Standards Bo No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of*

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THE ORCHARD ENTERPRISES INC

NOTES TO CONSOLIDATED FINANCIAL STATEMI

FASB Statement No. 109 (FIN 48), which clarifies the accounting for uncertainty in incor Orchard recognize in its financial statements the impact of a tax position if that tax position audit, based on the technical merits of the tax position. The provisions of FIN 48 are effectiv year, with the cumulative effect of any change in accounting principle recorded as an adjustr currently evaluating the impact of adopting FIN 48 on its consolidated financial statements.

In September 2006, FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), for measuring fair value, and expands required disclosures about fair value measurements. T years beginning after November 15, 2007. Orchard is currently evaluating the impact of ado

In February 2007, FASB issued SFAS 159, *The Fair Value Option for Financial Assets and* permits entities to choose to measure many financial assets and financial liabilities at fair va which the fair value option has been elected are reported in earnings. SFAS 159 is effective 2007. Orchard does not currently plan to adopt this pronouncement.

4. PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2006 and 2005, consist of the following:

Computer and office equipment	
Furniture and fixtures	
Leasehold improvements	
Total cost	
Less accumulated depreciation and amortization	
Property and equipment net	

Depreciation and amortization expense was $151,311, $45,745, and $18,064 for the years en respectively. In 2006, Orchard disposed of certain leasehold improvements and office equip $39,783 primarily as a result of Orchard s relocation in 2006. Cost of the equipment and lea $136,944 and the related accumulated depreciation was $46,154.

5. ACCRUED ROYALTIES

Orchard s distribution revenue from the sale of music recordings through digital distributio by the digital service providers, which provide Orchard with periodic notification of the sale physical sales are recognized when reported by the retail distributor for the products that are provision for future estimated returns determined by past historical trends.

Accordingly, royalties earned by labels, artists, songwriters, co-publishers, and other copyri
related accrued royalty liability is recognized on the balance sheet in the period in which the
takes place. Orchard typically enters into a

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contractual arrangement with the label or artist under which Orchard is obligated to pay roya percentage of the total distribution revenue. Orchard is normally obligated to pay the royalti receives the distribution revenue from the service provider. Accrued royalties amounted to $ and 2005, respectively.

6. INCOME TAXES

The following is a summary of Orchard s tax provision for the years ended December 31, 2

	2006
Current	$
Deferred	
U.S. Federal	2,897,000
Foreign	60,000
Subtotal	2,957,000
Valuation allowance	(2,957,000)
Total deferred	
Income tax benefit	$

The following table presents the principal reasons for the difference between the statutory U tax rates for the years ended December 31, 2006, 2005 and 2004, presented as follows:

Income tax benefit at U.S. statutory rate of 35%
State and local income taxes net of federal benefit
Effect of permanent differences
Total
Less valuation allowance
Effective income tax rate

At December 31, 2006, Orchard had approximately $15,800,000 of net operating loss carryf which expire in the years 2020 through 2027. Due to the uncertainty of their realization, no for these net operating loss carryforwards and valuation allowances have been established fo net operating losses may be subject to a substantial limitation due to the change of ownersh

Revenue Code and similar state provisions. Such limitation may result in the expiration of th
utilization.

At December 31, 2006, Orchard EU, Limited had available approximately $350,000 of forei
expiration date. At December 31, 2006, Orchard Management, Inc. had available approxima
which expire in the years 2020 through 2027.

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Significant components of Orchard s deferred tax assets for U.S. federal income taxes as of

Net operating loss carryforwards	
Other	
Total deferred tax assets	
Valuation allowance	
Net deferred tax assets	

The valuation allowance increased $2,957,000 and $966,000, respectively, during the years

7. NOTE PAYABLE

Orchard had a promissory note payable to a third party that Orchard was legally obligated to has disputed whether certain conditions were ever met by the lender. Management is not aw lender ceased operations in 2001. The principal amount of the debt, $100,000 and accrued in at December 31, 2005. In February 2006, the statute of limitations for the enforcement of the recognized the outstanding principle and interest of $130,000 related to this promissory note

8. PLAN OF RECAPITALIZATION

In May 2006, through written consents of its shareholders and board of directors, Orchard ar Incorporation and authorized (i) 20,000,000 shares of Series A Convertible Preferred Stock $.001 (ii) 20,000,000 shares of Series B Convertible Preferred Stock (Series B Preferred St (iii) 40,000,000 shares of Common Stock with a par value of $.001 per share (the May 200 2006 Recapitalization, the shareholders and board of directors also authorized the issuance o and (y) 7,931,000 shares of Series B Preferred Stock in exchange for the conversion and can balance of $7,931,000 (see Note 9).

Additionally, Orchard authorized the issuance of 284,832 shares of Common Stock to existi all were employees of Orchard at the date of issuance. The number of shares of Common St not significant. Orchard recognized $83,470 of compensation expense in 2006 related to the on the estimated fair value of the Common Stock. The estimated fair value was determined b independent valuation specialist.

9. CONVERTIBLE DEBT

On April 28, 2003, Orchard entered into a loan agreement with Dimensional (the Loan Ag loan Orchard $700,000. This initial loan was evidenced by a promissory note in the amount

into that number of shares of Orchard s Series A Preferred Stock determined by dividing th
per share of Series A Preferred Stock (i) at any time, at Dimensional s sole option or (ii) au

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closing of a sale of 3,000,000 shares of Orchard s Series A Preferred Stock pursuant to a st
Dimensional. The promissory note accrued interest at the prime rate as announced by Citiba
substantially all of Orchard s assets under a security agreement. The accrued interest was d

During the remainder of 2003 and through December 31, 2005, Dimensional periodically lo
Loan Agreement on substantially the same terms and conditions as the initial $700,000 loan
evidenced by any additional promissory notes and was payable on demand by Dimensional.
balance and accrued interest at December 31, 2005, was classified as a current liability in th
December 31, 2005, the outstanding principal balance of the Dimensional convertible debt w
accrued interest was $707,852. Pursuant to the May 2006 Recapitalization (see Note 8), Din
outstanding principal balance of the convertible debt into 7,931,000 shares of Series A Prefe
Preferred Stock. Interest expense on the convertible debt was $464,261 and $200,709 for the
respectively.

During 2006, Dimensional periodically loaned additional amounts to Orchard under the Loa
conditions as the initial $700,000 loan. This additional convertible debt was not evidenced b
payable on demand by Dimensional. Accordingly, the entire outstanding principal balance a
classified as a current liability in the accompanying consolidated balance sheet. At Decembe
the Dimensional convertible debt was $6,600,000 and the outstanding balance of the accrue
outstanding interest on the $7,931,000 debt that was converted in the May 2006 Recapitaliza
2006 on the $6,600,000 loaned by Dimensional during 2006). Interest expense on the conve
December 31, 2006.

In connection with the execution of the Loan Agreement, on April 28, 2003, the shareholder
(the Shareholder Agreement), which provides that the Board of Directors shall consist of
Dimensional so long as there are any loans outstanding under the Loan Agreement. Addition
Orchard s ability to declare dividends, sell assets, incur indebtedness and issue shares of an
Dimensional s written consent.

10. STOCKHOLDERS DEFICIENCY

Common Stock and Preferred Stock At December 31, 2006, Orchard had authorized the is

Series A Convertible Preferred Stock Orchard s Series A Preferred Stock (a) is its most se
preference of one times the amount of the Original Issue Price of $1.00 per share plus any u
Common Stock on an as converted basis), (c) earns a cumulative annual dividend equal to th
1.0% (calculated on a monthly basis), and (d) is convertible into shares of Common Stock w
Stock for each share of Series A Preferred Stock (subject to adjustment in accordance with t
Series A Preferred Stock). Dividends are payable when and if declared by Orchard s Board
Stock are automatically converted into shares of Common Stock upon the affirmative electio
two-thirds of the outstanding shares of Series A Preferred Stock, or immediately upon the cl

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to an effective registration statement under the Securities Act of 1933, as amended, covering Orchard in which the per share price is at least $4.00 per share and the net proceeds to Orcha A Preferred Stock may, at the option of the holder thereof, be converted at any time into sha is triggered upon (i) a sale, lease or other disposition of substantially all of Orchard s assets (iii) consolidation or merger of Orchard resulting in less than 50% ownership by the shareho converted basis with the shares of the Common Stock of Orchard. However, certain actions the outstanding Series A Preferred Stock such as amendments to the articles of incorporation and the payment of dividends.

At December 31, 2006 and 2005, there were 7,931,000 and no shares of Series A Preferred S

As of December 31, 2006, the board of directors of Orchard has not declared any dividends shareholders of Series A Preferred Stock were entitled to a cumulative dividend of $455,978

Series B Convertible Preferred Stock Orchard s Series B Preferred Stock (a) is junior to th preference of one times the amount of the Original Issue Price of $1.00 per share plus any u Common Stock on an as converted basis), and (c) is convertible into shares of Common Sto Common Stock for each share of Series B Preferred Stock. The shares of Series B Preferred Common Stock upon the affirmative election of the holders of at least 66 2/3% of the outstan immediately upon the closing of a public offering pursuant to an effective registration staten amended, covering the offer and sale of the Common Stock of Orchard in which the per sha proceeds to Orchard are at least $20,000,000. The shares of Series B Preferred Stock may, a any time into shares of Common Stock. The liquidation preference is triggered upon (i) a sa Orchard s assets, (ii) transfer of 50% of Orchard s voting power, or (iii) consolidation or m ownership by the shareholders. Series B Preferred Stock votes on an as converted basis with

At December 31, 2006 and 2005, there were 7,931,000 and no shares of Series B Preferred S

Common Stock Orchard s common stock (a) is its most junior class of stock, (b) has no liq and, (d) is not convertible. At December 31, 2006 and 2005, there were 1,762,444 and 1,477 outstanding, respectively. At December 31, 2006, Orchard has reserved 15,862,000 shares o of the outstanding Series A and Series B Convertible Preferred Stock.

11. EMPLOYEE BENEFIT PLANS

Defined Contribution Plan During 2005, Orchard implemented a 401(k) profit-sharing pla Certain employees have elected to participate in the defined contribution plan. Under the pla contributions based on a percentage of the employee elected contributions. Orchard did not years ended December 31, 2006, 2005 and 2004.

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12. GEOGRAPHIC INFORMATION

Orchard operates in one reportable segment, digital content distribution. Long-lived assets o
significant. Revenues by geographic region, based on the country in which the customer is l
2005, and 2004, were as follow:

U.S. sourced revenue	$
Non-U.S. sourced revenue	
Total revenue	$

13. RELATED-PARTY TRANSACTIONS

From time to time Orchard has amounts due to and from companies that have common own
These amounts are billed and paid on a regular basis. Net payables to affiliates totaled $46,2
respectively.

Management Agreement During 2004, Orchard entered into a management services agreer
incorporated and owned by the Investor Group, for ongoing consulting and management adv
executives employed by Dimensional Associates, Inc. Pursuant to this agreement, Orchard p
predetermined allocation percentage derived from the time spent by such executives on Orc
reviewed periodically by management of the Investor Group, usually semiannually, and the
recognized $657,000, $718,000, and $460,000 during the years ended December 31, 2006, 2
which are included in general and administrative expenses in the accompanying consolidate

Operating Lease With Affiliate Orchard utilized and paid for certain office space (under a
affiliated entity of the Investor Group through April 2006. Amounts included in operating ex
$68,429, $143,588 and $78,796 for the years ended December 31, 2006, 2005 and 2004, res
of leasehold improvements, which have been recorded as fixed assets, from this affiliate dur
respectively. Also, Orchard purchased $15,565 of furniture during 2005 from this affiliated
equipment in the accompanying consolidated balance sheet at December 31, 2005. This affi
ownership.

Beginning in April 2006, Orchard is utilizing space subleased by an affiliated entity, with no
pays the lessee directly for the space utilized. In 2006, Orchard incurred expenses of approx

Legal Costs Orchard has engaged several outside legal firms to represent its general busine
member of one of the senior executives employed by the Investor Group. Amounts included
services performed by this legal firm were $158,432, $26,094 and $110,396 for the years en
respectively.

Distribution Services With eMusic eMusic provides digital music distribution services to O
Agreement, dated January 1, 2004, as amended on March 31, 2007. eMusic is a majority-ow
grants eMusic worldwide rights, on a non-exclusive basis, to exploit Orchard s master reco

December 31, 2009. Per the

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agreement, Orchard is entitled to better royalty terms if eMusic allows any other independen of the agreement (Most Favored Nation clause). Amounts included in revenues in connec and $73,313, for the years ended December 31, 2006, 2005, and 2004, respectively. Amount with these services were $483,037 and $340,483 at December 31, 2006 and 2005, respective

Orchard has distribution agreements with certain labels whereby it is not permitted to charge eMusic. For the years ended December 31, 2006, 2005, and 2004, Orchard received revenue from eMusic relating to such agreements. These amounts were recorded in revenues and wit

Consulting Services With Dimensional Music Publishing, LLC Orchard provided consult during 2005. Dimensional Music Publishing, LLC is owned 100% by the Investor Group. R services during 2005 in the accompanying consolidated statements of operations. No such c

Sale of fixed assets to Dimensional Music Publishing, LLC Orchard sold fixed assets to D of $1,448 in 2006. The cost of the equipment was $5,650 and the related accumulated depre

Revenue Sharing Agreement With CGH Ventures, Inc During 2003 Orchard Managemen entered into a into a revenue sharing agreement with CGH Ventures, Inc., an entity owned b agreement, Orchard is obligated to pay CGH Ventures, Inc. 80% of the net revenues earned Management, Inc. provides management services to a recording group. Orchard recorded $6 and 2004, respectively, as commission expense for CGH s share of the net revenue earned u expense was included in costs of revenues in the accompanying consolidated statement of o

14. COMMITMENTS AND CONTINGENCIES

Lease Commitments Orchard utilized and paid for certain office space (under a written sub of the Investor Group through April 2006. Commencing April 2006, Orchard is utilizing spa formal sublease agreement in place. Rent expense was $487,558, $271,937 and $147,388 fo 2004, respectively.

As such there were no future minimum lease payments under operating leases as of Decemb

Litigation and Indemnification Orchard is a party to litigation matters and claims from tim including copyright infringement litigation, for which it is entitled to indemnification by cor and claims cannot be predicted with certainty, Orchard believes that the final outcome of su on its business, financial position, cash flows, or results of operations.

Contract Dispute In November 2006, Orchard settled an outstanding dispute with a supplie of an obligation for which Orchard had recorded a liability of $1,137,585. As a result of the that has been recorded as a reduction of costs of revenues.

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15. SUBSEQUENT EVENTS

Debt Conversion, Debt Forgiveness and Recapitalization In July 2007, through written co
Orchard ratified and confirmed the outstanding convertible debt of Orchard and authorized t
such convertible debt owed to Dimensional of $10,700,000, simultaneous with the authoriza
2007 Recapitalization). The July 2007 Recapitalization included amending and restating O
the issuance of (i) 10,700,000 shares of Series A Preferred Stock and (ii) 9,675,295 shares o
shares of Common Stock (which was issued to the original common shareholders). In additi
outstanding, including the interest owed and outstanding at December 31, 2006 of $961,442
the May 2006 Recapitalization (see Notes 8 and 9). In connection with the July 2007 Recapi
the Shareholder Agreement, which restated their respective rights and obligations. Pursuant
amended and restated its certificate of incorporation to increase its number of authorized sha
shares of Series A Preferred Stock (ii) 30,000,000 shares of Series B Preferred Stock, and (i

In connection with the July 2007 Recapitalization, a senior executive of Orchard and a senio
deferred stock awards of 745,240 and 279,465 shares of Series B Preferred Stock, which wil
event as defined in the deferred stock award. The award is fully vested and non-forfeitable.

Merger Agreement On July 10, 2007, Orchard entered into an Agreement and Plan of Merg
September 13, 2007 (the Merger Agreement), with Digital Music Group, Inc. (DMGI)
terms of the Merger Agreement, Merger Sub will merge with and into Orchard, with Orchar
wholly-owned subsidiary of DMGI.

Orchard s board of directors unanimously approved the Merger Agreement and the transact
merger, all shares of Orchard capital stock and all deferred stock awards shall be converted i
DMGI common stock and 448,833 shares of DMGI preferred stock (the Merger Shares).

The completion of the merger is subject to various customary conditions, including: (i) obta
DMGI s shareholders; (ii) compliance with all applicable waiting periods imposed by the H
(iii) obtaining reasonably satisfactory tax opinions; (iv) authorizing the issuance of the DMG
shares of DMGI Common Stock; and (v) execute and deliver various ancillary agreements a
rights agreement in favor of Orchard s shareholders covering the Merger Shares (and those
conversion of the DMGI Series A Preferred Stock issued as part of the Merger Shares).

The Merger Agreement also includes customary termination provisions for both Orchard an
termination of the Merger Agreement under specified circumstances relating to the receipt b
transaction with DMGI, Orchard may be required to pay DMGI a termination fee of $1.11 m
incurred in connection with the transaction up to $500,000.

The proposed merger is expected to be completed in the fourth calendar quarter of 2007.

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CONDENSED CONSOLIDATED BALANCE S

(Unaudited)

ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	
Accounts receivable net (including amounts from related parties of $642,973 in 2007 and $483,037 in 2006)	
Royalty advances	
Prepaid expenses and other current assets	
Due from affiliated entities	
Total current assets	
PROPERTY AND EQUIPMENT Net	
OTHER ASSETS	
TOTAL	
LIABILITIES AND STOCKHOLDERS DEFICIENCY	
CURRENT LIABILITIES:	
Accounts payable	
Accrued royalties	
Accrued expenses	
Due to affiliated entities	
Deferred revenue	
Accrued interest payable to a related party	
Convertible debt payable to a related party	
Total current liabilities	
COMMITMENTS AND CONTINGENCIES	
STOCKHOLDERS DEFICIENCY:	
Series A convertible preferred stock, $.001 par value 20,000,000 shares authorized, 7,931,000 issued and outstanding; liquidation preference of $ 8,750,772	
Series B convertible preferred stock, $.001 par value 20,000,000 shares authorized, 7,931,000 issued and outstanding; liquidation preference of $ 7,931,000	
Common stock, $.001 par value 40,000,000 shares authorized; 1,762,444 shares issued and outstanding	
Stock subscription receivable	
Paid-in capital	
Accumulated deficit	
Accumulated other comprehensive income	
Total stockholders deficiency	
TOTAL	

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THE ORCHARD ENTERPRISES INC

CONDENSED CONSOLIDATED STATEMENTS OF

(Unaudited)

REVENUES (including amounts from related parties of $1,316,823 in 2007 and $922,769 in	
COSTS OF REVENUES (including amounts from related parties of $15,978 in 2007 and $3 2006)	
GROSS PROFIT	
OPERATING EXPENSES:	
Product development (including amounts from related parties of $5,288 in 2007 and $2,486	
Sales and marketing (including amounts from related parties of $63,459 in 2007 and $57,17	
General and administrative (including amounts from related parties $102,740 in 2007 and $4 2006)	
Total operating expenses	
LOSS FROM OPERATIONS	
OTHER (INCOME) EXPENSE:	
Other income	
Interest income	
Interest expense from a related party	
Total other expense	
NET LOSS	

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THE ORCHARD ENTERPRISES INC

CONDENSED CONSOLIDATED STATEMENTS OF

(Unaudited)

CASH FLOWS FROM OPERATING ACTIVITIES:
Net loss
Adjustments to reconcile net loss to net cash used in operating activities:
Depreciation and amortization
Bad debt expense
Loss on sale/disposal of fixed assets
Gain on note payable and related accrued interest
Stock-based compensation
Changes in operating assets and liabilities:
Accounts receivable
Royalty advances
Prepaid expenses and other current assets
Other assets
Accounts payable
Accrued royalties
Accrued expenses
Due to affiliated entities
Deferred revenue
Accrued interest payable
Net cash used in operating activities
CASH FLOWS FROM INVESTING ACTIVITIES:
Purchases of property and equipment
Proceeds from the sale of fixed assets
Net cash used in investing activities
CASH FLOWS FROM FINANCING ACTIVITIES Proceeds from issuance of convertible a related party
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS
INCREASE IN CASH AND CASH EQUIVALENTS
CASH AND CASH EQUIVALENTS Beginning of period
CASH AND CASH EQUIVALENTS End of period

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THE ORCHARD ENTERPRISES INC

NOTES TO CONDENSED CONSOLIDATED FINANCIA

(Unaudited)

1. ORGANIZATION AND BUSINESS

Orchard Enterprises Inc. (Orchard) was incorporated in New York in September 2000 an content. Orchard is a global music marketing and distribution company, offering a suite of i create and sell product digitally across a worldwide network of digital entertainment service

On April 28, 2003, Dimensional Associates, LLC (Dimensional), an entity formed by a g invested in and acquired operating control of Orchard through the purchase of a convertible fundings under the same terms and conditions as the original convertible debt instrument (se principal of $7,931,000 was cancelled and exchanged for 7,931,000 shares of Orchard s Se shares of Orchard s Series B Convertible Preferred Stock (See Notes 6 and 7). In July of 20 was cancelled and exchanged for 10,700,000 shares of shares of Orchard s Series A Conver Orchard s Series B Convertible Preferred Stock (See Note 12).

2. BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements have been prepared pursuan Commission (the SEC). Certain information and footnote disclosures normally included i accounting principles generally accepted in the United States of America have been condens financial statements should be read in conjunction with Orchard s financial statements for t

In the opinion of management, the financial statements as of June 30, 2007 and for the six m include all adjustments (consisting of normal recurring accruals) necessary for a fair present of operations and cash flows for the periods presented. The results of operations for the six m necessarily indicative of the results to be expected for the full year.

The condensed consolidated financial statements have been prepared assuming Orchard will incurred losses and negative cash flows from operations since its inception. Orchard incurre ended June 30, 2007, has incurred operating losses since inception, has a working capital de deficit of $18,683,155 at June 30, 2007. Orchard s ability to continue operating as a going c generate operating cash flows through the execution of its business plan or to secure funding needs of its business. Until and unless Orchard s operations generate significant revenues a fund operations from cash on hand, through the issuance of debt and through the issuance of has committed to fund the operations of Orchard through at least October 1, 2008.

3. SIGNIFICANT ACCOUNTING POLICIES

Consolidation and Basis of Presentation The condensed consolidated financial statements owned subsidiaries, Orchard Management, Inc., and Orchard EU, Limited. The consolidated revenues, expenses, and cash flows of Orchard and all entities in which Orchard has a contro consolidated in

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accordance with accounting principles generally accepted in the United States (U.S. GAAP transactions have been eliminated in consolidation.

Use of Estimates The preparation of condensed consolidated financial statements and relate requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and revenues and expenses durin from those estimates. The most significant estimates relate to assessing the collectability of advances, the value of securities underlying stock based compensation, the realization of def allowances, and the useful lives and potential impairment of Orchard s property and equipm periodically and the effects of revisions are reflected in the period that they are determined t

Cash and Cash Equivalents Cash and cash equivalents include all short-term highly liquid amounts of cash and have maturities of three months or less when purchased.

Allowance for Doubtful Accounts Orchard establishes allowances for doubtful accounts ba economic and industry trends, contractual terms and conditions and historic payment experi Accordingly, at June 30, 2007 and December 31, 2006, Orchard had $75,387 and $70,000, r accounts.

Fair Value of Financial Instruments The carrying value of Orchard s short-term financia accounts payable, accrued expenses, and accrued royalties approximates their fair value due no market value information available for Orchard s convertible debt and a reasonable estim costs (see Note 7).

Foreign Currency Translation Orchard has foreign operations where the functional curren The functional currency of Orchard s subsidiary in the United Kingdom has been determine local currency is the functional currency, assets and liabilities are translated using end-of-pe flows are translated using average rates of exchange. For these operations, currency translati component of stockholders deficiency. Transaction gains and losses are recognized in the c

Concentrations of Credit Risk Orchard s customers are primarily commercial organizatio receivable are generally unsecured.

The revenues from two of its customers, iTunes and eMusic account for a significant portion iTunes were approximately 53% and 52% of total revenues and revenues from eMusic were the six months ended June 30, 2007 and 2006, respectively. Accounts receivable from iTune at June 30, 2007 and December 31, 2006, respectively. Accounts receivable from eMusic we 2007 and December 31, 2006.

Due From Digital Service Providers At June 30, 2007 and December 31, 2006, accounts re respectively, related to reimbursements to Orchard by its customers for digital encoding of C the customer s retail website.

Royalty Advances and Digital Rights Orchard has paid advance royalties and the cost of ac Orchard accounts for these advance royalty payments and digital rights acquisition costs pur Accounting Standards (SFAS) No. 50, *Financial Reporting in the Record and Music Indu* certain

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advance royalty payments that are believed to be recoverable from future royalties to be earn assets. Royalty advances will be recouped from Orchard s future royalty obligations resulti entertainment services. Digital rights acquired by Orchard are amortized using the straight-li Orchard classifies royalty advances as short-term or long-term based on the expectations of decision to capitalize an advance to an artist or songwriter as an asset requires significant ju The recoverability of these assets is assessed upon initial commitment of the advance, based from the sale of future and existing music and publishing-related products. In determining w evaluates the current and past popularity of the artist or songwriter, the initial or expected co and past popularity of the genre of music that the product is designed to appeal to, and other portion of such advances that is believed not to be recoverable is expensed. All advances an recoverability periodically, at minimum, on a quarterly basis.

Property and Equipment Property and equipment, consisting primarily of office equipmen are stated at cost less accumulated depreciation. Depreciation and amortization is determine useful lives of the assets. Leasehold improvements are stated at cost and are amortized using term of the lease or the estimated useful lives of the assets.

Major renewals and improvements are capitalized and minor replacements, maintenance and incurred. Upon retirement or disposal of assets, the cost and related accumulated depreciatio sheets and any gain or loss is reflected in the consolidated statements of operations.

Internal-Use Software Development Costs In accordance with AICPA Statement of Positio *Software Developed or Obtained for Internal Use*, Orchard capitalizes when necessary certa incurred during the application development stage. The application development stage gener coding, testing and installation activities. Training and maintenance costs are expensed as in capitalized if it is probable that such expenditures will result in additional functionality. Cap estimated useful life of the underlying project on a straight-line basis, generally not exceedi June 30, 2007 and 2006, Orchard capitalized $129,825 and $0 of internal-use software deve

Impairment of Long-Lived Assets Orchard reviews long-lived assets for impairment when that the carrying value of the asset may not be recoverable. In connection with this review, depreciation and amortization for these assets. Orchard assesses recoverability by determini will be recovered through the projected undiscounted future cash flows of the asset. If Orcha may not be recoverable, it measures any impairment based on the projected future discounte value. As of June 30, 2007, Orchard has not recorded any impairment charges on its long-liv

Revenue Recognition Orchard follows the provisions of Staff Accounting Bulletin (SAB (SAB 104), Emerging Issues Task Force (EITF) 00-21, *Revenue Arrangements with M Revenue Gross as a Principal versus Net as an Agent* (EITF 99-19). In general, Orchard evidence of an arrangement, the fee is fixed or determinable, the product or services have be receivable is reasonably assured.

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The Orchard s distribution revenue from the sale of recorded music products through digita products are sold by the digital service providers who provide Orchard with periodic notifica

For arrangements with multiple obligations (e.g., deliverable and undelivered music content services), Orchard allocates revenues to each component of the contract based on objective revenues allocated to undelivered products when the criteria for product revenues set forth a the fair value of the undelivered obligations is not available, the arrangement consideration amount allocable to the undelivered item(s) within the arrangement. Revenues are recognize Revenues from multiple element arrangements were not significant for the six months ende

In accordance with industry practice and as is customary in many territories, certain physica customers with the right to return unsold items. Net distribution revenues to Orchard from s by the retail distributor for the products that are shipped based on gross sales typically less a by distributors based on past historical trends. For the six months ended June 30, 2007 and 2 approximately 1% and 5% of total revenues, respectively.

Reimbursements received by Orchard from its customers for encoding Orchard s music con customer are recognized under the proportional performance method as revenue in the perio customer. Cash received in advance of providing the service is recorded as deferred revenue

Shipping and handling charges billed to customers are included in revenues and the costs as recorded as cost of revenues. The physical products are the property of the recording labels handling were not significant during the six months ended June 30, 2007 and 2006.

Costs of Revenues Costs of revenues includes the royalty expenses owed to the artists and charges, and digital delivery costs. Royalties earned by labels, artists, songwriters, co-publis as an expense in the period in which the sale of the digital or physical music takes place and accompanying condensed consolidated statements of operations.

Product Development Costs Costs incurred in connection with product development and te development costs for the six months ended June 30, 2007 and 2006, were $106,966 and $7

Income Taxes Orchard uses the asset and liability method to determine its income tax expe liabilities are recognized for the future tax consequences attributable to temporary difference amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets a expected to apply to taxable income in the years in which those temporary differences are ex deferred tax assets and liabilities of a change in tax rates is recognized in income in the perio allowances are established when realization of deferred tax assets is not considered more lik

Effective January 1, 2007, the Orchard adopted the provisions of the Financial Accounting S *Accounting for Uncertainty in Income Taxes* (FIN 48) an interpretation of SFAS No. 109 accounting for uncertainty in income taxes recognized in an enterprise s financial statement recognition

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threshold and measurement attribute for the financial statement recognition and measuremen
in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and p
and transition. As of January 1, 2007, Orchard had no significant unrecognized tax benefits.
Orchard recognized no adjustments for uncertain tax benefits. Orchard is subject to U.S. fed
all years since its inception. Orchard does not expect any significant changes to its unrecogn

Orchard recognizes interest and penalties related to uncertain tax positions in income tax exp
uncertain tax positions were accrued at June 30, 2007.

Orchard maintains a full valuation allowance on its deferred tax assets. Accordingly, Orchar

Comprehensive Income SFAS No. 130, *Reporting Comprehensive Income*, requires the dis
changes in equity that result from transactions and economic events from non-owner sources
ended June 30, 2007 and 2006 consisted of net loss and foreign currency translation adjustm

The components of comprehensive loss are as follows:

Net loss	
Foreign currency translation adjustment	
Comprehensive loss	

Loss Contingencies Orchard accrues for costs relating to litigation, claims and other contin
and reasonably estimable. Such estimates may be based on advice from third parties or on m
amounts paid may differ from amounts estimated, and such differences will be charged to op
determination of the liability is made.

Recent Accounting Pronouncements In September 2006, FASB issued SFAS No. 157, *Fa*
fair value, establishes a framework for measuring fair value, and expands required disclosur
of SFAS 157 are effective for fiscal years beginning after November 15, 2007. Orchard is cu
SFAS 157 on its financial statements.

In February 2007, FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets*
permits entities to choose to measure many financial assets and financial liabilities at fair va
which the fair value option has been elected are reported in earnings. SFAS 159 is effective
2007. Orchard does not currently plan to adopt this pronouncement.

4. ACCRUED ROYALTIES

Orchard s distribution revenue from the sale of music recordings through digital distributio
by the digital service providers who provide Orchard with periodic notification of the sales.
physical sales are recognized when reported by the retail distributor for the products that are
provision for future estimated returns determined by past historical trends.

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Accordingly, royalties earned by labels, artists, songwriters, co-publishers, other copyright h
accrued royalty liability is recognized on the balance sheet in the period in which the sale of
place. Orchard typically enters into a contractual arrangement with the label or artist under w
label or artist based on an agreed upon percentage of the total distribution revenue. Orchard
after the end of the quarter in which it receives the distribution revenue from the service pro
and $5,688,066 at June 30, 2007 and December 31, 2006, respectively.

5. NOTE PAYABLE

Orchard had a promissory note payable to a third party that Orchard was legally obligated to
has disputed whether certain conditions were ever met by the lender. Management is not aw
lender ceased operations in 2001. In February of 2006, the statute of limitations for the enfo
Orchard has recognized the outstanding principle and interest of $130,000 related to this pro

6. PLAN OF RECAPITALIZATION

In May 2006, through written consents of its shareholders and board of directors, Orchard ar
Incorporation and authorized (i) 20,000,000 shares of Series A Convertible Preferred Stock
$.001 (ii) 20,000,000 shares of Series B Convertible Preferred Stock (Series B Preferred St
(iii) 40,000,000 shares of Common Stock with a par value of $.001 per share (the May 200
2006 Recapitalization, the shareholders and board of directors also authorized the issuance o
and (y) 7,931,000 shares of Series B Preferred Stock in exchange for the conversion and can
balance of $7,931,000 (see Note 7).

Additionally, Orchard authorized the issuance of 284,832 shares of common stock to existin
were employees of Orchard at the date of issuance. The number of shares of common stock
significant. Orchard recognized $83,470 of compensation expense in the six months ended J
shares of common stock based on the estimated fair value of the common stock. The estimat
on a valuation performed by an independent valuation specialist.

7. CONVERTIBLE DEBT

On April 28, 2003, Orchard entered into a loan agreement with Dimensional (the Loan Ag
loan Orchard $700,000. This initial loan was evidenced by a promissory note in the amount
into that number of shares of Orchard s Series A Preferred Stock determined by dividing th
$1.00 per share of Series A Preferred Stock (i) at any time, at Dimensional s sole option or
3,000,000 shares of Orchard s Series A Preferred Stock pursuant to a stock purchase agreem
promissory note accrued interest at the prime rate as announced by Citibank N.A. plus 1.0%
assets under a security agreement. The accrued interest was due and payable on demand by

During the remainder of 2003 and through December 31, 2005, Dimensional periodically lo
Loan Agreement on substantially the same terms and conditions as the initial $700,000 loan
evidenced by any additional promissory notes and was payable on demand by Dimensional.
balance and accrued interest at December 31, 2005, was classified as a current liability in th

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December 31, 2005, the outstanding principal balance of the Dimensional convertible debt w
accrued interest was $707,852. Pursuant to the May 2006 Recapitalization (see Note 6), Dim
outstanding principal balance of the convertible debt into 7,931,000 shares of Series A Prefe
Preferred Stock.

During 2007 and 2006, Dimensional has periodically loaned additional amounts to Orchard
same terms and conditions as the initial $700,000 loan. This additional convertible debt was
and was payable on demand by Dimensional. Accordingly, the entire outstanding principal b
December 31, 2006, is classified as a current liability in the accompanying condensed conso
December 31, 2006, the outstanding principal balance of the Dimensional convertible debt w
outstanding balance of the accrued interest was $1,634,810 and $1,227,937 (which includes
that was converted in the May 2006 Recapitalization (see Note 6) and interest accrued durin
Dimensional during 2007 and 2006). Interest expense on the convertible debt was $406,873
2007 and 2006.

In connection with the execution of the Loan Agreement, on April 28, 2003, the shareholder
(the Shareholder Agreement), which provides that the Board of Directors shall consist of
Dimensional so long as there are any loans outstanding under the Loan Agreement. Addition
Orchard s ability to declare dividends, sell assets, incur indebtedness and issue shares of an
Dimensional s written consent.

8. STOCKHOLDERS DEFICIENCY

Common Stock and Preferred Stock At June 30, 2007, Orchard had authorized the issuanc

Series A Convertible Preferred Stock Orchard s Series A Preferred Stock (a) is its most ser
preference of one times the amount of the Original Issue Price of $1.00 per share plus any u
Common Stock on an as converted basis), (c) earns a cumulative annual dividend equal to th
1.0% (calculated on a monthly basis), and (d) is convertible into shares of Common Stock w
Stock for each share of Series A Preferred Stock (subject to adjustment in accordance with t
Series A Preferred Stock) Dividends are payable when and if declared by Orchard s Board
are automatically converted into shares of Common Stock upon the affirmative election of th
shares of Series A Preferred Stock, or immediately upon the closing of a public offering pur
the Securities Act of 1933, as amended, covering the offer and sale of the Common Stock of
$4.00 per share and the net proceeds to Orchard are at least $20,000,000. The shares of the S
holder thereof, be converted at any time into shares of Common Stock. The liquidation prefe
disposition of substantially all of Orchard s assets, (ii) transfer of 50% of Orchard s voting
resulting in less than 50% ownership by the shareholders. Series A Preferred Stock votes on
Common Stock of Orchard. However, certain actions of Orchard require the approval by a m
Stock such as amendments to the articles of incorporation, acquisitions, involuntary liquidat

At June 30, 2007 and December 31, 2006, there were 7,931,000 shares of Series A Preferred

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As of June 30, 2007, the board of directors of Orchard has not declared any dividends on the
Series A Preferred Stock were entitled to a cumulative dividend of $819,772 at June 30, 200

Series B Convertible Preferred Stock Orchard s Series B Preferred Stock (a) is junior to th
preference of one times the amount of the Original Issue Price of $1.00 per share plus any u
Common Stock on an as converted basis), and (c) is convertible into shares of Common Sto
Common Stock for each share of Series B Preferred Stock. The shares of Series B Preferred
Common Stock upon the affirmative election of the holders of at least 66 2/3 of the outstandi
immediately upon the closing of a public offering pursuant to an effective registration staten
amended, covering the offer and sale of the Common Stock of Orchard in which the per sha
proceeds to Orchard are at least $20,000,000. The shares of Series B Preferred Stock may, a
any time into shares of Common Stock. The liquidation preference is triggered upon (i) a sa
Orchard s assets, (ii) transfer of 50% of Orchard s voting power, or (iii) consolidation or m
ownership by the shareholders. Series B Preferred Stock votes on an as converted basis with

At June 30, 2007 and December 31, 2006, there were 7,931,000 shares of Series B Preferred

Common Stock Orchard s common stock (a) is its most junior class of stock, (b) has no liq
and (d) is not convertible. At June 30, 2007 and December 31, 2006, there were 1,762,444 s
June 30, 2007, Orchard has 15,862,000 shares of common stock reserved for issuance upon
Series B Convertible Preferred Stock.

9. GEOGRAPHIC INFORMATION

Orchard operates in one reportable segment, digital music content distribution. Long-lived a
not significant. Revenues by geographic region, based on the country in which the customer
and 2006, are as follow:

U.S. sourced revenue	
Non-U.S. sourced revenue	
Total revenue	

10. RELATED-PARTY TRANSACTIONS

From time to time Orchard has amounts due to and from companies that have common own
These amounts are billed and paid on a regular basis. Net receivable (payables) to affiliates
December 31, 2006, respectively.

Management Agreement During 2004 Orchard entered into a management services agreen
owned by the Investor Group, for ongoing consulting and management advisory services pe
Dimensional. Pursuant to this agreement, Orchard paid a monthly management fee based on
from the time

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spent by such executives on Orchard s business. As of January 1,2007 employees devoting were hired by Orchard and the management fee was suspended. Orchard recognized $306,0 management fees which are included in general and administrative expenses in the accompa operations.

Operating Lease With Affiliate Orchard utilized and paid for certain office space (under a affiliated entity of the Investor Group through April 2006. Amounts included in operating e $52,356 for the six months ended June 30, 2006.

In January 2006, Orchard began utilizing space subleased by an affiliated entity, with no for the lessee directly for the space utilized. For the six months ended June 30, 2007 and 2006, $169,225 and $96,800, respectively, under this arrangement. In August 2007, the sublease t Orchard. The lease expires in January 2009.

Legal Costs Orchard has engaged several outside legal firms to represent its general busine member of one of the senior executives employed by the Investor Group. Amounts included services performed by this legal firm were $2,263 and $34,670 for the six months ended Jun

Distribution Services With eMusic eMusic provides digital music distribution services to Agreement, dated January 1, 2004, as amended on March 31, 2007. eMusic is a majority ow grants eMusic worldwide rights, on a non-exclusive basis, to exploit Orchard s master reco December 31, 2009. Per the agreement, Orchard is entitled to better royalty terms if eMusic better terms during the Term of the agreement (Most Favored Nation clause). Amount were $1,316,823 and $922,769, for the six months ended June 30, 2007 and 2006, respectiv connection with these services were $642,973 and $483,087 at June 30, 2007 and Decembe

Orchard has distribution agreements with certain labels whereby it is not permitted to charg eMusic. For the six months ended June 30, 2007 and 2006, Orchard received revenues of $3 relating to such agreements. These amounts were recorded in revenues and with an equal am

Sale of fixed assets to Dimensional Music Publishing, LLC Orchard sold fixed assets to D of $1,448 for the six months ended June 30 2006. The cost of the equipment was $5,650 and

Revenue Sharing Agreement With CGH Ventures, Inc During 2003 Orchard Managemen entered into a revenue sharing agreement with CGH Ventures, Inc., an entity owned by two agreement, Orchard is obligated to pay CGH Ventures, Inc. 80% of the net revenues earned Management Inc. provides management services to a recording group. Orchard recorded $1 June 30, 2007 and 2006, respectively as commission expense for CGH s share of the net re The commission expense was included in costs of revenues in the accompanying condensed

11. COMMITMENTS AND CONTINGENCIES

Litigation and Indemnification Orchard is a party to litigation matters and claims from tim including copyright infringement litigation, for which it is entitled to

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indemnification by content providers. While the results of such litigation and claims cannot
the final outcome of such matters will not have a material adverse impact on its business, fi
operations.

12. SUBSEQUENT EVENTS

Debt Conversion, Debt Forgiveness and Recapitalization In July 2007, through written co
Orchard ratified and confirmed the outstanding convertible debt of Orchard and authorized t
such convertible debt owed to Dimensional of $10,700,000, simultaneous with the authoriza
2007 Recapitalization). The July 2007 Recapitalization included amending and restating O
the issuance of (i) 10,700,000 shares of Series A Preferred Stock and (ii) 9,675,295 shares o
(iii) 2,377,778 shares of Common Stock (which was issued to the original common shareho
compensation charge for the nine months ended September 30, 2007 based on the fair value
shareholders. In addition, Dimensional forgave all interest owed and outstanding, including
December 31, 2006, related to the debt converted in connection with the May 2006 Recapita
interest owed will be reflected in other income for the quarter ended September 30, 2007. In
the shareholders amended and restated the Shareholder Agreement, which restated their resp
2007 Recapitalization, Orchard amended and restated its certificate of incorporation to incre
stock as follows: (i) 30,000,000 shares of Series A Preferred Stock (ii) 30,000,000 shares of
shares of Common Stock.

In connection with the July 2007 Recapitalization, a senior executive of Orchard and a senio
deferred stock awards of 745,240 and 279,465 shares of Series B Preferred Stock, which wi
event, as defined in the deferred stock award. The award is fully vested and non-forfeitable.
charge for the nine months ended September 30, 2007 based on the fair value of the deferre

Merger Agreement On July 10, 2007, Orchard entered into an Agreement and Plan of Merg
September 13, 2007 (the Merger Agreement), with Digital Music Group, Inc. (DMGI)
terms of the Merger Agreement, Merger Sub will merge with and into Orchard, with Orchar
Surviving Corporation) and as a wholly-owned subsidiary of DMGI.

Orchard s board of directors unanimously approved the Merger Agreement and the transact
merger, all shares of Orchard capital stock and all deferred stock awards shall be converted i
DMGI Common Stock and 448,833 shares of DMGI Series A Preferred Stock (the Merger

The completion of the merger is subject to various customary conditions, including: (i) obta
DMGI s shareholders; (ii) compliance with all applicable waiting periods imposed by the H
(iii) obtaining reasonably satisfactory tax opinions; (iv) authorizing the issuance of the DMG
shares of DMGI Common Stock; and (v) execute and deliver various ancillary agreements a
rights agreement in favor of Orchard s shareholders covering the Merger Shares (and those
conversion of the DMGI Series A Preferred Stock issued as part of the Merger Shares).

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The Merger Agreement also includes customary termination provisions for both Orchard an termination of the Merger Agreement under specified circumstances relating to the receipt b transaction with DMGI, Orchard may be required to pay DMGI a termination fee of $1.11 n incurred in connection with the transaction up to $500,000.

The proposed merger is expected to be completed in the fourth calendar quarter of 2007.

* * * * * *

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DIGITAL MUSIC GROUP, INC.

INTRODUCTION TO UNAUDITED PRO FORMA

COMBINED FINANCIAL STATEMENT

The following unaudited pro forma condensed combined financial statements give effect to (DMGI) and The Orchard Enterprises Inc. (Orchard). For accounting purposes, Orcha the purchase price is allocated among the fair values of the assets and liabilities of DMGI, w in the results of the combined company. The transaction will be accounted for under the pur Statement of Financial Accounting Standards No 141, *Business Combinations*. Under the pu purchase price, calculated as described in Note 2 to these unaudited pro forma condensed co tangible and intangible assets acquired and liabilities assumed in connection with the transac time the merger is consummated.

For purposes of these unaudited pro forma condensed combined financial statements, DMGI estimated purchase price to the assets to be acquired and liabilities to be assumed based on p determination of the estimated fair values, will be made subsequent to the completion of the actual assets and liabilities of DMGI that exist as of the date of completion of the merger. Th the merger may differ materially from the information presented in these unaudited pro form result of:

- net cash used in DMGI s and Orchard s operations between the dates of the pro merger;
- other changes in DMGI s and Orchard s assets and liabilities that occur prior to
- the timing of completion of the merger; and
- other changes in estimated costs and fair values, which could cause material diffe

The unaudited pro forma condensed combined financial statements presented below are base and Orchard, adjusted to give effect to the acquisition of DMGI by Orchard for accounting p in the accompanying notes.

The unaudited pro forma condensed combined balance sheet as of June 30, 2007 gives effec June 30, 2007, and combines the historical balance sheets of DMGI and Orchard as of June statement.

The unaudited pro forma condensed combined statement of operations for the six months en was consummated on January 1, 2006, and combines the historical results of DMGI and Orc included herein. The unaudited pro forma condensed combined statement of operations for t if the merger was consummated on January 1, 2006, and combines the historical results of C December 31, 2006, and also gives effect to DMGI s acquisition of Digital Musicworks Int Bravo Entertainment LLC (Rio Bravo) on February 6, 2006 and DMGI s acquisition of 2006, as if these acquisitions also occurred on January 1, 2006. The historical results of DM 2006 were derived from their audited consolidated statements of operations included elsewh pre-acquisition pro forma results for companies acquired by DMGI during 2006 were derive statements for the year ended December 31, 2006, also included elsewhere in this proxy stat

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DIGITAL MUSIC GROUP, INC.

INTRODUCTION TO UNAUDITED PRO FORMA

COMBINED FINANCIAL STATEMENTS (C

These unaudited pro forma condensed combined financial statements have been prepared fo
of the consolidated financial position or results of operations in future periods or the results
and Orchard been a combined company during the periods presented. The pro forma adjustm
available at the time of the preparation of this proxy statement and are subject to change. Th
financial statements, including the notes thereto, are qualified in their entirety by reference t
historical financial statements of DMGI and Orchard included elsewhere in this proxy staten

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DIGITAL MUSIC GROUP, INC.

UNAUDITED PRO FORMA CONDENSED COMBINED

June 30, 2007

	Digital Music Group, Inc. Historical	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 13,968,883	$
Accounts receivable, net	1,835,638	
Current portion of royalty advances	1,983,679	
Prepaid expenses and other current assets	601,844	
Total current assets	18,390,044	
Furniture and equipment, net	1,020,541	
Digital rights, net	3,546,393	
Master recordings, net	2,122,843	
Royalty advances, less current portion	7,205,769	
Goodwill	5,355,944	
Other assets	42,563	
Total assets	$ 37,684,097	$
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable and accrued liabilities	$ 1,369,197	$
Royalties payable	2,204,311	
Deferred revenue		
Current portion of capital lease obligations	34,090	
Merger-related liabilities		
Accrued interest payable to a related party		
Convertible debt payable to a related party		
Total current liabilities	3,607,598	
Long-term liabilities:		
Capital lease obligations, less current portion	1,719	
Other long-term liabilities	89,285	
Total liabilities	3,698,602	
Commitments and contingencies		
Stockholders equity (deficit):		
Orchard Series A convertible preferred stock		
Orchard Series B convertible preferred stock		
Preferred stock, $.01 par value, 1,000,000 shares authorized: pro forma 448,833 shares issued and outstanding		
Orchard Common stock		
Common stock subscription receivable		

Common stock, $.01 par value, 30,000,000 shares authorized: pro forma 18,186,880 shares issued and outstanding	91,219	
Additional paid-in capital	40,564,757	
Accumulated deficit	(6,670,481)	
Accumulated other comprehensive income		
Total stockholders equity (deficit)	33,985,495	
Total liabilities and stockholders equity (deficit)	$ 37,684,097	$

The accompanying notes are an integral part of these unaudited pro forma cond

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DIGITAL MUSIC GROUP, INC.

UNAUDITED PRO FORMA CONDENSED COMBINED STATE

For the Six Months Ended June 30, 200

	Digital Music Group, Inc. Historical	The En H
Revenue	$ 6,543,811	$ 1
Cost of revenue:		
Royalties and payments to content owners	4,593,191	
Amortization	394,451	
Gross profit	1,556,169	
Operating, general and administrative expenses	3,482,509	
Merger-related expenses	328,844	
Loss from operations	(2,255,184)	(
Interest income	441,516	
Interest expense	(3,924)	
Other expense	(27,443)	
Loss before taxes	(1,845,035)	(
Income taxes	(800)	
Net loss	$ (1,845,835)	$ (
Loss per share:		
Basic	$ (0.20)	
Diluted	$ (0.20)	
Weighted average shares outstanding:		
Basic	9,030,880	
Diluted	9,030,880	

The accompanying notes are an integral part of these unaudited pro forma cond

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DIGITAL MUSIC GROUP, INC.

UNAUDITED PRO FORMA CONDENSED COMBINED STATE

For the Year Ended December 31, 2006

	Digital Music Group, Inc. Historical	Digital Music Group, Inc. (prior to acquisition)	Rio Bravo Entertainment LLC Carve Out Segment (prior to acquisition)	Digital Rights Agency LLC (prior to acquisition)
Revenue	$ 5,564,949	$	$ 63,196	$ 4,572,956
Cost of revenue:				
Royalties and payments to content owners	3,329,698		50,556	3,880,289
Amortization	422,489			
Gross profit	1,812,762		12,640	692,667
Operating, general and administrative expenses	5,655,161	10,000	624	733,800
Income (loss) from operations	(3,842,399)	(10,000)	12,016	(41,133)
Interest income	1,251,396			5,923
Interest expense	(13,649)	(4,667)		(1,538)
Other income (expense)	(16,982)			
Income (loss) before taxes	(2,621,634)	(14,667)	12,016	(36,748)
Income taxes	(800)			
Net income (loss)	$ (2,622,434)	$ (14,667)	$ 12,016	$ (36,748)
Loss per share:				
Basic	$ (0.32)			
Diluted	$ (0.32)			
Weighted average shares outstanding:				
Basic	8,071,393			
Diluted	8,071,393			

The accompanying notes are an integral part of these unaudited pro forma cond

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DIGITAL MUSIC GROUP, INC.

NOTES TO THE UNAUDITED PRO FORMA CO

COMBINED FINANCIAL STATEMENT

1. The Merger and Basis of Presentation

On July 10, 2007, DMGI and Orchard entered into a merger agreement, which was amended which a wholly-owned subsidiary of DMGI, DMGI New York, Inc. (DMGI NY), will me as the surviving company and becoming a wholly-owned subsidiary of DMGI. Pursuant to t aggregate of 9,064,941 shares of common stock of DMGI, par value $0.01 per share, and 44 preferred stock or the right to receive such shares, as applicable, par value $0.01 per share, i and preferred stock of Orchard and deferred stock awards. Each share of the preferred stock voting rights equivalent to, ten shares of DMGI common stock, with a liquidation preferenc

Because Orchard stockholders will own a majority of the voting stock of the combined com deemed to be the acquiring company for accounting purposes and the transaction will be acc with Statement of Financial Accounting Standards No 141, *Business Combinations*. Accordi recorded as of the merger closing date at their estimated fair value.

The accompanying pro forma condensed combined financial statements do not give effect to expected to result from the merger of DMGI and Orchard. Further, these pro forma condens perhaps materially, based on facts and circumstances as of the closing of the merger.

2. Preliminary Purchase Price Allocation

The preliminary estimated purchase price is as follows:

Fair value of DMGI outstanding common stock	
Estimated fair value of DMGI stock options and warrants	
Direct merger-related costs	
Total estimated purchase price	

On July 10, 2007, DMGI had 9,121,939 shares of common stock outstanding and has not iss value of DMGI common stock used in determining the purchase price was $4.248 per share for the two days prior to through the two days subsequent to the merger announcement date DMGI s stock options and warrants was determined using the Trinomial Lattice Model usi return of %; expected volatility of %; dividend rate of 0%; and a weighted-average e

Orchard s merger-related costs include approximately $1,072,500 in legal, accounting and employee termination, relocation, lease cancellation and other costs to be incurred in connec and Orchard operations.

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DIGITAL MUSIC GROUP, INC.

NOTES TO THE UNAUDITED PRO FORMA CO

COMBINED FINANCIAL STATEMENTS (C

Under the purchase method of accounting, the total purchase price is allocated to the acquire liabilities of DMGI based on their estimated fair values as of the merger closing date. The ex assets acquired and liabilities assumed is allocated to goodwill. A preliminary allocation of t shown above, to the acquired tangible and intangible assets and assumed liabilities of DMGI 2007, is as follows:

Cash and cash equivalents	
Accounts receivable and other current assets	
Royalty advances	
Furniture and equipment	
Digital rights	
Master recordings	
Goodwill	
Assumed liabilities	
Integration and other merger related costs, including DMGI	
Net assets acquired	

The final determination of the purchase price allocation will be based on the estimated fair v acquired and liabilities assumed at the date of the closing of the merger and will be made as purchase price allocation will remain preliminary until DMGI completes its valuation of the liabilities assumed. The final amounts allocated to assets acquired and liabilities assumed co presented in these pro forma financial statements.

3. Pro Forma Adjustments

(a) To record DMGI s change of control bonuses and other employee-related obligations th estimated amount of approximately $847,000 and estimated costs to be incurred by DMGI t $927,000. Merger-related costs include fees payable for investment banking, legal and accou fees, printing, proxy solicitation and other costs, including $328,844 incurred prior to June 3 forma adjustment.

(b) To eliminate DMGI s historical stockholders equity accounts.

(c) To reflect the conversion of Orchard s convertible debt, accrued interest and Orchard pr Orchard s debt conversion, debt forgiveness and recapitalization, as described in Note 12 to statements for the period ended June 30, 2007 included elsewhere in this proxy statement, ha

(d) To reflect 9,121,939 shares of DMGI common stock outstanding at the date of the merge all classes of Orchard equity for 9,064,941 shares of DMGI common stock and 448,833 shar value of $.01 per share.

(e) To record the preliminary purchase price of DMGI totaling $40,772,497 by adjusting the
their estimated fair values as described in Note 2 above.

(f) To eliminate DMGI s historical depreciation and amortization expense.

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DIGITAL MUSIC GROUP, INC.

NOTES TO THE UNAUDITED PRO FORMA CO

COMBINED FINANCIAL STATEMENTS (C

(g) To record DMGI s pro forma depreciation and amortization expense based on the prelim

(h) To record the amortization and depreciation of the fair value of the assets of DRA and R of the period.

(i) To eliminate interest expense associated with Orchard s convertible debt to reflect Orcha recapitalization, as described in Note 12 to Orchard s unaudited consolidated financial state elsewhere in this proxy statement, as if it had occurred as of the beginning of the period.

4. Pro Forma Loss Per Share

Weighted averages shares outstanding for the six months ended June 30, 2007 include DMG plus the 9,064,941 shares of DMGI common stock to be issued in connection with the merg

Weighted average shares outstanding for the year ended December 31, 2006 include:

DMGI shares outstanding prior to its IPO
DMGI shares attributable to the acquisition of DMI
DMGI shares attributable to the acquisition of certain assets of Rio Bravo
DMGI shares attributable to the acquisition of DRA
DMGI common shares to be issued in connection with the merger
DMGI shares issued in connection with its IPO in the amount of 3,900,000, outstandin February 7, 2006 through December 31, 2006

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AMENDED AND RESTATED AGREEMENT AND PLA

by and among

DIGITAL MUSIC GROUP, INC.

DMGI NEW YORK, INC.

and

THE ORCHARD ENTERPRISES INC

DATED AS OF SEPTEMBER 13, 2007

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AMENDED AND RESTATED AGREEMENT AND PL

AMENDED AND RESTATED AGREEMENT AND PLAN OF MERGER, dated as of Sep
The Orchard Enterprises Inc., a New York corporation (the Orchard), Digital Music Grou
New York, Inc., a New York corporation (Merger Sub).

W I T N E S S E T H:

WHEREAS, the Boards of Directors of the Orchard, DMGI and Merger Sub have determine
companies and their stockholders to consummate the strategic business combination transac
Merger Sub will, subject to the terms and conditions set forth herein, merge with and into th
surviving corporation (hereinafter sometimes referred to in such capacity as the Surviving

WHEREAS, to that end, the parties entered into that certain Agreement and Plan of Merger
(the Execution Date); and

WHEREAS, the parties now desire to change certain provisions of the Old Agreement and t
entirety as set forth herein; and

WHEREAS, for Federal income tax purposes, it is intended by the Orchard, DMGI and Mer
reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 198
constitute a plan of reorganization within the meaning of Treasury Regulation Section 1.

WHEREAS, the parties desire to make certain representations, warranties and agreements in
certain conditions to the Merger.

NOW, THEREFORE, in consideration of the mutual covenants, representations, warranties
and valuable consideration, the receipt and adequacy of which are hereby acknowledged, an
agree as follows:

ARTICLE I

THE MERGER

1.1 *The Merger*. Subject to the terms and conditions of this Agreement, in accordance with t
NYBCL), at the Effective Time (Effective Time), Merger Sub shall merge with and in
Corporation in the Merger, and shall continue its corporate existence under the laws of the S
Merger, the separate corporate existence of Merger Sub shall terminate.

1.2 *Effective Time*. The Merger shall become effective as set forth in the certificate of merge
Department of State of the State of New York (the New York Department), on the Closin
and time when the Merger becomes effective, as set forth in the Certificate of Merger.

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1.3 *Effects of the Merger*. At and after the Effective Time, the Merger shall have the effects

1.4 *Conversion of the Orchard Stock*. At the Effective Time, by virtue of the Merger and wi DMGI, the Orchard or the holder of any of the following securities:

(a) Subject to Article II, each share of Series A preferred stock, par value $0.001, of the Orc outstanding immediately prior to the Effective Time except for shares of the Series A Prefer or owned, directly or indirectly, by the Orchard or any of its wholly-owned Subsidiaries, sha

(i) that number of shares of the Series A preferred stock, par value $0.001 per share of DMC the quotient of (A) the sum of (1) the $1.00 liquidation preference on such share of Series A dividends on such share of Series A Preferred Stock (collectively, the Series A Preference aggregate number of shares of DMGI Series A Preferred Stock issuable pursuant to this Sec Preferred Limit); and

(ii) to the extent that the aggregate number of shares of DMGI Series A Preferred Stock issu the DMGI Preferred Limit, then, in lieu thereof, any share of Series A Preferred Stock (or po converted into shares of DMGI Series A Preferred Stock shall instead convert into that numb $0.001 per share, of DMGI (the DMGI Common Stock) equal to the quotient of (A) the S

For the avoidance of doubt, to the extent that the aggregate Series A Preference exceeds $25 shall be allocated shares of DMGI Series A Preferred Stock and DMGI Common Stock to be rata basis.

(b) Subject to Article II, each share of Series B preferred stock, par value $0.001, of the Orc the Effective Time (the Series B Preferred Stock), except for shares of the Series B Prefe owned, directly or indirectly, by the Orchard or any of its wholly-owned Subsidiaries, shall

(i) that number of shares of DMGI Series A Preferred Stock equal to the quotient of (A) the Series B Preferred Stock (the Series B Preference), divided by (B) $55.70; provided that Preferred Stock issuable pursuant to this Section 1.4(b)(i) shall not exceed an amount equal DMGI Series A Preferred Stock issuable pursuant to Section 1.4(a)(i) (the Junior DMGI Pr

(ii) to the extent that the aggregate number of shares of DMGI Series A Preferred Stock issu the Junior DMGI Preferred Limit, then, in lieu thereof, any share of Series B Preferred Stock converted into shares of DMGI Series A Preferred Stock shall instead convert into that numb the quotient of (A) the Series B Preference, divided by (B) $4.07.

For the avoidance of doubt, solely for purposes of calculating the total number of shares of S immediately prior to the Effective Time, all Deferred B Shares shall be deemed to be issued shares of DMGI Series A Preferred Stock and DMGI Common Stock that would otherwise b Section 1.4 in consideration of such Deferred B Shares shall not be issued and instead, shall For the further avoidance of doubt, to the extent that the aggregate Series B Preference (incl Shares) exceeds the Series B Remainder, the holders of

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Series B Preferred Stock shall be allocated shares of DMGI Series A Preferred Stock and DI
Section 1.4(b) on a pro rata basis. As used herein, Series B Remainder means an amount
Limit and (ii) $55.70. As used herein, Deferred B Shares means any shares of Series B Pr
pursuant to the terms of the Deferred Stock Awards but are still held by the Orchard or (y) a
the Deferred Stock Awards.

(c) Subject to Article II, each share of common stock, par value $0.001, of the Orchard issue
Effective Time the (Common Stock), except for shares of the Common Stock owned by t
indirectly, by the Orchard or any of its wholly-owned Subsidiaries, shall be converted into th
Common Stock equal to the product of (i) the Common Stock Ratio, times (ii) the Remainin

In no event shall DMGI be obligated to issue more than 9,064,941 shares of DMGI Commo
Deferred Stock Awards. For purposes of this Agreement, the Common Stock Ratio shall
number of shares of Common Stock (including shares of common stock issuable upon conv
(including any Deferred B Shares)). For purposes of this Agreement, the Remaining DMG
(1) 9,064,941 and (2) the number of shares of DMGI Common Stock issuable pursuant to Se

(d) All of the shares of the Orchard Capital Stock converted into the right to receive DMGI
longer be outstanding and shall automatically be cancelled and shall cease to exist as of the
Certificate) previously representing any such shares of the Orchard Capital Stock shall th
certificate representing the number of whole shares of DMGI Capital Stock and (ii) cash in l
the Orchard Capital Stock represented by such Certificates have been converted pursuant to
previously representing shares of the Orchard Capital Stock shall be exchanged for certificat
Stock and cash in lieu of fractional shares issued in consideration therefor upon the surrende
II, without any interest thereon. If, prior to the Effective Time, the outstanding shares of DM
shall have been increased, decreased, changed into or exchanged for a different number or k
reorganization, recapitalization, reclassification, stock dividend, stock split, reverse stock sp
there shall be any extraordinary dividend or distribution, an appropriate and proportionate ad
forth in Section 1.4(a), Section 1.4(b) and/or Section 1.4(c), as applicable.

(e) Notwithstanding anything in the Agreement to the contrary, at the Effective Time, all sha
directly or indirectly, by the Orchard or any of its wholly-owned Subsidiaries shall be cance
or other consideration shall be delivered in exchange therefor.

1.5 *Merger Sub Stock*. At the Effective Time, by virtue of the Merger and without any actio
or the holder of any of the following securities:

(a) Each share of common stock, par value $1.00 per share, of Merger Sub issued and outsta
(Merger Sub Common Stock), except for shares of the Merger Sub Common Stock owne
converted into one (1) share of the common stock, par value $0.001 per share, of the Survivi
Common Stock).

(b) Each certificate previously representing any such shares of Merger Sub Common Stock s
representing the number of whole shares of Surviving Corporation Common Stock represen
Section 1.4.

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1.6 *DMGI Stock*. At and after the Effective Time, except as set forth in Section 1.6 of the DI
Common Stock and each option granted and warrant issued by DMGI to purchase shares of
and outstanding immediately prior to the Effective Time shall remain issued and outstanding

1.7 *Certificate of Incorporation of the Orchard*. At the Effective Time, the Certificate of Inc
as in effect at the Effective Time, shall be the Certificate of Incorporation of the Surviving C
be amended, effective as of the Effective Time, to change the name of the Surviving Corpor

1.8 *Bylaws of the Orchard*. At the Effective Time, the Bylaws of the Orchard, as in effect im
the Bylaws of the Surviving Corporation, until thereafter amended in accordance with applic

1.9 *Tax Consequences*. It is intended that the Merger shall constitute a reorganization wit
that this Agreement shall constitute a plan of reorganization within the meaning of Treasu

1.10 *Name of Surviving Corporation*. From and after the Effective Time, the name of the Su
Inc.

ARTICLE II

EXCHANGE OF CERTIFICATES

2.1 *Exchange Procedures*. At the Closing, upon surrender of Certificates for cancellation to
representing shares of DMGI Capital Stock to each holder of record of a Certificate or Certi
Time represented outstanding shares of Orchard Capital Stock whose shares were converted
Stock pursuant to Section 1.4. The holders of such Certificates shall only be entitled to recei
shares of DMGI Capital Stock (after aggregating all Certificates surrendered by such holder
Certificates so surrendered shall forthwith be canceled. Until so surrendered, outstanding Ce
Effective Time, for all corporate purposes, to evidence only the right to receive upon surrend
Capital Stock to which such holder is entitled pursuant to Section 1.4.

2.2 *Lost, Stolen or Destroyed Certificates*. In the event that any Certificates shall have been
the making of an affidavit of that fact and personal indemnity by the holder thereof, certifica
Stock into which the shares of Orchard Capital Stock represented by such lost, stolen or dest
Section 1.4.

2.3 *No Further Ownership Rights in Stock*. All shares of DMGI Capital Stock issued in acco
have been issued in full satisfaction of all rights pertaining to such shares of Orchard Capital
of transfers on the records of the Orchard of shares of Orchard Capital Stock that were outst
after the Effective Time Certificates are presented to DMGI for any reason, they shall be can
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ARTICLE III

REPRESENTATIONS AND WARRANTIES OF TH

Except as disclosed in the disclosure schedule delivered by the Orchard to DMGI concurren
the Orchard hereby represents and warrants to DMGI and Merger Sub as follows:

3.1 *Corporate Organization*. (a) The Orchard is a corporation duly organized, validly existi
State of New York. The Orchard has the corporate power and authority to own or lease all o
business as it is now being conducted, and is duly licensed or qualified to do business in eac
conducted by it or the character or location of the properties and assets owned or leased by i
except where the failure to be so licensed or qualified would not, either individually or in th
Material Adverse Effect on the Orchard. As used in this Agreement, the term Material Adv
Orchard or the Surviving Corporation, as the case may be, a material adverse effect on (i) th
condition of such party and its Subsidiaries taken as a whole (provided, however, that, with
shall not include effects resulting from (A) changes, after the Execution Date, in U.S. genera
(B) changes, after the Execution Date, in laws, rules or regulations of general applicability o
Governmental Entities, (C) changes, after the Execution Date, in global, national or regional
war or acts of terrorism) or in economic or market conditions generally affecting companies
distribution or music business in general, except to the extent that any such changes have a
party, or (D) public disclosure of the transactions contemplated hereby or actions expressly
are taken with the prior written consent of the other party in contemplation of the transactio
party to timely consummate the transactions contemplated hereby. True and complete copie
and the Bylaws of the Orchard, as in effect as of the Execution Date, have previously been

(b) Each Orchard Subsidiary (Orchard Subsidiary) (i) is duly organized and validly existi
(ii) is duly qualified to do business and, where such concept is recognized under applicable
federal, state, local or foreign) where its ownership or leasing of property or the conduct of i
which the failure to be so qualified would reasonably be expected to have a Material Adver
corporate power and authority to own or lease its properties and assets and to carry on its bu
of the Certificate of Incorporation and the bylaws of each Orchard Subsidiary, as in effect as
made available by the Orchard to DMGI.

As used in this Agreement, the word Subsidiary when used with respect to any party, me
company, or other organization, whether incorporated or unincorporated, which is consolida
purposes.

3.2 *Capitalization*. (a) The authorized capital stock of the Orchard consists of (i) 80,000,000
as of the Execution Date, 4,140,224 shares were issued and outstanding and none of which
are listed in Schedule 3.2(a) of the Orchard Disclosure Schedule, (ii) 30,000,000 shares of S
Execution Date, 18,631,000 shares were issued and outstanding and none of which were hel
listed in Schedule 3.2(a) of the Orchard Disclosure Schedule, (iii) 30,000,000 shares of Seri
Execution Date, 17,606,295 shares were issued and outstanding and none of which were hel
listed in Schedule 3.2(a) of the Orchard Disclosure

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Schedule. All of the issued and outstanding shares of the Orchard Capital Stock have been d
paid, nonassessable and free of preemptive rights, with no personal liability attaching to the
of Orchard Capital Stock or any other equity securities of the Orchard have been issued in v
(the Securities Act). The Orchard does not have and is not bound by any outstanding subs
agreements of any character calling for the purchase or issuance of any shares of the Orchar
the Orchard or any securities representing the right to purchase or otherwise receive any sha
Orchard Rights). As of the date hereof, no shares of the Orchard Capital Stock were reser
has not issued any shares of Orchard Capital Stock.

(b) The Orchard owns, directly or indirectly, all of the issued and outstanding shares of capi
each of the Orchard Subsidiaries, free and clear of any liens, pledges, charges, encumbrance
all of such shares or equity ownership interests are duly authorized and validly issued and ar
rights, with no personal liability attaching to the ownership thereof. No Orchard Subsidiary
options, warrants, calls, commitments or agreements of any character calling for the purchas
other equity security of such Subsidiary or any securities representing the right to purchase o
any other equity security of such Subsidiary. Section 3.2(b) of the Orchard Disclosure Sched
the Orchard in corporations, joint ventures, partnerships, limited liability companies and oth
Non-Subsidiary Affiliate).

3.3 *Authority; No Violation*. (a) The Orchard has full corporate power and authority to execu
the transactions contemplated hereby. The execution and delivery of this Agreement and the
hereby have been duly and validly approved by the Board of Directors of the Orchard. The B
this Agreement and the transactions contemplated hereby be submitted to the Orchard s sto
stockholders and, except for the approval of this Agreement by the affirmative vote of the ho
the Orchard Capital Stock, no other corporate proceedings on the part of the Orchard are nec
consummate the transactions contemplated hereby. This Agreement has been duly and valid
(assuming due authorization, execution and delivery by DMGI) constitutes a valid and bindi
the Orchard in accordance with its terms, subject to any applicable bankruptcy and insolvenc
creditors rights from time to time in effect.

(b) Neither the execution and delivery of this Agreement by the Orchard nor the consummat
contemplated hereby, nor compliance by the Orchard with any of the terms or provisions her
Articles or Bylaws or (ii) assuming that the consents and approvals referred to in Section 3.4
ordinance, rule, regulation, judgment, order, writ, decree or injunction applicable to the Orch
Affiliates or any of their respective properties or assets or (y) violate, conflict with, result in
benefit under, constitute a default (or an event which, with notice or lapse of time, or both, w
termination of or a right of termination or cancellation under, accelerate the performance req
upon any of the respective properties or assets of the Orchard, any of its Subsidiaries or Non
conditions or provisions of any note, bond, mortgage, indenture, deed of trust, license, perm
obligation to which the Orchard, any of its Subsidiaries or its Non-Subsidiary Affiliates is a
properties or assets may be bound or affected, except for such violations, conflicts, breaches
aggregate, would not reasonably be expected to have a Material Adverse Effect on the Orcha

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3.4 *Consents and Approvals*. Except for (i) the filing of any required applications or notices
such applications and notices (the State and Foreign Approvals), (ii) the filing of the Cert
pursuant to the NYBCL (iii) the filings required by the Hart-Scott-Rodino Antitrust Improve
and regulations promulgated thereunder (the HSR Act) and (iv) the approval of this Agre
Orchard, no consents or approvals of or filings or registrations with any court, administrativ
authority or instrumentality (each a Governmental Entity) are necessary in connection wi
this Agreement and (B) the consummation by the Orchard of the Merger and the other transa

3.5 *Financial Statements*. (a) Each of (i) the audited consolidated balance sheets of the Orch
and December 31, 2005, respectively, and the related audited consolidated statements of ope
Orchard and its Subsidiaries for the years then ended, including the notes thereto (collective
unaudited consolidated balance sheet of the Orchard and its Subsidiaries as of December 31
statements of operations, shareholders equity and cash flows of the Orchard and its Subsid
condensed, consolidated footnotes thereto (collectively, the Unaudited Financial Statement
consolidated balance sheet of the Orchard and its Subsidiaries as of March 31, 2007 and the
statements of operations, shareholders equity and cash flows of the Orchard and its Subsid
Statements), (x) have been prepared from, and are in accordance with, the books and recor
present in all material respects the consolidated results of operations, cash flows, changes in
position of the Orchard and its Subsidiaries for the respective fiscal periods or as of the resp
Draft Quarterly Statements to recurring year-end audit adjustments normal in nature and am
with GAAP consistently applied during the periods involved, except, in each case, as indicat
books and records of the Orchard and its Subsidiaries have been, and are being, maintained
and any other applicable legal and accounting requirements and reflect only actual transactio
been dismissed as independent public accountants of the Orchard as a result of or in connect
matter of accounting principles or practices, financial statement disclosure or auditing scope

(b) Neither the Orchard nor any of its Subsidiaries has any material liability of any nature w
or otherwise and whether due or to become due), except for (i) those liabilities that are reflec
balance sheet of the Orchard for the quarter ended March 31, 2007 (including any condense
liabilities incurred in the ordinary course of business consistent with past practice since Mar
and the transactions contemplated hereby; and (iii) contingent liabilities that would not reas
in the aggregate, a Material Adverse Effect on the Orchard.

(c) The records, systems, controls, data and information of the Orchard and its Subsidiaries
under means (including any electronic, mechanical or photographic process, whether compu
ownership and direct control of the Orchard or its Subsidiaries or accountants (including all
for any non-exclusive ownership and non-direct control that would not reasonably be expect
Orchard. The Orchard maintains accounting records which fairly and accurately reflect, in a
Orchard has devised and maintains accounting controls sufficient to provide reasonable assu
accordance with management s general or specific authorization and (ii) recorded as necess
statements in accordance with GAAP.

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(d) Since March 31, 2007, (i) neither the Orchard nor any of its Subsidiaries has received or material complaint, allegation, assertion or claim, whether written or oral, regarding the acc methodologies or methods of the Orchard or any of its Subsidiaries or their respective intern complaint, allegation, assertion or claim that the Orchard or any of its Subsidiaries has enga practices, and (ii) no attorney representing the Orchard or any of its Subsidiaries, whether or Subsidiaries, has reported evidence of a breach of fiduciary duty or similar violation by the employees or agents to the Board of Directors of the Orchard or any committee thereof or to

3.6 *Receivables*. All accounts receivable reflected on the consolidated balance sheet include created since March 31, 2007, represent valid obligations of customers of Orchard arising fr ordinary course of business consistent with past practices.

3.7 *Broker s Fees*. Neither the Orchard nor any Orchard Subsidiary nor any of their respect finder or incurred any liability for any broker s fees, commissions or finder s fees in conne contemplated by this Agreement.

3.8 *Absence of Certain Changes or Events*. (a) Since March 31, 2007, no event or events ha expected to have, either individually or in the aggregate, a Material Adverse Effect on the O

(b) Since March 31, 2007, the Orchard and its Subsidiaries have carried on their respective b course consistent with past practices , including the timely payment of vendors, Content ow when due. As of the Execution Date, other than in the ordinary course of business consisten past-due obligations of the Orchard.

(c) Since March 31, 2007, neither the Orchard nor any of its Subsidiaries has (i) except for n termination payments made in the ordinary course of business consistent with past practice, expressly contemplated by this Agreement, increased the wages, salaries, compensation, pen payable to any executive officer, employee or director from the amount thereof in effect as termination pay, entered into any contract to make or grant any severance or termination pay year-end bonuses for fiscal year 2006 in amounts consistent with past practice, (ii) granted a any rights to acquire any shares of its capital stock, or issued any shares of its capital stock, other than grants made prior to the Execution Date in the ordinary course of business consis work stoppage, slow-down, or other labor disturbance or (iv) repurchased any shares of the

3.9 *Legal Proceedings*. (a) Neither the Orchard nor any of its Subsidiaries is a party to any, the Orchard , threatened, legal, administrative, arbitral or other proceedings, claims, actions any nature against the Orchard or any of its Subsidiaries, except as would not reasonably be the Orchard, or challenging the validity or propriety of the transactions contemplated by this

(b) There is no injunction, order, judgment, decree, or regulatory restriction imposed upon t the Orchard or any of its Subsidiaries that has had, or would reasonably be expected to have Adverse Effect on the Orchard or the Surviving Corporation.

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As used in this Agreement, the term Knowledge of the Orchard shall mean all informatio
Scholl, (iii) Stanley Schneider, (iv) Tom Etergino, (v) Brad Navin, or (vi) Jeff Nimerofsky.

3.10 *Taxes and Tax Returns*. (a) Each of the Orchard and its Subsidiaries has duly and timel
material Tax Returns required to be filed by it (all such Tax Returns being accurate and com
Taxes shown thereon as due and payable and has duly and timely paid all material Taxes tha
asserted to be due and payable from it by federal, state, foreign or local taxing authorities ot
faith, which have not been finally determined, and have been adequately reserved against in
balance sheet of the Orchard and its Subsidiaries as of December 31, 2006 included in the U

Each of the Orchard and its Subsidiaries has in all material respects withheld, collected and
is in all material respects properly holding for such payments, all Taxes required by law to b
and its Subsidiaries has complied in all material respects with all information reporting and
applicable legal requirements, including maintenance of required records with respect theret
has granted any waiver of the statute of limitations in respect of Taxes or agreed to any exte
deficiency that remains in effect.

There are no disputes, audits, examinations or proceedings related to Taxes or Tax Returns
being conducted, pending or, to the Knowledge of the Orchard, threatened, and there are no
threatened claims by any Taxing Authority for Taxes or assessments, upon the Orchard or a
not have reserves that are adequate under GAAP on the unaudited consolidated balance shee
December 31, 2006 included in the Unaudited Financial Statements. There is no deficiency
dispute or claim concerning any Tax liability, of either the Orchard or any of its Subsidiaries
Authority in writing. No claim is currently pending that has been made in writing by a Taxi
any of its Subsidiaries does not file a Tax Return that the Orchard or any of its Subsidiaries
jurisdiction. No issues related to Taxes of Orchard or any of its Subsidiaries were raised in
audit or examination that can reasonably be expected to recur in a later taxable period. Ther
assets, income or operations of the Orchard or any of its Subsidiaries, other than statutory Li
Orchard has made available to DMGI true and complete copies of any private letter ruling re
agreements with respect to Taxes requested or executed in the last six years. Neither the Orc
bound by any Tax sharing, allocation or indemnification agreement or similar contract or ar
written or unwritten.

Neither the Orchard nor any of its Subsidiaries (A) has been a member of an affiliated group
(other than a group the common parent of which was the Orchard) or (B) has any liability fo
or any of its Subsidiaries or any of its or their predecessors) by reason of contract, agreemen
assumption, transferee, successor or similar liability, operation of law, or under Treasury Re
successor thereof or any similar or analogous provision of state, local or foreign Law). Neith
been, within the past two years or otherwise as part of a plan (or series of related transactio
Code of which the Merger is also a part, a distributing corporation or a controlled corpo
the Code) in a distribution of stock intending to qualify for tax-free treatment under Section
its Subsidiaries has entered into any transaction identified by the Internal Revenue Service a
purposes of Treasury Regulations Section 1.6011-4(b)(2) or

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301.6111-2(b)(2), or any other reportable transaction within the meaning of Treasury Reg require the filing of an IRS Form 8886. At no time during the past five years has the Orchard corporation within the meaning of Section 897(c)(2) of the Code.

(b) As used in this Agreement:

(i) the term Tax or Taxes means all federal, state, local and foreign income, excise, gro sales, transfer, use, license, payroll, employment, social security, severance, unemployment, intangibles, franchise, backup withholding, value added, alternative or add-on minimum, est customs, duties, governmental fees or like assessments or charge of any kind whatsoever, to interest thereon, whether disputed or not, imposed by any Governmental Entity;

(ii) the term Tax Return means any return, declaration, report, claim for refund, or inform including any schedule or attachment thereto, and including any claim for refund or amendm supplied or required to be supplied to a Governmental Entity; and

(iii) as used in this Agreement, the term Taxing Authority means any governmental autho the assessment, determination, collection, or other imposition of any Taxes.

(c) Neither the Orchard nor any of its Subsidiaries has taken or agreed to take any action, ha agreement, plan or other circumstance that is reasonably likely to prevent the Merger from q of Section 368(a) of the Code.

3.11 *Employees*. (a) Section 3.11 of the Orchard Disclosure Schedule sets forth a true and co profit-sharing, deferred compensation, stock option, employee stock ownership, severance p other employee programs, arrangements, agreements, or payroll practices, qualified or nonq plans, all life insurance plans, and all other employee benefit plans or fringe benefit plans, in plan as that term is defined in Section 3(3) of the Employee Retirement Income Security A benefits to any current or former employees of the Orchard or any of its Subsidiaries, wheth the Orchard or any of its Subsidiaries (an Orchard ERISA Affiliate) (collectively, the O

(b) For each Orchard Benefit Plan, the Orchard has heretofore made available to DMGI true extent applicable): (i) the plan documents, summary plan descriptions and any summaries of annual reports (Form 5500 and all schedules and attachments thereto) filed with the Departm statements or actuarial reports; (iii) the most recent determination letter or opinion letter rec (iv) all related trust agreements, insurance contracts, or other funding agreements; and (v) ar Governmental Entity relating to such Orchard Benefit Plan.

(c)(i) Each of the Orchard Benefit Plans has been operated and administered in all material r including, but not limited to, ERISA and the Code, and has been administered and operated terms; (ii) each of the Orchard Benefit Plans that is intended to be qualified within the me has requested, a favorable determination letter, and to the Knowledge of Orchard, there are n occurred that will, or could reasonably, adversely affect the qualified status of any such Orch provides benefits, including, without limitation, death or medical benefits (whether or not in

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employees or directors of the Orchard or its Subsidiaries beyond their retirement or other ter
mandated by applicable law, including 4980B of the Code regarding COBRA continuation c
(B) death benefits or retirement benefits under any employee pension plan (as such term
compensation benefits accrued as liabilities on the books of the Orchard or its Subsidiaries c
the current or former employee or director (or his beneficiary), (iv) no Orchard Benefit Plan
of ERISA, or Section 412 of the Code, (B) a multiemployer pension plan (as such term is
multiple employer plan within the meaning of Section 4063 of ERISA, nor has the Orcha
any time contributed to or been obligated to contribute to any multiemployer plan or multipl
amounts payable by the Orchard or its Subsidiaries as of the Effective Time with respect to
prior plan years have been paid or accrued in accordance with GAAP, (vi) none of the Orcha
any fiduciary, has engaged in a transaction in connection with which the Orchard, its Subsid
to either a material civil penalty assessed pursuant to Section 409 or 502(i) of ERISA or a m
4976 of the Code, (vii) there are no pending or, to the Knowledge of the Orchard, threatened
for benefits) by, on behalf of or against any of Orchard Benefit Plans or any trusts related th
either individually or in the aggregate, a Material Adverse Effect on the Orchard; and (viii)
terminated at any time at the sole discretion of the sponsor thereof without liability other tha
termination, subject only to such constraints as imposed by applicable law.

(d) There are no pending or, to the Knowledge of the Orchard, threatened material labor grie
charges against the Orchard or any of its Subsidiaries, or any strikes or other material labor
Subsidiaries. Neither the Orchard nor its Subsidiaries are party to or bound by any collective
organization, or work rules or practices agreed to with any labor organization or employee a
or its Subsidiaries and, to the Knowledge of the Orchard, there are no organizing efforts by a
employees of the Orchard or any of its Subsidiaries.

(e) None of the execution and delivery of this Agreement, the approval of this Agreement by
of the transactions contemplated hereby will (either alone or in conjunction with any other e
limitation, severance, unemployment compensation, excess parachute payment (within th
forgiveness of indebtedness or otherwise) becoming due to any director or any employee of
Orchard, DMGI or any of their respective affiliates under any Orchard Benefit Plan or other
under any Orchard Benefit Plan or (iii) result in any acceleration of the time of payment or v

(f) Neither the Orchard nor any of its Subsidiaries or Orchard ERISA Affiliates maintains or
vehicle, and the Merger and other transactions contemplated by this Agreement shall not cau
ERISA Affiliates to establish or make any contribution to a rabbi trust or similar funding ve

3.12 *SEC Reports*. The Orchard has not previously filed a registration statement pursuant to
reporting requirements of the Securities Exchange Act of 1934, as amended (the Exchange

3.13 *Compliance with Applicable Law*. The Orchard and each of its Subsidiaries hold all lice
necessary for the lawful conduct of their respective businesses under and

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pursuant to each, except where neither the cost of failure to hold nor the cost of obtaining an authorization would, either individually or in the aggregate, reasonably be expected to have Orchard and each of its Subsidiaries have complied with and are not in default under any ap and/or guideline of any Governmental Entity relating to the Orchard or any of its Subsidiarie noncompliance or default nor the cost of compliance or cure of default would, either individ to have a Material Adverse Effect on the Orchard. Without limitation, during the three (3) ye Orchard, and of its Subsidiaries, or any director, officer, employee, agent or other person act Subsidiaries has to the Knowledge of the Orchard, directly or indirectly, (i) used any funds o unlawful contributions, unlawful gifts, unlawful entertainment or other expenses relating to to foreign or domestic governmental officials or employees or to foreign or domestic politica or any of its Subsidiaries; (iii) violated any provision that would result in the violation of the amended, or any similar law; (iv) established or maintained any unlawful fund of monies or Subsidiaries; (v) made any fraudulent entry on the books or records of the Orchard or any of unlawful rebate, unlawful payoff, unlawful influence payment, unlawful kickback or other u regardless of form, whether in money, property or services, to obtain favorable treatment in for the Orchard or any of its Subsidiaries, to pay for favorable treatment for business secured obtained for the Orchard or any of its Subsidiaries.

3.14 *Certain Contracts*. (a) Neither the Orchard nor any of its Subsidiaries is a party to or bo or understanding (whether written or oral) (i) with respect to the employment of any director ordinary course of business consistent with past practice, (ii) which, upon the execution or d of this Agreement or the consummation of the transactions contemplated by this Agreement additional acts or events) result in any payment (whether of severance pay or otherwise) bec Surviving Corporation, or any of their respective Subsidiaries to any officer or employee the any line of business by the Orchard or any of its Subsidiaries or upon consummation of the Surviving Corporation to engage in any line of business, (iv) with or to a labor union or guil or (v) (including any stock option plan, stock appreciation rights plan, restricted stock plan o which will be increased, or the vesting of the benefits of which will be accelerated, by the oc Agreement, stockholder approval of this Agreement or the consummation of any of the trans value of any of the benefits of which will be calculated on the basis of any of the transaction arrangement, commitment or understanding to which the Orchard or any of its Subsidiaries bound, whether or not set forth in the Orchard Disclosure Schedule, is referred to herein as a Orchard, there are not nor has the Orchard received notice of, any violations of any Orchard would reasonably be expected to have, either individually or in the aggregate, a Material Ad

(b)(i) Each Orchard Contract is valid and binding on the Orchard or any of its Subsidiaries, a Orchard, is in full force and effect, (ii) the Orchard and each of its Subsidiaries has in all ma to be performed by it through the Execution Date under each the Orchard Contract, except w in the aggregate, would not reasonably be expected to have a Material Adverse Effect on the each third-party counterparty to each Orchard Contract has in all material respects performe through the Execution Date under such Orchard Contract, and (iv) no event or condition exi

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time or both, will constitute, a material default on the part of the Orchard or any of its Subsi
except where such default, either individually or in the aggregate, would not reasonably be e
Orchard.

(c) Section 3.14 of the Orchard Disclosure Schedule identifies all of the libraries or collectio
Subsidiaries. As used in this Agreement, (i) Content means any digital music tracks or ot
distributed by a party for purposes of sale or license or purchase by consumers through Cha
means online music, mobile and video stores and other sellers and distributors of digital me
transmission, mobiletones and streaming, and any other persons or entities licensed to use th

(d) Subject to the rights of the Content owners, the Orchard or its Subsidiaries have valid rig
through the Orchard s Channel Outlets to consumers. After the consummation of the transa
to license, distribute and sell all of the Content shall be retained by the Surviving Corporatio
kind to any third party.

(e) Neither the Orchard nor any of its Subsidiaries has transferred ownership of or granted a
Content other than to consumers through the Orchard s Channel Outlets in the ordinary cou

(f) Excluding third-party, peer-to-peer file sharing, peer-to-peer providers, device distributio
providers and other systematic infringers, neither the Orchard nor its Subsidiaries has receiv
infringing or misappropriating any rights with respect to the Content.

(g) Since March 31, 2007, no Content owner, Channel Outlet, vendor or supplier of the Orc
modified its relationship with the Orchard or any of its Subsidiaries, as applicable, in a man
taken as a whole, and no such person has, to the Knowledge of the Orchard, communicated
intention to do so.

3.15 *Environmental Liability*. There are no legal, administrative, arbitral or other proceedin
environmental investigations or remediation activities or governmental investigations of any
reasonably result in the imposition, on the Orchard of any liability or obligation arising und
environmental statute, regulation or ordinance including, without limitation, the Comprehen
Liability Act of 1980, as amended (CERCLA), pending or, to the Knowledge of the Orch
or obligation would reasonably be expected to have, either individually or in the aggregate,
Knowledge of the Orchard, there is no reasonable basis for any such proceeding, claim, acti
impose any liability or obligation on the Orchard or any Orchard Subsidiary that would reas
in the aggregate, a Material Adverse Effect on the Orchard. The Orchard is not subject to an
memorandum by or with any court, governmental authority, regulatory agency or third party
to the foregoing that would reasonably be expected to have, either individually or in the agg

3.16 *Property*. The Orchard or an Orchard Subsidiary (a) has good title to all the properties
sheet of Orchard and the Orchard Subsidiaries included in the Reviewed Quarterly Statemen
properties sold or otherwise disposed of since the date thereof in the ordinary course of busi
clear of all material Liens, except (i) statutory Liens securing payments not yet due, (ii) Lie

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(iii) easements, rights of way, and other similar encumbrances that do not materially affect t affected thereby or otherwise materially impair business operations at such properties and (i Liens as do not materially affect the use of the properties or assets subject thereto or affecte operations at such properties (collectively, Permitted Encumbrances), and (b) is the lesse Financial Statements or acquired after the date thereof (except for leases that have expired b disposed of in accordance with terms of its lease and in the ordinary course of business sinc and, collectively with the Orchard Owned Properties, the Orchard Real Property), free an Encumbrances, and is in possession of the properties purported to be leased thereunder, and Orchard or an Orchard Subsidiary without default thereunder by the lessee or, to the Knowl

3.17 *Intellectual Property*. The Orchard or each of its Subsidiaries owns, or is licensed to us Liens), all Intellectual Property used in or necessary for the conduct of its business as curren Property by the Orchard and its Subsidiaries does not, to the Knowledge of the Orchard, infr person and is in accordance with any applicable license pursuant to which the Orchard or an Intellectual Property. To the Knowledge of the Orchard, no person is challenging, or to the otherwise violating, any right of the Orchard or any of its Subsidiaries with respect to any In the Orchard or its Subsidiaries. Neither the Orchard nor any Orchard Subsidiary has receive respect to any Intellectual Property used by the Orchard or any Orchard Subsidiary which w individually or in the aggregate, a Material Adverse Effect on the Orchard. For purposes of t trademarks, service marks, brand names, certification marks, trade dress and other indicatio foregoing and registrations in any jurisdiction of, and applications in any jurisdiction to regi modification or renewal of any such registration or application; inventions, discoveries and i jurisdiction; patents, applications for patents (including divisions, continuations, continuatio renewals, extensions or reissues thereof, in any jurisdiction; nonpublic information, trade se any jurisdiction to limit the use or disclosure thereof by any person; writings and other work jurisdiction; and registrations or applications for registration of copyrights in any jurisdictio similar intellectual property or proprietary rights.

3.18 *State Takeover Laws*. (a) The Board of Directors of the Orchard has unanimously appro contemplated hereby as required to render inapplicable to such agreements and transactions Knowledge of the Orchard, any similar moratorium, control share, fair price, take Statutes).

(b) The Orchard has taken all action, if any, necessary or appropriate so that the entering int transactions contemplated hereby, does not and will not result in the ability of any person to

3.19 *The Orchard Information*. The information relating to the Orchard and its Subsidiaries representatives for inclusion in the Proxy Statement, or in any other document filed with an herewith, will not contain any untrue statement of a material fact or omit to state a material light of the circumstances in which they are made, not misleading.

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ARTICLE IV

REPRESENTATIONS AND WARRANTIES OF DMGI A

Except as disclosed in the disclosure schedule delivered by DMGI and Merger Sub to the Or
Disclosure Schedule), DMGI and Merger Sub, jointly and severally represent and warrant

4.1 *Corporate Organization*. (a) DMGI is a corporation duly organized, validly existing and
Delaware. DMGI has the corporate power and authority to own or lease all of its properties
being conducted, and is duly licensed or qualified to do business in each jurisdiction in whic
character or location of the properties and assets owned or leased by it makes such licensing
failure to be so licensed or qualified would not, either individually or in the aggregate, reaso
Effect on DMGI. True and complete copies of the Certificate of Incorporation of DMGI (the
effect as of the Execution Date, have previously been made available by DMGI to the Orcha

(b) Each DMGI Subsidiary, including Merger Sub (i) is duly organized and validly existing
(ii) is duly qualified to do business and, where such concept is recognized under applicable l
Federal, state, local or foreign) where its ownership or leasing of property or the conduct of
which the failure to be so qualified would reasonably be expected to have a Material Advers
corporate power and authority to own or lease its properties and assets and to carry on its bu
of the Certificate of Incorporation and the bylaws of each DMGI Subsidiary, as in effect as
available by DMGI to the Orchard.

4.2 *Capitalization*. (a) The authorized capital stock of DMGI consists of (i) 30,000,000 shar
Execution Date, 9,121,939 shares were issued and outstanding and none of which were held
stock, of which, as of the Execution Date, no shares were issued and outstanding. All of the
Stock have been duly authorized and validly issued and are fully paid, nonassessable and fre
attaching to the ownership thereof. None of the outstanding shares of DMGI Capital Stock
issued in violation of the Securities Act. Except for this Agreement or pursuant to the terms
with Section 5.2(b)) pursuant to the DMGI Stock Plans or as disclosed in the DMGI Reports
outstanding subscriptions, options, warrants, calls, commitments or agreements of any chara
shares of DMGI Capital Stock or any other equity securities of DMGI or any securities repr
any shares of DMGI Capital Stock (collectively, DMGI Rights). At and after the Effectiv
outstanding immediately prior to the Effective Time shall remain issued and outstanding and
Execution Date, no shares of DMGI Common Stock were reserved for issuance, except for
exercise of options issued pursuant to employee and director stock plans of DMGI in effect
or (ii) as disclosed in the DMGI Reports. Since March 31, 2007, DMGI has not issued any s
Rights, other than as permitted by Section 5.2(b) in the case of grants made following the Ex
options granted prior to such date.

(b) DMGI owns, directly or indirectly, all of the issued and outstanding shares of capital sto
the DMGI Subsidiaries, including Merger Sub, free and clear of any Liens, and all of such s
authorized and validly issued and are fully paid, nonassessable and free of preemptive rights
ownership thereof. No DMGI Subsidiary has or is bound by any outstanding subscriptions,

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commitments or agreements of any character calling for the purchase or issuance of any sha
such Subsidiary or any securities representing the right to purchase or otherwise receive any
security of such Subsidiary. Section 4.2(b) of the DMGI Disclosure Schedule sets forth a lis
Non-Subsidiary Affiliates.

4.3 *Authority; No Violation*. (a) Each of DMGI and Merger Sub has full corporate power an
and to consummate the transactions contemplated hereby. The execution and delivery of this
transactions contemplated hereby have been duly and validly approved by the Board of Dire
Board of Directors of each of DMGI and Merger Sub has directed that this Agreement and t
to DMGI s stockholders and DMGI, as sole shareholder of Merger Sub, for approval at a m
approval of this Agreement by the affirmative vote of the holders of a majority of the outsta
DMGI, as sole shareholder of Merger Sub, no other corporate proceedings on the part of DM
consummate the transactions contemplated hereby. This Agreement has been duly and valid
Merger Sub and (assuming due authorization, execution and delivery by the Orchard) consti
DMGI and Merger Sub, enforceable against DMGI and Merger Sub in accordance with its t
insolvency laws affecting generally the enforceability of creditors rights from time to time

(b) Neither the execution and delivery of this Agreement by each of DMGI and Merger Sub
Merger Sub of the transactions contemplated hereby, nor compliance by each of DMGI and
hereof, will (i) violate any provision of the DMGI Articles or Bylaws, (ii) violate any provis
of Merger Sub or (iii) assuming that the consents and approvals referred to in Section 4.4 ar
ordinance, rule, regulation, judgment, order, writ, decree or injunction applicable to DMGI,
Affiliates or any of their respective properties or assets or (y) violate, conflict with, result in
benefit under, constitute a default (or an event which, with notice or lapse of time, or both, w
termination of or a right of termination or cancellation under, accelerate the performance req
upon any of the respective properties or assets of DMGI, any of its Subsidiaries or its Non-S
conditions or provisions of any note, bond, mortgage, indenture, deed of trust, license, perm
obligation to which DMGI, any of its Subsidiaries or Non-Subsidiary Affiliates is a party, or
properties or assets may be bound or affected, except for such violations, conflicts, breaches
aggregate would not reasonably be expected to have a Material Adverse Effect on DMGI.

4.4 *Consents and Approvals*. Except for (i) the State and Foreign Approvals, (ii) the filing w
form or schedule required by the Exchange Act, (iii) the filing of the Certificate of Merger w
NYBCL, (iv) the filings required by the HSR Act, (v) such filings and approvals as are requ
Blue Sky laws of various states in connection with the issuance of the shares of DMGI C
approval of this Agreement by the requisite vote of the stockholders of DMGI and DMGI, a
approvals of or filings or registrations with any Governmental Entity are necessary in conne
of DMGI and Merger Sub of this Agreement and (B) the consummation by each of DMGI a
transactions contemplated hereby.

4.5 *Financial Statements*. (a) The financial statements of DMGI and its Subsidiaries include
annual report on Form 10-K for the year ended December 31, 2006

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and quarterly report on Form 10-Q for the quarter ended March 31, 2007 (including the relat
prepared from, and are in accordance with, the books and records of DMGI and its Subsidia
consolidated results of operations, cash flows, changes in shareholders equity (but solely w
consolidated financial position of DMGI and its Subsidiaries for the respective fiscal period
(subject in the case of unaudited statements to recurring year-end audit adjustments normal
prepared in accordance with GAAP consistently applied during the periods involved, except
in the notes thereto. The books and records of DMGI and its Subsidiaries have been, and are
accordance with GAAP and any other applicable legal and accounting requirements and refl
not resigned or been dismissed as independent public accountants of DMGI as a result of or
on a matter of accounting principles or practices, financial statement disclosure or auditing s

(b) Neither DMGI nor any of its Subsidiaries has any material liability of any nature whatso
otherwise and whether due or to become due), except for (i) those liabilities that are reflecte
sheet of DMGI included in its Quarterly Report on Form 10-Q for the fiscal quarter ended M
(ii) current liabilities incurred in the ordinary course of business consistent with past practic
Agreement and the transactions contemplated hereby, and (iii) contingent liabilities that wou
individually or in the aggregate, a Material Adverse Effect on DMGI.

(c) The records, systems, controls, data and information of DMGI and its Subsidiaries are re
means (including any electronic, mechanical or photographic process, whether computerized
and direct control of DMGI or its Subsidiaries or accountants (including all means of access
non-exclusive ownership and non-direct control that would not reasonably be expected to ha
maintains accounting records which fairly and accurately reflect, in all material respects, its
maintains accounting controls sufficient to provide reasonable assurances that such transacti
management s general or specific authorization and (ii) recorded as necessary to permit the
accordance with GAAP.

(d) Since March 31, 2007, (i) neither DMGI nor any of its Subsidiaries has received or other
complaint, allegation, assertion or claim, whether written or oral, regarding the accounting o
methods of DMGI or any of its Subsidiaries or their respective internal accounting controls,
assertion or claim that DMGI or any of its Subsidiaries has engaged in questionable account
representing DMGI or any of its Subsidiaries, whether or not employed by DMGI or any of
material violation of securities laws, breach of fiduciary duty or similar violation by DMGI
agents to the Board of Directors of DMGI or any committee thereof or to any director or off

4.6 *Broker s Fees*. With the exception of the engagement of SMH Capital, neither DMGI n
officers or directors has employed any broker or finder or incurred any liability for any brok
connection with the Merger or related transactions contemplated by this Agreement. DMGI
complete copy of any engagement letter or other contract between DMGI and SMH Capital
contemplated hereunder.

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4.7 *Absence of Certain Changes or Events*. (a) Except as publicly disclosed in the DMGI Re March 31, 2007, no event or events have occurred that have had or would reasonably be exp aggregate, a Material Adverse Effect on DMGI.

(b) Except as publicly disclosed in DMGI Reports filed prior to the Execution Date, since M carried on their respective businesses in all material respects in the ordinary course consiste payment of vendors, Content owners, employee payrolls and other liabilities as and when du ordinary course of business consistent with past practices, there are no material past-due obl

(c) Since March 31, 2007, neither DMGI nor any of its Subsidiaries has (i) except for norma payments made in the ordinary course of business consistent with past practice or as require contemplated by this Agreement, increased the wages, salaries, compensation, pension, or o executive officer, employee, or director from the amount thereof in effect as of March 31, 2 entered into any contract to make or grant any severance or termination pay, or paid any bon fiscal year 2006 in amounts consistent with past practice, (ii) granted any stock appreciation any shares of its capital stock, or issued any shares of its capital stock, to any executive offic (A) publicly disclosed in the DMGI Reports filed on or prior to the Execution Date and (B) Execution Date as permitted by Section 5.2(b)(iii) or (iv), (iii) suffered any strike, work stop (iv) repurchased any shares of DMGI Capital Stock.

4.8 *Legal Proceedings*. (a) Neither DMGI nor any of its Subsidiaries is a party to any, and th DMGI , threatened, legal, administrative, arbitral or other proceedings, claims, actions or g nature against DMGI or any of its Subsidiaries, except as would not reasonably be expected or challenging the validity or propriety of the transactions contemplated by this Agreement.

(b) There is no injunction, order, judgment, decree, or regulatory restriction imposed upon D DMGI or any of its Subsidiaries that has had or would reasonably be expected to have, eithe Adverse Effect on DMGI or the Surviving Corporation.

As used in this Agreement, the term Knowledge of DMGI shall mean all information actu Davis, (iii) Tuhin Roy, and (iv) Clayton Trier.

4.9 *Taxes and Tax Returns*. (a) Each of DMGI and its Subsidiaries has duly and timely filed Tax Returns required to be filed by it (all such Tax Returns being accurate and complete in a shown thereon as due and payable and has duly and timely paid all material Taxes that are o to be due and payable from it by federal, state, foreign or local taxing authorities other than which have not been finally determined, and have been adequately reserved against in accor statements contained in the DMGI Reports.

Each of DMGI and its Subsidiaries has in all material respects withheld, collected and paid all material respects properly holding for such payments, all Taxes required by Law to be wi Subsidiaries has complied in all material respects with all information reporting and backup legal requirements, including maintenance of required records with respect thereto. Neither waiver of the statute of limitations in respect of Taxes or agreed to any extension of time wi remains in effect.

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There are no disputes, audits, examinations or proceedings related to Taxes or Tax Returns c conducted, pending or, to the Knowledge of DMGI, threatened, and there are no pending or, by any Taxing Authority for Taxes or assessments, upon DMGI or any of its Subsidiaries fo adequate under GAAP on the financial statements included in the DMGI Reports. There is n Taxes or other dispute or claim concerning any Tax liability, of either DMGI or any of its Su Taxing Authority in writing. No claim is currently pending that has been made in writing by or any of its Subsidiaries does not file a Tax Return that DMGI or any of its Subsidiaries is c There are no Liens for any Taxes upon any of the assets, income or operations of DMGI or a for Taxes not yet due and payable. No issues related to Taxes of DMGI were raised in writin audit or examination that can reasonably be expected to recur in a later taxable period. DMG complete copies of any private letter ruling requests, closing agreements or gain recognition executed in the last six years. Neither DMGI nor any of its Subsidiaries is a party to or is bo written or unwritten.

Neither DMGI nor any of its Subsidiaries (A) has been a member of an affiliated group filin than a group the common parent of which was DMGI) or (B) has any liability for the Taxes Subsidiaries or any of its or their predecessors) by reason of contract, agreement (including transferee, successor or similar liability, operation of law, or under Treasury Regulation Sec thereof or any similar or analogous provision of state, local or foreign Law). Neither DMGI past two years or otherwise as part of a plan (or series of related transactions) within the Merger is also a part, a distributing corporation or a controlled corporation (within the distribution of stock intending to qualify for tax-free treatment under Section 355 of the Cod entered into any transaction identified by the Internal Revenue Service as of the Execution D Treasury Regulations Section 1.6011-4(b)(2) or 301.6111-2(b)(2), or any other reportable Regulations Section 1.6011-4(b)(1) that required or will require the filing of an IRS Form 88 DMGI been a United States real property holding corporation within the meaning of Section

(b) Neither DMGI nor any of its Subsidiaries has taken or agreed to take any action, has fail agreement, plan or other circumstance that is reasonably likely to prevent the Merger from q of Section 368(a) of the Code.

4.10 *Employees*. (a) Section 4.10 of the DMGI Disclosure Schedule sets forth a true and cor profit-sharing, deferred compensation, stock option, employee stock ownership, severance p other employee programs, arrangements, agreements, or payroll practices, qualified or nonq plans, all life insurance plans, and all other employee benefit plans or fringe benefit plans, in plan as that term is defined in Section 3(3) of ERISA, providing benefits to any current or Subsidiaries, whether or not incorporated, or any trade or business of DMGI or any of its Su (collectively, the DMGI Benefit Plans).

(b) For each DMGI Benefit Plan, DMGI has heretofore made available to the Orchard true a applicable): (i) the plan documents, summary plan descriptions, and any summaries of mate annual reports (Form 5500 and all schedules and attachments thereto) filed with the Departm statements or actuarial reports; (iii) the most recent determination letter or opinion letter rec (iv) all related trust agreements, insurance contracts, or other funding agreements; and (v) an Governmental Entity relating to such DMGI Benefit Plan.

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(c)(i) Each of the DMGI Benefit Plans has been operated and administered in all material re
including, but not limited to, ERISA and the Code and has been administered and operated i
terms; (ii) each of the DMGI Benefit Plans that is intended to be qualified within the mea
has requested, a favorable determination letter, and to the Knowledge of DMGI there are no
occurred that will, or could reasonably, adversely affect the qualified status of any such DM
provides benefits, including, without limitation, death or medical benefits (whether or not in
employees or directors of DMGI or its Subsidiaries beyond their retirement or other termina
by applicable law, including 4980B of the Code regarding COBRA continuation coverage a
benefits or retirement benefits under any employee pension plan (as such term is defined
compensation benefits accrued as liabilities on the books of DMGI or its Subsidiaries or (D)
current or former employee or director (or his beneficiary), (iv) no DMGI Benefit Plan is (A
ERISA, or Section 412 of the Code, (B) a multiemployer pension plan (as such term is de
employer plan within the meaning of Section 4063 of ERISA, nor has DMGI, its Subsidiar
contributed to or been obligated to contribute to any multiemployer plan or multiple employ
payable by DMGI or its Subsidiaries as of the Effective Time with respect to each DMGI Be
have been paid or accrued in accordance with GAAP, (vi) none of DMGI, its Subsidiaries or
engaged in a transaction in connection with which DMGI, its Subsidiaries or any DMGI Ben
penalty assessed pursuant to Section 409 or 502(i) of ERISA or a material tax imposed pursu
the Knowledge of DMGI there are no pending, threatened or anticipated claims (other than r
against any of DMGI Benefit Plans or any trusts related thereto that would reasonably be ex
aggregate, a Material Adverse Effect on DMGI, and (viii) each DMGI Benefit Plan may be a
discretion of the sponsor thereof without liability other than for benefits accrued prior to suc
constraints as imposed by applicable law.

(d) There are no pending or, to the Knowledge of DMGI, threatened material labor grievanc
charges against DMGI or any of its Subsidiaries, or any strikes or other material labor dispu
Neither DMGI nor its Subsidiaries are party to or bound by any collective bargaining or sim
work rules or practices agreed to with any labor organization or employee association applic
and, to the Knowledge of DMGI, there are no organizing efforts by any union or other group
any of its Subsidiaries.

(e) None of the execution and delivery of this Agreement, the approval of this Agreement by
transactions contemplated hereby will (either alone or in conjunction with any other event) (
limitation, severance, unemployment compensation, excess parachute payment (within th
forgiveness of indebtedness or otherwise) becoming due to any director or any employee of
Orchard or any of their respective affiliates under any DMGI Benefit Plan or otherwise, (ii)
DMGI Benefit Plan or (iii) result in any acceleration of the time of payment or vesting of an

(f) Neither DMGI nor any of its DMGI ERISA Affiliates maintains or contributes to a rabbi
and other transactions contemplated by this Agreement shall not cause or require DMGI or i
or make any contribution to a rabbi trust or similar funding vehicle.

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4.11 *SEC Reports*. DMGI has previously made available to the Orchard an accurate and com
prospectus, report, schedule and definitive proxy statement filed since September 29, 2005 b
Act or the Exchange Act (the DMGI Reports) and prior to the Execution Date and (b) cor
since September 29, 2005 and prior to the Execution Date, and no such DMGI Report or cor
untrue statement of a material fact or omitted to state any material fact required to be stated
statements therein, in light of the circumstances in which they were made, not misleading, e
before the Execution Date) shall be deemed to modify information as of an earlier date. Sinc
dates, all DMGI Reports filed under the Securities Act and the Exchange Act complied in al
regulations of the SEC with respect thereto.

4.12 *Compliance with Applicable Law*. DMGI and each of its Subsidiaries hold all licenses,
for the lawful conduct of their respective businesses under and pursuant to each, except whe
obtaining and holding such license, franchise, permit or authorization would, either individu
have a Material Adverse Effect on DMGI. DMGI and each of its Subsidiaries have complied
law, statute, order, rule, regulation, policy and/or guideline of any Governmental Entity rela
where neither the cost of such noncompliance or default nor the cost of compliance or cure
aggregate, reasonably be expected to have a Material Adverse Effect on DMGI. Without lim
Execution Date, none of DMGI, and of its Subsidiaries, or any director, officer, employee, a
any of its Subsidiaries has, to the Knowledge of DMGI directly or indirectly, (i) used any fu
unlawful contributions, unlawful gifts, unlawful entertainment or other expenses relating to
to foreign domestic governmental officials or employees or to foreign or domestic political
of its Subsidiaries, (iii) violated any provision that would result in the violation of the Foreig
any similar law (iv) established or maintained any unlawful fund of monies or other assets o
fraudulent entry on the books or records of DMGI or any of its Subsidiaries, or (vi) made an
payoff, unlawful influence payment, unlawful kickback or other unlawful payment to any pe
whether in money, property or services, to obtain favorable treatment in securing business to
its Subsidiaries, to pay for favorable treatment for business secured or to pay for special con
Subsidiaries.

4.13 *Certain Contracts*. (a) Neither DMGI nor any of its Subsidiaries is a party to or bound
understanding (whether written or oral) (i) with respect to the employment of any directors,
course of business consistent with past practice, (ii) which, upon the execution or delivery o
Agreement or the consummation of the transactions contemplated by this Agreement will (e
additional acts or events) result in any payment (whether of severance pay or otherwise) bec
Surviving Corporation, or any of their respective Subsidiaries to any officer or employee the
any line of business by DMGI or any of its Subsidiaries or upon consummation of the Merg
Surviving Corporation to engage in any line of business, (iv) with or to a labor union or guil
or (v) (including any stock option plan, stock appreciation rights plan, restricted stock plan o
which will be increased, or the vesting of the benefits of which will be accelerated, by the oc
Agreement, stockholder approval of this Agreement or the consummation of any of the trans
value of any of the benefits of which will be calculated on the basis of any of the transaction
previously made available to the Orchard true and correct copies of all employment and defe
writing and to which DMGI or any of its Subsidiaries is a party. Each contract,

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arrangement, commitment or understanding to which DMGI is a party or by which its prope
in the DMGI Disclosure Schedule, is referred to herein as a DMGI Contract, and to the K
received notice of, any violations of the above by any DMGI Contract of the other parties th
have, either individually or in the aggregate, a Material Adverse Effect on DMGI.

(b) (i) Each DMGI Contract is valid and binding on DMGI and/or one of its Subsidiaries, as
full force and effect, (ii) DMGI and each of its Subsidiaries has in all material respects perfo
it through the Execution Date under each DMGI Contract, except where such noncompliance
not reasonably be expected to have a Material Adverse Effect on DMGI, (iii) to the Knowle
each DMGI Contract has in all material respects performed all obligations required to be per
such DMGI Contract and (iv) no event or condition exists which constitutes or, after notice
default on the part of DMGI or any of its Subsidiaries under any such DMGI Contract, excep
aggregate, would not reasonably be expected to have a Material Adverse Effect on DMGI.

(c) Section 4.13 of the DMGI Disclosure Schedule identifies all of the libraries or collection

(d) Subject to the rights of the Content owners pursuant to DMGI s Standard Form of Agen
rights to license, distribute and sell all of the Content through DMGI s Channel Outlets to c

(e) Neither DMGI nor any of its Subsidiaries has transferred ownership of or granted any rig
other than to consumers through DMGI s Channel Outlets in the ordinary course of busines

(f) Excluding third-party, peer-to-peer file sharing, peer-to-peer providers, device distributor
providers and other systematic infringers, neither DMGI nor its Subsidiaries has received wr
misappropriating any rights with respect to the Content.

(g) Since March 31, 2007, no Content owner, Channel Outlet, vendor or supplier of DMGI c
modified its relationship with DMGI or any of its Subsidiaries, as applicable, in a manner ad
whole, and no such person has, to the Knowledge of DMGI, communicated in writing to DM

4.14 *Environmental Liability*. There are no legal, administrative, arbitral or other proceeding
environmental investigations or remediation activities or governmental investigations of any
reasonably result in the imposition, on DMGI of any liability or obligation arising under con
environmental statute, regulation or ordinance including, without limitation, CERCLA, penc
or obligation would reasonably be expected to have, either individually or in the aggregate,
Knowledge of DMGI, there is no reasonable basis for any such proceeding, claim, action or
any liability or obligation that would reasonably be expected to have, either individually or i
DMGI. DMGI is not subject to any agreement, order, judgment, decree, letter or memorandu
regulatory agency or third party imposing any liability or obligation with respect to the foreg
either individually or in the aggregate, a Material Adverse Effect on DMGI.

4.15 *Property*. DMGI or a DMGI Subsidiary (a) has good and marketable title to all the prop
balance sheet included in the DMGI Reports as being owned by DMGI or a

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DMGI Subsidiary or acquired after the date thereof (except properties sold or otherwise disp
course of business) (the DMGI Owned Properties), free and clear of all material Liens, ex
lessee of all leasehold estates reflected in the latest audited financial statements included in s
thereof (except for leases that have expired by their terms or leased property that has been di
lease and in the ordinary course of business since the date thereof) (the DMGI Leased Prop
Properties, the DMGI Real Property), free and clear of all material Liens, except for Perm
properties purported to be leased thereunder, and each such lease is a valid obligation of DM
thereunder by the lessee or, to the Knowledge of DMGI, the lessor.

4.16 *Intellectual Property*. DMGI and each of its Subsidiaries owns, or is licensed to use (in
all Intellectual Property used in or necessary for the conduct of its business as currently cond
DMGI and its Subsidiaries does not, to the Knowledge of DMGI, infringe on or otherwise v
accordance with any applicable license pursuant to which DMGI or any DMGI Subsidiary a
To the Knowledge of DMGI, no person is challenging, or to the Knowledge of DMGI, infrin
or any of its Subsidiaries with respect to any Intellectual Property owned by and/or licensed
any DMGI Subsidiary has received any written notice of any pending claim with respect to a
DMGI Subsidiary which would reasonably be expected to have, either individually or in the

4.17 *State Takeover Laws; DMGI Rights*. (a) The Board of Directors of DMGI has unanimo
transactions contemplated hereby as required to render inapplicable to such agreements and
Knowledge of DMGI, any other Takeover Statutes.

(b) DMGI has taken all action, if any, necessary or appropriate so that the entering into of th
transactions contemplated hereby, do not and will not result in the ability of any person to ex
DMGI Rights to separate from the shares of DMGI Common Stock to which they are attach

4.18 *Opinion*. Prior to the execution of this Agreement, DMGI has received an opinion from
thereof and based upon and subject to the matters set forth therein, the Exchange Ratio pursu
point of view to DMGI and its shareholders (the Fairness Opinion). The Fairness Opinion
Execution Date.

4.19 *DMGI Information*. The information relating to DMGI and its Subsidiaries to be contai
definitive form relating to the meeting of stockholders to be held in connection with this Ag
(including any amendments or supplements thereto (the Proxy Statement), or the informa
provided by DMGI or its representatives for inclusion in any other document filed with any
herewith, will not contain any untrue statement of a material fact or omit to state a material f
light of the circumstances in which they are made, not misleading. The Proxy Statement (ex
the Orchard or any of its Subsidiaries) will comply with the provisions of the Exchange Act

4.20 *Merger Sub s Operations*. Merger Sub was formed solely for the purpose of engaging
and has not engaged in any business activities or conducted any operations other then in con

4.21 *Receivables*. All accounts receivable reflected on the consolidated balance sheet includ
the quarter ended March 31, 2007, and created since March 31, 2007,

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represent valid obligations of customers of DMGI arising from bona fide transactions entere
consistent with past practices.

4.22 *Registration Rights*. Section 4.22 of the DMGI Disclosure Schedule sets forth a comple
have registration rights, and the number of registerable shares of DMGI Common Stock held
Second Amended and Restated Stockholders Agreement, dated September 8, 2005, or other

ARTICLE V

COVENANTS RELATING TO CONDUCT OF B

5.1 *Conduct of Businesses Prior to the Effective Time*. During the period from the Execution
contemplated or permitted by this Agreement (including the Orchard Disclosure Schedule an
DMGI and the Orchard shall, and shall cause each of their respective Subsidiaries to, (a) con
reasonable best efforts to maintain and preserve intact its business organization, employees a
retain the services of its key officers and key employees, and (c) take no action that would re
the ability of either DMGI or the Orchard to obtain any necessary approvals of any Governm
contemplated hereby or to perform its covenants and agreements under this Agreement or to
hereby.

5.2 *Forbearances*. During the period from the Execution Date to the Effective Time, except
the Orchard Disclosure Schedule, as the case may be, and, except as expressly contemplated
nor the Orchard shall, and neither DMGI nor the Orchard shall permit any of their respective
of the other party to this Agreement:

(a) incur any indebtedness for borrowed money (other than indebtedness of the Orchard or a
Subsidiaries, on the one hand, or of DMGI or any of its Subsidiaries to DMGI or any of its S
guarantee, endorse or otherwise as an accommodation become responsible for the obligation
entity, or make any loan or advance;

(b) (i) adjust, split, combine or reclassify any capital stock;

(ii) make, declare or pay any dividend, or make any other distribution on, or directly or indir
shares of its capital stock or any securities or obligations convertible (whether currently con
time or the occurrence of certain events) into or exchangeable for any shares of its capital st
Subsidiaries of each of DMGI and the Orchard to DMGI or the Orchard or any of their whol
DMGI and the Orchard, (B) the acceptance of shares of the Orchard Common Stock or DMG
payment for the exercise price of stock options or for withholding taxes incurred in connecti
vesting of restricted stock, in each case in accordance with past practice and the terms of the
the DMGI Rights);

(iii) grant any stock appreciation rights, performance shares, restricted stock units or other e
corporation or other entity any right to acquire any shares of its capital stock; or

(iv) issue any additional shares of capital stock except pursuant to the exercise of stock optio
Date;

(c) sell, transfer, mortgage, encumber or otherwise dispose of any of its material properties o
entity other than a Subsidiary, or cancel, release or assign any

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indebtedness owed to or from any such person or any claims by or against any such person, business consistent with past practices or pursuant to contracts or agreements in force at the

(d) except for transactions in the ordinary course of business consistent with past practices o the Execution Date or otherwise permitted by this Agreement, make any material investmen contributions to capital, property transfers, or purchase of any property or assets of any othe a Subsidiary thereof;

(e) except for transactions in the ordinary course of business consistent with past practices, t Orchard Contract or DMGI Contract, as the case may be, or make any change in any instrun its securities, or material lease or contract, other than normal renewals of contracts and lease respect to the Orchard or DMGI, as the case may be;

(f) increase in any manner the compensation or fringe benefits of any of its employees or pa required by any existing plan or agreement to any such employees or become a party to, ame profit-sharing or welfare benefit plan or agreement or employment agreement with or for the ordinary course of business, or accelerate the vesting of, or the lapsing of restrictions with re compensation (except to the extent required under the terms of the applicable plan or related

(g) settle any material claim, action or proceeding, except in the ordinary course of business

(h) knowingly take any action that would reasonably be expected to prevent the Merger from meaning of Section 368 of the Code;

(i) amend its articles of incorporation, its bylaws or comparable governing documents;

(j) take any action that is intended or expected to result in any of its representations and war becoming untrue in any material respect at any time prior to the Effective Time, or in any of VII not being satisfied or in a violation of any provision of this Agreement, except, in every

(k) implement or adopt any change in its accounting principles, practices or methods, other t

(l) agree to take, make any commitment to take, or adopt any resolutions of its board of dire by this Section 5.2.

ARTICLE VI

ADDITIONAL AGREEMENTS

6.1 *Regulatory Matters*. (a) DMGI shall promptly prepare and file with the SEC the Proxy S filing, DMGI shall mail or deliver the Proxy Statement to its stockholders. DMGI shall also necessary state securities law or Blue Sky permits and approvals required to carry out the the Orchard shall furnish all information concerning the Orchard and the holders of the Orch in connection with any such action.

(b) The parties hereto shall cooperate with each other and use their reasonable best efforts to documentation, to effect all applications, notices, petitions and filings

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(including the filing under the HSR Act), to obtain as promptly as practicable all permits, co
parties and Governmental Entities which are necessary or advisable to consummate the trans
(including, without limitation, the Merger), and to comply with the terms and conditions of a
authorizations of all such Governmental Entities. With the exception of any filings made und
have the right to review in advance, and, to the extent practicable, each will consult the othe
relating to the exchange of information, all the information relating to the Orchard or DMGI
Subsidiaries, which appear in any filing made with, or written materials submitted to, any th
connection with the transactions contemplated by this Agreement. In exercising the foregoin
reasonably and as promptly as practicable. The parties hereto agree that they will consult wi
permits, consents, approvals and authorizations of all third parties and Governmental Entitie
transactions contemplated by this Agreement and each party will keep the other apprised of
transactions contemplated herein.

(c) DMGI and the Orchard shall, upon request, furnish each other with all information conce
officers and stockholders and such other matters as may be reasonably necessary or advisabl
other statement, filing, notice or application made by or on behalf of DMGI, the Orchard or
Governmental Entity in connection with the Merger and the other transactions contemplated

(d) DMGI and the Orchard shall promptly advise each other upon receiving any communica
consent or approval is required for consummation of the transactions contemplated by this A
there is a reasonable likelihood that any Requisite Regulatory Approval will not be obtained
materially delayed.

6.2 *Access to Information*. (a) Upon reasonable notice and subject to the matters set forth in
Disclosure Schedule and to all antitrust laws, each of DMGI and the Orchard, for the purpos
of the other and preparing for the Merger and the other matters contemplated by this Agreem
Subsidiaries to, afford to the officers, employees, accountants, counsel and other representat
business hours during the period prior to the Effective Time, to all its properties, books, con
period, each of DMGI and the Orchard shall, and shall cause their respective Subsidiaries to
each report, schedule, registration statement and other document filed or received by it durin
federal securities laws (other than reports or documents which DMGI or the Orchard, as the
applicable law) and (ii) all other information concerning its business, properties and personn
DMGI nor the Orchard nor any of their respective Subsidiaries shall be required to provide a
access or disclosure would violate or prejudice the rights of DMGI s or the Orchard s, as th
attorney-client privilege of the institution in possession or control of such information or (z)
judgment, decree, fiduciary duty or binding agreement entered into prior to the Execution D
substitute disclosure arrangements under circumstances in which the restrictions of the prec

(b) Each of DMGI and the Orchard shall hold all information furnished by or on behalf of th
representatives pursuant to Section 6.2(a) in confidence to the extent required by, and in acc
agreement, dated December 8, 2006, between DMGI and the Orchard (the Confidentiality

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(c) No investigation by either of the parties or their respective representatives shall affect the forth herein.

6.3 *Stockholders Approvals*. Each of DMGI and the Orchard shall call a meeting of its stoc Meeting, respectively) to be held as soon as reasonably practicable for the purpose of votin in connection with this Agreement and the Merger and, if so desired and mutually agreed, up before an annual meeting of shareholders, and each shall use its reasonable best efforts to ca practicable and on the same date. The Board of Directors of each of DMGI and the Orchard the stockholders of DMGI and the Orchard, as the case may be, the vote in favor of the appr amendment to the DMGI Articles) required by the DGCL to consummate the transactions co the contrary contained in this Agreement, DMGI shall adjourn or postpone the DMGI Meeti necessary supplement or amendment to the Proxy Statement is provided to DMGI s stockho described above, or, if, as of the time for which such meeting is originally scheduled there a represented (either in person or by proxy) to constitute a quorum necessary to conduct the bu good faith determination of DMGI additional time is needed to solicit an affirmative stockho obtain the requisite vote for the foregoing matters; provided that DMGI shall, at least three b postponement, notify the Orchard of the potential adjournment or postponement and shall co such adjournment or postponement. Notwithstanding anything to the contrary herein, unless Agreement shall be submitted to the stockholders of DMGI and the Orchard at the DMGI M the purpose of voting on the approval of this Agreement and the other matters contemplated deemed to relieve either DMGI or the Orchard of such obligation, the shareholders of Orcha contemplated herein by written consent in lieu of a meeting.

6.4 *Legal Conditions to Merger*. Each of DMGI and the Orchard shall, and shall cause its Su (a) to take, or cause to be taken, all actions necessary, proper or advisable to comply prompt imposed on such party or its Subsidiaries with respect to the Merger and, subject to the cond consummate the transactions contemplated by this Agreement and (b) to obtain (and to coop consent, authorization, order or approval of, or any exemption by, any Governmental Entity obtained by the Orchard or DMGI or any of their respective Subsidiaries in connection with contemplated by this Agreement.

6.5 *Stock Exchange Listing*. DMGI shall cause the shares of DMGI Common Stock to be iss of the DMGI Series A Preferred Stock in accordance with the terms thereof, to be approved System, subject to official notice of issuance, prior to the Effective Time.

6.6 *Employee Benefit Plans*. (a) From and after the Effective Time, unless otherwise mutual DMGI Benefit Plans in effect as of the Execution Date shall remain in effect with respect to respective Subsidiaries), respectively, covered by such plans at the Effective Time until such shall, subject to applicable law, the terms of this Agreement and the terms of such plans, mo with respect to employees of DMGI and the Surviving Corporation and their respective Sub Closing Date, the Orchard and DMGI shall cooperate in reviewing, evaluating and analyzing Benefit Plans with a view towards developing appropriate New Benefit Plans for the employ Orchard and DMGI, to the extent permitted by applicable laws, to develop New Benefit Plan

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soon as reasonably practicable after the Effective Time, which, among other things, (i) treat equivalent basis, taking into account all relevant factors, including duties, geographic locatio not discriminate between employees who were covered by the DMGI Benefit Plans, on the Benefit Plans on the other, at the Effective Time.

(b) With respect to any Benefit Plans in which any employees of DMGI or the Orchard (or t become eligible to participate on or after the Effective Time, and in which such employees New Plans), DMGI or the Surviving Corporation, as the case may be, shall: (A) waive all periods with respect to participation and coverage requirements applicable to such employee Plans in which such employees may be eligible to participate after the Effective Time, excep exclusions or waiting periods would apply under the analogous DMGI Benefit Plan or Orch each such employee and their eligible dependents with credit for any co-payments and dedu DMGI Benefit Plan or the Orchard Benefit Plan (to the same extent that such credit was give Effective Time) in satisfying any applicable deductible or out-of-pocket requirements under eligible to participate after the Effective Time; and (C) recognize all service of such employ respective affiliates, for all purposes (including, purposes of eligibility to participate, vesting respect to defined benefit pension plans, benefit accrual) in any New Plan in which such em Effective Time, to the extent such service is taken into account under the applicable New Pl the extent it would result in duplication of benefits.

(c) Each of DMGI and the Surviving Corporation, as the case may be, agrees to honor in acc the Execution Date under the DMGI Benefit Plans or Orchard Benefit Plans or under other understandings described in the DMGI Disclosure Schedule and the Orchard Disclosure Sch

(d) Nothing in this Section 6.6 shall be interpreted as preventing DMGI and the Surviving C modifying or terminating any DMGI Benefit Plans, Orchard Benefit Plans, or other contract in accordance with their terms and applicable law. Without limiting the generality of the fin Section 6.6, express or implied, is intended to or shall confer upon any other person includi the Orchard, any right, benefit or remedy of any nature whatsoever under or by reason of thi shall constitute an amendment of any benefit plan of DMGI or the Orchard.

6.7 *Indemnification; Directors and Officers Insurance*. (a) In the event of any threatened investigation, whether civil, criminal or administrative, including, without limitation, any su in which any individual who is now, or has been at any time prior to the Execution Date, or director or officer or employee of the Orchard or any of its Subsidiaries (the Orchard Inde party based in whole or in part on, or arising in whole or in part out of, or pertaining to (i) th employee of the Orchard or any of its Subsidiaries or (ii) this Agreement or any of the transa asserted or arising before or after the Effective Time, the parties hereto agree to cooperate, a efforts to defend against and respond thereto, except that prior to the Effective Time, the for directors, officers or employees of the Orchard shall be only to cooperate. In the event of an proceeding or investigation, whether civil, criminal or administrative, including, without lim investigation in which any individual who is now, or has been at any time prior to the Execu Time, a director or officer or

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employee of DMGI or any of its Subsidiaries (the DMGI Indemnified Parties), is, or is th
part on, or arising in whole or in part out of, or pertaining to (i) the fact that he is or was a di
Subsidiaries or (ii) this Agreement or any of the transactions contemplated hereby, whether
Effective Time, the parties hereto agree to cooperate, and the parties shall use their reasonab
thereto, except that prior to the Effective Time, the foregoing obligation of the Orchard with
DMGI shall be only to cooperate. It is understood and agreed that after the Effective Time, I
to the fullest extent permitted by law, each such Orchard Indemnified Party and DMGI Inde
damages, liabilities, costs, expenses (including reasonable attorney s fees and expenses in a
proceeding or investigation to each Indemnified Party to the fullest extent permitted by law
applicable law), judgments, fines and amounts paid in settlement (to the extent, in the case o
writing by DMGI, such approval not to be unreasonably withheld) in connection with any su
proceeding or investigation. It is understood that after the Effective Time DMGI may assum
DMGI is obligated to provide indemnification under this Section 6.7(a), provided that the fo
for which counsel has been retained with the approval of the applicable liability insurer (if s
insurance policy, if any, to obtain coverage) and commenced the defense prior to the Effecti
otherwise determines following the Effective Time.

(b) DMGI shall cause the individuals serving as officers and directors of DMGI and the Orc
prior to the Effective Time to be (i) covered for a period of two years from the Effective Tim
policy maintained by DMGI (in the case of officers and directors of DMGI) and the Orchard
Orchard) (provided that DMGI and the Orchard, as the case may be, may substitute therefor
amounts containing terms and conditions that are not less advantageous than such policy) w
the Effective Time that were committed by such officers and directors in their capacity as su
covered for a period of five years by a tail policy on the Orchard s and DMGI s existing di
case may be, of at least the same coverage and amounts containing terms and conditions tha
policy; provided, however, that in no event shall DMGI be required to expend more than 20
expended by DMGI per year of coverage as of the Execution Date (the Maximum Amount
pursuant hereto. If DMGI is unable to maintain or obtain the insurance called for by this Sec
insurance as available for the Maximum Amount. DMGI shall cause such DMGI and Orcha
make reasonable application and provide reasonable and customary representations and war
of obtaining such insurance, comparable in nature and scope to the applications, representati
officers and directors of DMGI (in the case of DMGI) and the Orchard (in the case of the Or

(c) The provisions of this Section 6.7 shall survive the Effective Time and are intended to be
each Indemnified Party and his or her heirs and representatives.

6.8 *Additional Agreements*. In case at any time after the Effective Time any further action is
of this Agreement (including, without limitation, any merger between a Subsidiary of DMG
Orchard, on the other) or to vest the Surviving Corporation with full title to all properties, as
of any of the parties to the Merger, the proper officers and directors of each party to this Agr
take all such necessary action as may be reasonably requested by, and at the sole expense of

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6.9 *Advice of Changes*. DMGI and the Orchard shall each promptly advise the other party of Adverse Effect on it or (ii) which it believes would or would be reasonably likely to cause o representations, warranties or covenants contained herein; provided that any failure to give r respect to any breach shall not be deemed to constitute a violation of this Section 6.9 or the 7.3 to be satisfied, or otherwise constitute a breach of this Agreement by the party failing to underlying breach would independently result in a failure of the conditions set forth in Secti termination right.

6.10 *Officers following Effective Time*. DMGI shall take all such action as may be necessary the Effective Time are only as set forth on Schedule 6.10(a) hereto, assuming that such perso on such Schedule 6.10(a). Orchard shall take all such action as may be necessary so that the Effective Time are as only set forth on Schedule 6.10(b) hereto, assuming that such persons such Schedule 6.10(b).

6.11 *Board of Directors*. (a) DMGI shall take all such action as may be necessary so that, im of the DMGI Board of Directors shall be seven (7) members and that the directors of DMGI assuming that such persons are willing to serve in such capacity. In the event that any such p schedule shall be unable or unwilling to so serve, DMGI shall have the power to designate a any such person listed as an Orchard Designee such schedule shall be unable or unwilling to designate a replacement for such person.

(b) Orchard shall take all such action as may be necessary so that, immediately following the as set forth on Schedule 6.11(b) hereto, assuming that such persons are willing to serve in su

6.12 *Acquisition Proposals*. (a) Until this Agreement has been terminated in accordance with agrees that it will not, and will cause its controlled Affiliates and its and their officers, direct indirectly, (i) (A) initiate, solicit, encourage or knowingly facilitate inquiries or proposals w negotiations concerning, (C) provide any confidential or nonpublic information or data to or discussions with any person relating to, any Acquisition Proposal (as defined in clause (d) b person from, or waive or permit the waiver of any provisions of, or otherwise fail to exercise similar agreement to which such party is a party or under which such party has any rights wi securities or any material portion of the assets of such party, (iii) withdraw, modify or qualif any manner adverse to the other party the recommendation by such party s Board of Direct action or make any statement in connection with such party s meeting of stockholders incon action to approve, recommend or endorse, or to propose to approve, recommend or endorse, in Recommendation) or (iv) enter into any agreement, letter of intent, agreement-in-princip contemplating or otherwise relating to any Acquisition Proposal or requiring such party to a the transactions contemplated hereby, including the Merger.

(b) Notwithstanding Section 6.12(a), prior to approval of the transactions contemplated by th held pursuant to Section 6.3, each of DMGI and the Orchard (the Acting Party) may, and appropriate officers, directors, agents and representatives to furnish or cause to be furnished such negotiations or discussions with, any person in response to an unsolicited, bona fide an the Acting Party after the Execution Date and prior to the approval

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of the transactions contemplated by this Agreement at its meeting of stockholders to be held
modify or qualify the recommendation by such party s Board of Directors of this Agreemer
so long as (A) none of the Acting Party, any of its controlled Affiliates or any of its or their
violated any of the provisions of this Section 6.12, (B) the Board of Directors of the Acting
advice of its outside counsel and its financial advisors) that failure to take such actions woul
applicable law, (C) at least twenty-four (24) hours prior to furnishing or causing to be furnis
participating in such negotiations or discussions with, such person, the Acting Party provide
of such person and of the Acting Party s intention to participate in discussions or negotiatio
information to, such person, (D) prior to providing any nonpublic information to such perso
confidentiality and standstill agreement with such person (a copy of which it shall have prov
restrictive upon such person, in any respect, than the terms applicable to the other party und
confidentiality and standstill agreement shall not provide such person with any exclusive rig
effect of preventing the Acting Party from satisfying its obligations under this Agreement, (
furnishing or causing to be furnished nonpublic information or data to such person, the Acti
party (to the extent such information has not been previously delivered or made available by
to so withdrawing, modifying or qualifying the recommendation by its Board of Directors o
party five business days prior written notice of its intention to do so (unless at the time suc
less than five business days prior to the Acting Party s stockholders meeting, in which case
reasonably practicable), and during such time, the Acting Party, if requested by the other pa
to amend this Agreement (including by making its officers and its financial and legal adviso
Board of Directors of the Acting Party may continue to recommend the approval of this Agr

(c) If DMGI effects a Change in Recommendation, the Orchard shall have the option (the
business days after such Change in Recommendation, to cause DMGI s Board of Directors
purpose of adopting this Agreement and approving the Merger.

(d) Each of DMGI and the Orchard shall, and shall cause its controlled Affiliates and its and
representatives to, immediately cease and cause to be terminated any activities, discussions
Date with any persons other than the Orchard or DMGI, as applicable, with respect to any A
(within one day) request each person who has heretofore executed a confidentiality agreeme
acquiring such party or any portion thereof (including any of its Subsidiaries) to return all n
person by or on behalf of such party and shall advise the other party of the particulars of suc
hours) advise the other party following receipt of any request for information, of any Acquis
reasonably be expected to lead to an Acquisition Proposal, and the substance thereof (includ
of the person making, such request, Acquisition Proposal or inquiry), (ii) promptly (within 2
materials received by such party in connection with the foregoing and (iii) keep the other pa
discussions and negotiations on a current basis. Each of DMGI and the Orchard shall use its
confidentiality or standstill agreements to which it or any of its Subsidiaries is a party in acc

(e) As used in this Agreement, Acquisition Proposal shall mean any offer, proposal or inc
Alternative Transaction received by a party from any person

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other than the other party, in each case, whether or not in writing and whether or not deliver party generally. As used in this Agreement, an Alternative Transaction means any of (i) a pursuant to which any person (or group of persons), directly or indirectly, acquires or would more than 15% of the outstanding shares of a party s common stock or outstanding voting p stock that would be entitled to a class or series vote with respect to the Merger or that would value of the outstanding equity interests of such party, whether from such party or pursuant (ii) a merger, share exchange, business combination, consolidation, sale of all or substantiall similar transaction involving a party or any of its significant subsidiaries (as defined in R SEC), (iii) any transaction (or series of related transactions) pursuant to which any person (o control of assets (including for this purpose the outstanding equity securities of Subsidiaries surviving any merger or business combination including any of its Subsidiaries) of such part than 15% of the fair market value of all the assets, net revenues or net income of such party immediately prior to such transaction (or series of related transactions) or (iv) any other con or similar transaction (or series of related transactions) involving a party or any of its Subsid

(f) Nothing contained in this Agreement shall prevent DMGI or its Board of Directors from the Exchange Act with respect to an Acquisition Proposal; provided, that such Rules will in action pursuant to such Rules would otherwise have under this Agreement.

(g) Any violation of this Section 6.12 by a party s Affiliates or a party s or any of its contro representatives shall be deemed to be a breach of this Agreement by such party.

6.13 *Agreement of Affiliates*. The Orchard has disclosed in Section 6.13 of the Orchard Disc believes may be deemed an affiliate of the Orchard for purposes of Rule 145 under the Se efforts to cause each such person to deliver to DMGI, not later than the date of mailing of th substantially the form of Exhibit A.

6.14 *Certificate of Designation; Doing Business As*.

(a) DMGI shall take all such actions as are necessary so that prior to the Effective Time a Ce of State of the State of Delaware establishing the terms and number of authorized shares of I Exhibit B attached hereto.

(b) DMGI shall take all such actions as are necessary so that immediately after the Effective Orchard, Inc. in all jurisdictions where it conducts business.

6.15 *Certain Tax Matters*. (a) Each of DMGI and the Orchard shall use its reasonable best ef reorganization within the meaning of Section 368(a) of the Code and to obtain the opinio Section 7.2(d) or 7.3(f) hereof. This Agreement is intended to constitute a plan of reorgani Section 1.368-2(g).

(b) Officers of DMGI, Merger Sub and the Orchard shall execute and deliver to Jackson Wa Sub, and Reed Smith LLP, tax counsel to the Orchard, certificates substantially in the form a time or times as may be reasonably requested by such law firms, including at the Effective T respective delivery of opinions pursuant to Sections 7.2(d) and 7.3(f) hereof. Each of DMGI reasonable best efforts not to take or cause to be taken any action

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which would cause to be untrue (or fail to take or cause not to be taken any action which wo
and representations included in the certificates described in this Section 6.15(b).

(c) DMGI and the Orchard shall cooperate in the preparation, execution and filing of all Tax
documents regarding any real property transfer or gains, sales, use, transfer, value added, sto
recording, registration and other fees and any similar Taxes which become payable in conne
Agreement that are required or permitted to be filed on or before the Effective Date. Each of
deduction from any amount payable to holders of shares of the Orchard Capital Stock and w
such Taxes or fees imposed on it by any Governmental Entity (or for which its stockholders
connection with the transactions contemplated by this Agreement.

6.16 *Headquarters*. The parties hereby acknowledge and agree that DMGI shall be headquar

6.17 *Financial Statements*. Within 15 business days following the Execution Date, the Orch
delivered) to DMGI an audited consolidated balance sheet of the Orchard and its Subsidiarie
consolidated statement of operations, shareholders equity and cash flows for the period the
together with a report thereon by Deloitte & Touche LLP (the 2006 Audited Financial Stat
Execution Date, the Orchard shall prepare and deliver (or cause to be delivered) to DMGI th
Orchard and its Subsidiaries as of March 31, 2007 and the related Reviewed consolidated sta
cash flows of the Orchard and its Subsidiaries for the period then ended, including the conde
Reviewed Quarterly Statements). As used herein, the term Reviewed means reviewed
Statement of Auditing Standards No. 100 Objective and General Principles Governing an A

6.18 *NY Office Lease*. Between the Execution Date and the Effective Time, the Orchard shal
the consent of both the over-landlord and the sub-landlord to the assignment of that certain S
sub-landlord and eMusic.com, Inc., as subtenant, dated December 20, 2005.

6.19 *Advances*. The parties hereby acknowledge and agree that any advance to be paid by th
Execution Date and the Effective Time to Content owners in connection with the Orchard s
to the Orchard by Dimensional Associates, LLC (Dimensional) and shall be treated as fol
treated as additional capital contributions made by Dimensional to the Orchard, and (b) any
treated as a loan to the Orchard (the Advances Loan), which shall (i) have a maximum ag
interest at the applicable federal rate (as defined in Section 1274(d) of the Code) in effect
payable upon the earlier of the demand of the holder or one year from the date of such advan
it shall assume and be responsible for repaying the Advances Loan to Dimensional as soon a
event, no later than 30 days after the Effective Time, so long as (x) the Orchard and Dimens
$250,000 was contributed to the Orchard and (y) the Advances Loan is adequately documen

6.20 *DMGI Options*. Following the Effective Time, subject to the approval of the Compensa
DMGI, DMGI shall grant (a) options to purchase DMGI Common Stock and (b) restricted a
to an aggregate of 650,000 shares pursuant to DMGI s Amended and Restated 2005 Stock I
(including the

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vesting provisions thereunder) or the form of restricted stock award grant (including the ves
employees of the Orchard and DMGI in such amounts as shall be approved by the Compens
upon the recommendation of Greg Scholl; provided that such employees remain employees
the Effective Time (or become employees of DMGI).

6.21 *Deferred Stock Awards*. The parties acknowledge and agree that prior to the Execution
Award Agreements with each of Greg Scholl and David Pakman (the Recipients), pursua
receive shares of Series B Preferred Stock in the number and on the terms and conditions se
DMGI acknowledges that the Orchard has provided it with copies of the Deferred Stock Aw
(a) it shall assume and be responsible for (or shall cause to be assumed or responsible for) p
the Deferred Stock Awards from and after the Effective Time, (b) it shall reserve for issuanc
Preferred Stock and DMGI Common Stock, as applicable, that the Deferred Shares would h
had such shares already been transferred to the Recipients as of the Effective Time (the Re
be deducted from the 9,064,941 shares of DMGI Common Stock and the 448,833 shares of
issuance at the Effective Time, (c) it shall issue and transfer to the Recipients the Reserved S
manner specified in the Deferred Stock Awards and (d) as soon as practicable following the
the Deferred Stock Awards, it shall register for resale all such shares of DMGI Common Sto
Stock issuable upon conversion of the shares of DMGI Series A Preferred Stock so issued, u
Securities Act by filing with the SEC a registration statement covering the resale of all such
registration statement under the Securities Act.

ARTICLE VII

CONDITIONS PRECEDENT

7.1 *Conditions to Each Party s Obligation To Effect the Merger*. The respective obligations
to the satisfaction at or prior to the Effective Time of the following conditions:

(a) *Stockholder Approval*. This Agreement (which shall include the requisite approval of the
been approved by the requisite affirmative vote of the holders of DMGI Common Stock enti
affirmative votes of the holders of the Orchard Capital Stock entitled to vote thereon.

(b) *NASDAQ Listing*. The shares of DMGI Common Stock to be authorized for listing on th
official notice of issuance pursuant to Section 6.5 shall have been so authorized.

(c) *Other Approvals*. The applicable waiting period under the HSR Act shall have expired or
Governmental Entities required to consummate the transactions contemplated hereby shall h
and effect and all statutory waiting periods in respect thereof shall have expired, other than s
would not, either individually or in the aggregate, reasonably be expected to have a Material
Corporation (such approvals and the expiration of such waiting periods being referred to her

(d) *No Injunctions or Restraints; Illegality*. No order, injunction or decree issued by any cou
legal restraint or prohibition preventing the consummation of the Merger or any of the other
shall be in effect. No statute, rule,

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regulation, order, injunction or decree shall have been enacted, entered, promulgated or enfo
or makes illegal consummation of the Merger.

7.2 *Conditions to Obligations of DMGI*. The obligation of DMGI to effect the Merger is also
at or prior to the Effective Time, of the following conditions:

(a) *Representations and Warranties*. The representations and warranties of the Orchard set f
materiality or Material Adverse Effect shall be true and correct in all respects, and the rep
materiality or Material Adverse Effect shall be true and correct in all material respects, ot
expressly speak as of a specific date or time (which need only be true and correct in all respe
applicable, as of such date or time). DMGI shall have received a certificate signed on behalf
the Orchard to the foregoing effect.

(b) *Performance of Obligations of the Orchard*. The Orchard shall have performed in all ma
performed by it under this Agreement at or prior to the Closing Date, and DMGI shall have
Orchard by the Chief Executive Officer of the Orchard to such effect.

(c) *Officers and Directors*. Orchard shall have complied with its obligations under Section 6

(d) *Tax Opinions*. DMGI shall have received the opinion of Jackson Walker, L.L.P., or such
form and substance reasonably satisfactory to DMGI dated as of the Closing Date, rendered
assumptions set forth in such opinions and the certificates obtained from officers of DMGI,
consistent with the state of facts existing as of the Effective Time, to the effect that the Merg
meaning of Section 368(a) of the Code. In rendering the opinion described in this Section 7.
and may rely upon the certificates and representations referred to in Section 6.15(b) hereof.

(e) *Affiliate Agreements*. DMGI shall have received from each person named in Section 6.13
agreement substantially in the form of Exhibit B hereto.

(f) *Release of Claims*. DMGI shall have received from each of the Orchard s shareholders a
Exhibit C.

7.3 *Conditions to Obligations of the Orchard*. The obligation of the Orchard to effect the Me
by the Orchard at or prior to the Effective Time of the following conditions:

(a) *Representations and Warranties*. The representations and warranties of DMGI set forth i
or Material Adverse Effect shall be true and correct in all respects, and the representation
or Material Adverse Effect shall be true and correct in all material respects, other than rep
of a specific date or time (which need only be true and correct in all respects or true and corr
such date or time). The Orchard shall have received a certificate signed on behalf of DMGI
foregoing effect.

(b) *Performance of Obligations of DMGI*. DMGI shall have performed in all material respec
under this Agreement at or prior to the Closing Date, and the Orchard shall have received a
Executive Officer of DMGI to such effect.

(c) *Certificate of Designation.* DMGI shall have complied with its obligations under Section

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(d) *Officers and Directors*. DMGI shall have complied with its obligations under Section 6.1

(e) *Officer and Director Resignations*. Each of the officers and directors of DMGI as listed i submitted to DMGI his or her resignation in such capacity to be effective as of the Effective

(f) *Tax Opinions*. The Orchard shall have received the opinion of Reed Smith LLP, or such Orchard, in form and substance reasonably satisfactory to the Orchard, dated as of the Closi representations and assumptions set forth in such opinions and the certificates obtained from all of which are consistent with the state of facts existing as of the Effective Time, to the eff reorganization within the meaning of Section 368(a) of the Code, and (ii) no gain or loss Orchard as a result of the exchange of their shares of Common Stock solely for shares of DM except with respect to cash, if any, received in lieu of fractional shares of DMGI Common S the stockholders of the Orchard as a result of the exchange of their shares of Series A Prefer Preferred Stock and, possibly, DMGI Common Stock, as the case may be, pursuant to the M in lieu of fractional shares of DMGI Capital Stock and (iv) no gain or loss should be recogni of the exchange of their shares of Series B Preferred Stock solely for shares of DMGI Series as the case may be, pursuant to the Merger, except with respect to cash, if any, received in li rendering the opinion described in this Section 7.3(f), Reed Smith LLP shall have received a representations referred to in Section 6.15(b) hereof.

(g) *Registration Rights Agreement*. DMGI shall have executed and delivered a Registration Exhibit D.

(h) *Lien Releases*. DMGI shall have secured the termination of all liens on its assets (and the set forth on Section 4.15 of the DMGI Disclosure Schedule, and shall have provided the Orc Orchard) of the termination of all such liens; provided, however that the lien filed against D provided for in Section 4.15 of the DMGI Disclosure Schedule, shall not be terminated.

ARTICLE VIII

TERMINATION AND AMENDMENT

8.1 *Termination*. This Agreement may be terminated at any time prior to the Effective Time Agreement by the stockholders of DMGI or the Orchard:

(a) by mutual consent of DMGI and the Orchard in a written instrument, if the Board of Dir majority of the members of its entire Board of Directors;

(b) by either the Board of Directors of DMGI or the Board of Directors of the Orchard if any Regulatory Approval has denied approval of the Merger and such denial has become final a competent jurisdiction shall have issued a final nonappealable order permanently enjoining transactions contemplated by this Agreement, unless the failure to obtain a Requisite Regula party seeking to terminate this Agreement to perform or observe the covenants and agreeme

(c) by either the Board of Directors of DMGI or the Board of Directors of the Orchard if the before December 31, 2007, unless the failure of the Closing to occur

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by such date shall be due to the failure of the party seeking to terminate this Agreement to p
of such party set forth herein;

(d) by either the Board of Directors of DMGI or the Board of Directors of the Orchard (prov
material breach of any representation, warranty, covenant or other agreement contained here
covenants or agreements or any of the representations or warranties set forth in this Agreem
termination by DMGI, or DMGI, in the case of a termination by the Orchard, which breach,
constitute, if occurring or continuing on the Closing Date, the failure of the conditions set fo
which is not cured within 30 days following written notice to the party committing such brea
prior to the Closing Date;

(e) by either the Board of Directors of DMGI or the Board of Directors of the Orchard if eith
affirmative vote of its stockholders required to consummate the transactions contemplated h
Meeting, as applicable, or any adjournment or postponement thereof at which a vote on such
not have the right to terminate this Agreement pursuant to this Section 8.1(e) as a result of th
Agreement at the DMGI Meeting or the Orchard Meeting, as applicable, if such party has fa
obligations under Sections 6.1(a), 6.3 or 6.12;

(f) by the Orchard, if the Board of Directors of DMGI shall have (i) failed to recommend in
Agreement, (ii) effected a Change in Recommendation, or resolved to do so, or failed to rec
exchange offer for outstanding DMGI Common Stock that has been publicly disclosed (othe
Orchard) within 10 business days after the commencement of such tender or exchange offer
terms hereof or (iii) knowingly breached its obligations under Section 6.1(a), 6.3 or 6.12 in a

(g) by DMGI, if the Board of Directors of the Orchard shall have (i) effected a Change in Re
(ii) knowingly breached its obligations under Section 6.1(a), 6.3 or 6.12 in any material resp

(h) by DMGI, if within five business days of the Orchard s delivery of the 2006 Audited Fi
Directors delivers written notification to the Orchard of (i) its good faith determination that a
or cash flows of the Orchard as set forth in the 2006 Audited Financial Statements has chang
Statements in such a manner that the amount of change could be deemed to have a Material
intention to terminate this Agreement; provided, however that notwithstanding anything to t
Section 8.1(i), non-cash compensation charges shall not be considered in determining wheth
have occurred;

(i) by DMGI, if within five business days of the Orchard s delivery of the Reviewed Quarte
Directors delivers written notification to the Orchard of (i) its good faith determination that a
or cash flows of the Orchard as set forth in the Reviewed Quarterly Statements has changed
Statements in such a manner that the amount of change could be deemed to have a Material
intention to terminate this Agreement; provided, however that notwithstanding anything to t
Section 8.1(j), non-cash compensation charges shall not be considered in determining wheth
have occurred;

(j) by DMGI if within two business days of the Orchard s delivery of the 2006 Audited Fina
rescinds or withdraws the Fairness Opinion;

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(k) by DMGI, if the Board of Directors of DMGI shall have effected a Change in Recomme Stockholder Vote Option within ten business days of being notified of the DMGI Board of D

(l) by the Orchard, if the Board of Directors of the Orchard shall have effected a Change in

8.2 *Effect of Termination*. (a) In the event of termination of this Agreement by either DMGI Agreement shall forthwith become void and have no effect, and none of DMGI, the Orchard officers or directors of any of them shall have any liability of any nature whatsoever hereunc contemplated hereby, except that (i) Sections 6.2(b) and 8.2 and Article IX (other than Secti Agreement and (ii) notwithstanding anything to the contrary contained in this Agreement, n released from any liabilities or damages (which the parties acknowledge and agree shall not out-of-pocket costs, and may include to the extent proven the benefit of the bargain lost by a relevant matters, including other combination opportunities and the time value of money), w of such party) arising out of its willful breach of any provision of this Agreement.

(b)(i) In the event that (A) a Pre-Termination Takeover Proposal Event (as hereinafter defin with respect to the Orchard and thereafter this Agreement is terminated by either DMGI or t thereafter this Agreement is terminated by DMGI pursuant to Section 8.1(d) as a result of a Orchard or pursuant to Section 8.1(c) if the failure to consummate the Merger on or before t any willful material breach of this Agreement by the Orchard and (B) either (1) prior to the such termination the Orchard consummates an Alternative Transaction, the Orchard shall, o consummated, pay DMGI a fee equal to $1.11 million plus DMGI s reasonable costs and e contemplated by this Agreement, not to exceed $500,000 in the aggregate, by wire transfer twelve (12) months after the date of such termination the Orchard enters into a definitive ac Transaction (Acquisition Agreement), the Orchard shall, on the date of entry into such A $1.11 million plus DMGI s reasonable costs and expenses incurred in connection with the t exceed $500,000 in the aggregate, by wire transfer of same day funds.

(ii) In the event that this Agreement is terminated by DMGI pursuant to Section 8.1(g) or by Orchard shall pay DMGI a fee equal to $1.11 million plus DMGI s reasonable costs and ex contemplated by this Agreement, not to exceed $500,000 in the aggregate, by wire transfer

(c)(i) In the event that (A) a Pre-Termination Takeover Proposal Event (as hereinafter defin with respect to DMGI and thereafter this Agreement is terminated by either DMGI or the O Agreement is terminated by the Orchard pursuant to Section 8.1(d) as a result of a willful m pursuant to Section 8.1(c) if the failure to consummate the Merger on or before the date con material breach of this Agreement by DMGI and (B) either (1) prior to the date that is twelv DMGI consummates an Alternative Transaction, DMGI shall, on the date an Alternative Tra equal to $1.11 million plus the Orchard s reasonable costs and expenses incurred in connec Agreement, not to exceed $500,000 in the aggregate, by wire transfer of same day funds or after the date of such termination DMGI enters into an Acquisition Agreement, DMGI shall Agreement,

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pay the Orchard a fee equal to $1.11 million plus the Orchard s reasonable costs and expens contemplated by this Agreement, not to exceed $500,000 in the aggregate, by wire transfer notwithstanding anything to the contrary contained in this Section 8.1(c)(i), that if this Agre Orchard pursuant to Section 8.1(e) after the Orchard has elected to use the Stockholder Vote this Section 8.2(c)(i) shall be reduced by one half.

(ii) In the event that this Agreement is terminated by the Orchard pursuant to Section 8.1(f) DMGI shall pay the Orchard a fee equal to $1.11 million plus the Orchard s reasonable cos transactions contemplated by this Agreement, not to exceed $500,000 in the aggregate, by w termination.

(d) For purposes of this Section 8.2, a Pre-Termination Takeover Proposal Event shall be the right to terminate this Agreement, a bona fide Acquisition Proposal shall have been mad Acquisition Proposal relating to the Orchard) or shall have been made known to DMGI (in t DMGI) or has been made directly to its stockholders generally or any person shall have pub intention (whether or not conditional) to make an Acquisition Proposal (the term Acquisitio Proposal for purposes of this Section 8.2, and as used in this Section 8.2, shall have the sam references to more than 15% contained in the definition of Alternative Transaction shall definition shall not include any merger, share exchange, consolidation, business combinatio shares of such party immediately prior to such transaction (or series of related transactions) majority of the outstanding shares of common stock and the outstanding voting power of the parent) in the transaction (or series of related transactions) immediately after the consumma such holders held the shares of such party s common stock immediately prior to the consu least a majority of the surviving or resulting entity s (or its ultimate parent s) board of dire

(e) Notwithstanding anything to the contrary herein, but without limiting the right of any pa aggregate amount of fees payable by a single party under this Section 8.2 shall be $1.61 mil

(f) Each of DMGI and the Orchard acknowledges that the agreements contained in this Sect contemplated by this Agreement, and that, without these agreements, the other party would DMGI or the Orchard, as the case may be, fails promptly to pay the amount due pursuant to payment, the other party commences a suit which results in a judgment against the non-payi such non-paying party shall pay the costs and expenses of the other party (including attorne In addition, if DMGI or the Orchard, as the case may be, fails to pay the amounts payable in on such overdue amounts at a rate per annum equal to the prime rate (as announced by JP effect on the date on which such payment was required to be made.

8.3 *Amendment*. Subject to compliance with applicable law and Section 1.1(b), this Agreem action taken or authorized by their respective Boards of Directors, at any time before or afte with Merger by the stockholders of DMGI and the Orchard; provided, however, that after a this Agreement by the respective stockholders of DMGI or the Orchard, there may not be, w amendment of this Agreement that changes the amount or the form of the consideration to b Capital Stock, other than as contemplated by this Agreement. This Agreement may not be a on behalf of each of the parties hereto.

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8.4 *Extension; Waiver*. At any time prior to the Effective Time, the parties hereto, by action
Directors, may, to the extent legally allowed, (a) extend the time for the performance of any
hereto, (b) waive any inaccuracies in the representations and warranties contained herein or
(c) waive compliance with any of the agreements or satisfaction of any conditions contained
approval of the transactions contemplated by this Agreement by the respective stockholders
without further approval of such stockholders, any extension or waiver of this Agreement or
changes the form of the consideration to be delivered to the holders of Orchard Capital Stoc
Agreement. Any agreement on the part of a party hereto to any such extension or waiver sha
signed on behalf of such party, but such extension or waiver or failure to insist on strict com
or condition shall not operate as a waiver of, or estoppel with respect to, any subsequent or

ARTICLE IX

GENERAL PROVISIONS

9.1 *Closing*. Subject to the terms and conditions of this Agreement, the closing of the Merge
York City time on a date and at a place to be specified by the parties, which shall be no later
waiver (subject to applicable law) of the latest to occur of the conditions set forth in Article
only be satisfied at closing, but subject to the satisfaction thereof), unless extended by mutua

9.2 *Nonsurvival of Representations, Warranties and Agreements*. None of the representation
Agreement or in any instrument delivered pursuant to this Agreement (other than the Confid
accordance with its terms) shall survive the Effective Time, except for Section 6.7 and for th
herein and therein which by their terms apply in whole or in part after the Effective Time.

9.3 *Expenses*. All costs and expenses incurred in connection with this Agreement and the tra
the party incurring such expense; provided, however, any filing fee required under the HSR
equally by DMGI and the Orchard.

9.4 *Notices*. All notices and other communications hereunder shall be in writing and shall be
(with confirmation), mailed by registered or certified mail (return receipt requested) or deliv
the parties at the following addresses (or at such other address for a party as shall be specifie

(a) if to DMGI, to: Digital Music Group, Inc.

2151 River Plaza Drive

Suite 200

Sacramento, CA 95833

Attention: Chief Financial Officer

Telecopier: (916) 239-6017

With a copy to:

Jackson Walker L.L.P.

1401 McKinney

Suite 1900

Houston, TX 77010

Attention: Richard S. Roth

Facsimile: (713) 752-4221

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(b) if to the Orchard, to: The Orchard Enterprises, Inc.

100 Park Avenue

2nd Floor

New York, NY 10017

Attention: Chief Executive Officer

Telecopier: (212) 201-9292

and

Attention: General Counsel

Telecopier: (212) 201-9203

With a copy to:

Reed Smith LLP

599 Lexington Avenue

New York, NY 10022

Attention: David M. Grimes

Antone P. Manha, Jr.

Facsimile: (212) 521-5450

9.5 *Interpretation*. When a reference is made in this Agreement to Articles, Sections, Exhibi
Article or Section of or Exhibit or Schedule to this Agreement unless otherwise indicated. T
Agreement are for reference purposes only and shall not affect in any way the meaning or in
words include, includes or including are used in this Agreement, they shall be deem
purposes hereof, documents shall have been deemed to have been made available to a party
available on the EDGAR system of the SEC. The Orchard Disclosure Schedule and the DM
schedules and all exhibits hereto, shall be deemed part of this Agreement and included in an
of such Schedules contains language expressing agreements of the parties, such agreements
extent as if they were set forth in Article VI of this Agreement.

9.6 *Counterparts*. This Agreement may be executed in counterparts, all of which shall be co
become effective when counterparts have been signed by each of the parties and delivered to

parties need not sign the same counterpart.

9.7 *Entire Agreement; Effect on Old Agreement*. This Agreement (including the documents a
with the Confidentiality Agreement constitutes the entire agreement and supersedes all prior
oral, among the parties with respect to the subject matter hereof. For the avoidance of doubt
the Old Agreement in its entirety and the Old Agreement is null and void and shall have no

9.8 *Governing Law*. This Agreement shall be governed and construed in accordance with the
contracts executed in and to be performed entirely within the State of New York, without re
except as specifically provided herein.

9.9 *Publicity*. Except as otherwise required by applicable law or the rules of the NASDAQ,
permit any of its Subsidiaries to, issue or cause the publication of any press release or other
make any public statement concerning, the transactions contemplated by this Agreement wit
proposed announcement or statement by DMGI, or DMGI, in the case of a proposed announ
consent shall not be unreasonably withheld.

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9.10 *Assignment; Third Party Beneficiaries*. Neither this Agreement nor any of the rights, in
the parties hereto (whether by operation of law or otherwise) without the prior written conse
sentence, this Agreement will be binding upon, inure to the benefit of and be enforceable by
assigns. Except (a) as otherwise specifically provided in Section 6.7, and (b) for the rights o
respective stockholders, to pursue damages pursuant Section 8.2(a)(ii) hereof, this Agreeme
referred to herein) is not intended to confer upon any person other than the parties hereto an

9.11 *Specific Performance*. The parties hereto agree that irreparable damage would occur if
performed in accordance with the terms hereof and, accordingly, that the parties shall be ent
breaches of this Agreement or to enforce specifically the performance of the terms and prov
consummate the Merger) in any federal court located in the State of New York (or, to the ex
does not exist in any such federal court, then in any New York state court located in New Y
which they are entitled at law or in equity. Each of the parties hereto submits to the jurisdict
proceeding seeking to enforce any provision of, or based on any matter arising out of, or in
transactions contemplated hereby and hereby irrevocably waives the benefit of jurisdiction
otherwise in such action or proceeding. Each party hereto irrevocably waives, to the fullest
now or hereafter have to the laying of the venue of any such suit, action or proceeding in an
proceeding brought in any such court has been brought in an inconvenient forum.

[Signature Page Follows]

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IN WITNESS WHEREOF, The Orchard Enterprises, Inc., Digital Music Group, Inc. and DI
to be executed by their respective officers thereunto duly authorized as of the date first abov

THE C

By:
Name:
Title:

DIGIT

By:
Name:
Title:

DMGI

By:
Name:
Title:

[Signature Page to Agreement and Plan of Me

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Exhibit A

Form of Affiliate Letter

Digital Music Group, Inc.

2151 River Plaza Drive

Suite 200

Sacramento, CA 95833

Ladies and Gentlemen:

I have been advised that as of the date hereof I may be deemed to be an affiliate of The C
the term affiliate is defined for purposes of paragraphs (c) and (d) of Rule 145 of the rule
Commission under the Securities Act of 1933, as amended. I have been further advised that
of Merger dated as of July 10, 2007, by and between the Orchard and Digital Music Group,
be merged with and into Merger Sub.

All terms used in this letter but not defined herein shall have the meanings ascribed thereto i

I represent, warrant and covenant to DMGI that in the event I receive any DMGI Capital Sto

(a) The DMGI Capital Stock to be received by me as a result of the Merger will be taken for
indirectly, in whole or part, and I shall not make any sale, transfer or other disposition of DM
Rules and Regulations.

(b) I have carefully read this letter and the Merger Agreement and discussed its requirement
to sell, transfer or otherwise dispose of DMGI Capital Stock to the extent I believed necessa

(c) I have been advised that the issuance of DMGI Capital Stock to me pursuant to the Merg
under the Act on a Registration Statement but will be subject to certain registration rights. I
Merger will be submitted for a vote of the stockholders of the Orchard I may be deemed to h
distribution by me of DMGI Capital Stock has not been registered under the Act, I may not s
Capital Stock issued to me in the Merger unless (i) such sale, transfer or other disposition ha
transfer or other disposition is made in conformity with the volume and other limitations of
the Act, or (iii) in the opinion of counsel reasonably acceptable to DMGI, such sale, transfer
registration under the Act.

(d) I understand that, except to the extent set forth in the Registration Rights Agreement, DM
transfer or other disposition of DMGI Capital Stock by me or on my behalf under the Act or
make compliance with an exemption from such registration available.

(e) I also understand that stop transfer instructions will be given to DMGI s transfer agents
will be placed on the certificates for DMGI Capital Stock issued to me, or any substitutions

The securities represented by this certificate have been issued in a transaction to which Ru
1933 applies and may only be sold or otherwise transferred in

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compliance with the requirements of Rule 145 or pursuant to a registration statement under

(f) I also understand that unless the transfer by me of my DMGI Capital Stock has been regi
conformity with the provisions of Rule 145, DMGI reserves the right to put the following le

The shares represented by this certificate have not been registered under the Securities Act
received such shares in a transaction to which Rule 145 promulgated under the Securities Ac
by the holder not with a view to, or for resale in connection with, any distribution thereof wi
and may not be offered, sold, pledged or otherwise transferred except in accordance with an
the Securities Act of 1933.

It is understood and agreed that the legends set forth above shall be removed by delivery of
the issuance of a letter to DMGI s transfer agent removing such stop transfer instructions, a
apply, if (A) one year (or such other period as may be required by Rule 145(d)(2) under the
elapsed from the Closing Date and the provisions of such Rule are then available to me; or (
required by Rule 145(d)(3) under the Securities Act or any successor thereto) shall have elap
such Rule are then available to me; or (C) I shall have delivered to DMGI (i) a copy of a lett
opinion of counsel in form and substance reasonably satisfactory to DMGI, or other evidenc
that such legend and/or stop transfer instructions are not required for purposes of the Securit
reasonably satisfactory to DMGI that the securities represented by such certificates are being
conformity with the provisions of Rule 145 under the Securities Act or pursuant to an effect

I recognize and agree that the foregoing provisions also apply to (i) my spouse, (ii) any relat
(iii) any trust or estate in which I, my spouse or any such relative owns at least 10% benefici
executor or in any similar capacity and (iv) any corporate or other organization in which I, n
of any class of equity securities or of the equity interest.

By its acceptance hereof, DMGI agrees, for a period of two years after the Effective Time th
file on a timely basis all reports required to be filed by it pursuant to Section 13 of the Excha
of Rule 144(c) under the Securities Act are satisfied and the resale provisions of Rules 145(
available to the undersigned in the event the undersigned desires to transfer any DMGI Capi
communication with the Merger.

It is understood and agreed that this Letter Agreement shall terminate and be of no further fo
terminated in accordance with its terms.

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Execution of this letter should not be construed as an admission on my part that I am an af
paragraph of this letter or as a waiver of any rights I may have to object to any claim that I a
letter.

Very t

By:
Name:

Accep

Digita

By:
Name:
Title:

A-A-3

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EXHIBIT B

Terms of DMGI

Preferred Series A Stock

CONVERTIBLE PREFERRED STOCK.

Four hundred forty-eight thousand eight hundred thirty-three (448,833) shares of the authori
designated Series A Convertible Preferred Stock (the *Series A Preferred Stock*), each wit
privileges and restrictions, qualifications and limitations.

1. *Dividends*. Except as provided herein, the holders of Series A Preferred Stock shall not be
Corporation shall not declare, pay or set aside any dividends on shares of Common Stock un
then outstanding shall first receive, or simultaneously receive, a dividend in an amount equa
outstanding shares of Series A Preferred Stock (subject in each case to appropriate adjustme
combination or other similar recapitalization affecting such shares) had been converted into
for the payment of such dividend.

2. *Priority in Certain Payments and Distributions*.

(a) *Payments to Holders of Series A Preferred Stock Upon Liquidation, Dissolution or Wind*
voluntary or involuntary liquidation, dissolution or winding up of the Corporation, the holde
outstanding shall be entitled to be paid out of the assets of the Corporation available for dist
securities or other property), before any payment shall be made to the holders of Common S
on liquidation junior to the Series A Preferred Stock by reason of their ownership thereof, an
share (subject in each case to appropriate adjustment in the event of any stock dividend, stoc
recapitalization affecting such shares), plus any dividends declared pursuant to Subsection 1
per share as would have been payable had each share of the Series A Preferred Stock been c
Subsection 4 below immediately prior to such liquidation, dissolution or winding up, plus an
above but unpaid thereon (the greater of (i) and (ii) is hereinafter referred to as the *Series A*
liquidation, dissolution or winding up of the Corporation, the remaining assets of the Corpor
shall be insufficient to pay the holders of shares of Series A Preferred Stock, and any class o
with the Series A Preferred Stock, the full amount to which such holders shall be entitled, th
and any class or series of stock ranking on liquidation on a parity with the Series A Preferre
the remaining assets and funds of the Corporation in proportion to the respective amounts w
shares held by them upon such distribution if all amounts payable on or with respect to such

(b) *Payments to Holders of Junior Stock Upon Liquidation, Dissolution or Winding Up of th*
preferential amounts required to be paid to the holders of the Series A Preferred Stock and a
ranking on liquidation senior to or on parity with the Series A Preferred Stock, upon the diss
Corporation, the holders of shares of Common Stock or any other class or series of stock ran
Preferred Stock then outstanding shall be entitled to receive the remaining assets and funds o
stockholders.

(c) *Payments and Distributions Upon Change of Control Event*. For so long as any shares of
Corporation shall not enter into or otherwise effect any transaction (or

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series of transactions) constituting a Change of Control Event (as defined below) unless (i) v
involving the sale or exclusive license of all or substantially all of the Corporation s assets
transaction or a series of transactions) the Corporation shall as promptly as practicable there
Corporation and distribute the assets of the Corporation (whether in cash, securities or other
accordance with Subsections 2(a) and 2(b) and (ii) with respect to a Change of Control Even
stockholders of the Corporation will receive consideration from an unrelated third party, the
of transactions) provides that the consideration payable to the stockholders of the Corporatio
shall be allocated among them in accordance with Subsections 2(a) and 2(b).

For purposes of this Section 2(c), a *Change of Control Event* shall mean any of the follow

(A) a merger or consolidation in which: (1) the Corporation is a constituent party; or (2) a su
except in either case, any such merger or consolidation involving the Corporation or a subsi
Corporation immediately prior to such merger or consolidation continue to hold immediatel
approximately the same proportion as such shares were held immediately prior to such merg
and economic interest, of the capital stock of (x) the surviving or resulting corporation or (y
wholly owned subsidiary of another corporation immediately following such merger or cons
surviving or resulting corporation;

(B) the sale or exclusive license, in a single transaction or series of related transactions, by t
assets or intellectual property of the Corporation (except where such sale or exclusive licens
Corporation); or

(C) the sale, in a single transaction or series of related transactions, by the Corporation or its
outstanding stock by voting power or economic interest (or securities convertible into stock)
of sales in which the holders of capital stock of the Corporation immediately prior to such sa
following such sale or sales, in approximately the same proportion as such shares were held
51%, by voting power and economic interest, of the capital stock of the Corporation.

3. *Voting*.

(a) *General Rights*. On any matter presented to the stockholders of the Corporation for their
stockholders of the Corporation (or by written action of stockholders in lieu of meeting), eac
Preferred Stock shall be entitled to the number of votes equal to the number of whole shares
A Preferred Stock held by such holder are convertible as of the record date for determining s
Except as provided by law or by the provisions of Subsection 2(c) above and Subsection 3(b
vote together with the holders of Common Stock, and with the holders of any other series of
a single class.

(b) *Separate Vote of Series A Preferred*. For so long as any shares of Series A Preferred Stoc
vote or consent required herein or by law, the vote or written consent of the holders of at lea
Preferred Stock, consenting or voting (as the case may be) separately as a class, shall be nec
actions:

(i) Any amendment, alteration or repeal (including any amendment, alteration or repeal effe
business combination) of any provision of the Certificate of Incorporation

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or the Bylaws of the Corporation (including any filing of a Certificate of Designation) that a
dividends or other special rights or privileges, qualifications, limitations or restrictions of th

(ii) Any increase or decrease (other than by redemption or conversion) in the authorized nun

(iii) Any authorization or any designation, whether by reclassification or otherwise, of any n
convertible into equity securities of the Corporation) ranking superior to or on a parity with
voting powers, preferences, dividends or the other special rights or privileges, qualifications
if any such new class or series is consented to by the holders of Series A Preferred Stock, an
designated number of any such new class or series;

(iv) Any reorganization, recapitalization or reclassification of the Corporation and its capital

(v) Any redemption or repurchase of any securities of the Corporation or rights to acquire se
repurchases of Common Stock made in accordance with the terms of any applicable stock pl

4. *Conversion*.

The holders of the Series A Preferred Stock shall have conversion rights as follows (the *Co*

(a) *Right to Convert*.

(i) Each share of Series A Preferred Stock shall be convertible, at the option of the holder th
without the payment of additional consideration by the holder thereof, into such number of f
Stock as is determined by dividing $55.70 by the Series A Conversion Price in effect at the t
Rate). The *Series A Conversion Price* shall initially be $55.70. Such initial Series A Co
Preferred Stock may be converted into shares of Common Stock, shall be subject to adjustm

(ii) In the event of a notice of redemption of any shares of Series A Preferred Stock pursuan
shares designated for redemption shall terminate at the close of business on the last full day
below), unless either (A) a Redemption Right Termination occurs in which case the Corpora
shall immediately terminate and become null and void and the Conversion Rights for such s
Price (as defined below) is not paid on such Redemption Date, in which case the Conversion
price is paid in full. In the event of a liquidation, dissolution or winding up of the Corporatio
close of business on the last full day preceding the date fixed for the payment of any such am
of Series A Preferred Stock. In the event of such a redemption or liquidation, dissolution or
holder of shares of Series A Preferred Stock notice of such redemption or liquidation, dissol
at least 30 days prior to the termination of the Conversion Rights and (y) state the amount pe
paid or distributed on such redemption or liquidation, dissolution or winding up, as the case

(b) *Fractional Shares*. No fractional shares of Common Stock shall be issued upon conversi
fractional shares to which the holder would otherwise be entitled, the Corporation shall pay
effective Series A Conversion Price.

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(c) *Mechanics of Conversion*.

(i) In order for a holder of Series A Preferred Stock to convert shares of Series A Preferred S shall surrender the certificate or certificates for such shares of Series A Preferred Stock, at th Preferred Stock (or at the principal office of the Corporation if the Corporation serves as its that such holder elects to convert all or any number of the shares of the Series A Preferred S Such notice shall state such holder s name or the names of the nominees in which such hold Common Stock to be issued. If required by the Corporation, certificates surrendered for con written instrument or instruments of transfer, in form satisfactory to the Corporation, duly ex attorney duly authorized in writing. The date of receipt of such certificates and notice by the Corporation serves as its own transfer agent) shall be the conversion date (*Conversion Dat* conversion of the shares represented by such certificate shall be deemed to be outstanding o soon as practicable after the Conversion Date, issue and deliver at such office to such holder nominees, a certificate or certificates for the number of shares of Common Stock to which s lieu of any fraction of a share.

(ii) The Corporation shall at all times when any Series A Preferred Stock shall be outstandin but unissued stock, for the purpose of effecting the conversion of the Series A Preferred Sto Common Stock as shall from time to time be sufficient to effect the conversion of all outsta

(iii) All shares of Series A Preferred Stock which shall have been surrendered for conversion be outstanding and all rights with respect to such shares, including the rights, if any, to recei and terminate on the Conversion Date, except only the right of the holders thereof to receive and payment of any dividends declared or accrued pursuant to Subsection 1 above but unpai so converted shall be retired and cancelled and shall not be reissued, and the Corporation (w time to time take such appropriate action as may be necessary to reduce the authorized numb Stock accordingly.

(iv) The Corporation shall pay any and all issue and other similar taxes that may be payable Common Stock upon conversion of shares of Series A Preferred Stock pursuant to this Subs required to pay any tax which may be payable in respect of any transfer involved in the issu name other than that in which the shares of Series A Preferred Stock so converted were regis made unless and until the person or entity requesting such issuance has paid to the Corporati to the satisfaction of the Corporation, that such tax has been paid.

(d) *Adjustment for Stock Splits and Combinations*. If the Corporation shall at any time or fro for the Series A Preferred Stock effect a subdivision of the outstanding Common Stock or co Preferred Stock, the applicable Series A Conversion Price then in effect immediately before proportionately decreased. If the Corporation shall at any time or from time to time after the Stock combine the outstanding shares of Common Stock or effect a subdivision of the outsta Series A Conversion Price then in effect immediately before the combination or subdivision

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adjustment under this paragraph shall become effective at the close of business on the date t

For purposes of this Subsection 4, the term *Original Issue Date* shall mean the date on w issued.

(e) *Adjustment for Certain Dividends and Distributions*. In the event the Corporation at any Issue Date for the Series A Preferred Stock shall make or issue, or fix a record date for the d entitled to receive, a dividend or other distribution payable in additional shares of Common Conversion Price then in effect immediately before such event shall be decreased as of the ti date shall have been fixed, as of the close of business on such record date, by multiplying th fraction:

(1) the numerator of which shall be the total number of shares of Common Stock issued and issuance or the close of business on such record date, and

(2) the denominator of which shall be the total number of shares of Common Stock issued a such issuance or the close of business on such record date plus the number of shares of Com or distribution; *provided*, *however*, that if such record date shall have been fixed and such di not fully made on the date fixed therefor, the Series A Conversion Price shall be recomputed record date and thereafter the Series A Conversion Price shall be adjusted pursuant to this pa dividends or distributions; and *provided further*, *however*, that no such adjustment shall be m simultaneously receive (i) a dividend or other distribution of shares of Common Stock in a m Stock as they would have received if all outstanding shares of Series A Preferred Stock had such event or (ii) a dividend or other distribution of shares of Series A Preferred Stock whic such number of shares of Common Stock as is equal to the number of additional shares of C share of Common Stock in such dividend or distribution.

(f) *Adjustments for Other Dividends and Distributions*. In the event the Corporation at any ti Issue Date for the Series A Preferred Stock shall make or issue, or fix a record date for the d entitled to receive, a dividend or other distribution payable in securities of the Corporation (other property, then and in each such event the holders of Series A Preferred Stock shall rec holders of Common Stock, a dividend or other distribution of such securities, cash or other p securities, cash or other property as they would have received if all outstanding shares of Se Common Stock on the date of such event or record date, as the case may be.

(g) *Certificate as to Adjustments*. Upon the occurrence of each adjustment or readjustment o Subsection 4, the Corporation at its expense shall, as promptly as reasonably practicable but compute such adjustment or readjustment in accordance with the terms hereof and furnish to certificate setting forth such adjustment or readjustment and showing in detail the facts upon The Corporation shall, as promptly as reasonably practicable after the written request at any (but in any event not later than 10 days thereafter), furnish or cause to be furnished to such h Conversion Price then in effect.

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(h) *Notice of Record Date*. In the event:

(i) the Corporation shall take a record of the holders of its Common Stock (or other stock or the Series A Preferred Stock) for the purpose of entitling or enabling them to receive any div to subscribe for or purchase any shares of stock of any class or any other securities, or to rec

(ii) of any capital reorganization of the Corporation, any reclassification of the Common Sto merger of the Corporation with or into another corporation (other than a consolidation or me entity and its Common Stock is not converted into or exchanged for any other securities or p of the assets of the Corporation; or

(iii) of the voluntary or involuntary dissolution, liquidation or winding-up of the Corporation

then, and in each such case, the Corporation will send or cause to be sent to the holders of th the case may be, (i) the record date for such dividend, distribution or right, and the amount a right, or (ii) the effective date on which such reorganization, reclassification, consolidation, winding-up is to take place, and the time, if any is to be fixed, as of which the holders of rec securities at the time issuable upon the conversion of the Series A Preferred Stock) shall be Stock (or such other stock or securities) for securities or other property deliverable upon suc merger, transfer, dissolution, liquidation or winding-up. Such notice shall be sent at least 10 the event specified in such notice.

5. *Redemption*.

(a) *Optional Redemption*. On any date commencing after the fifth anniversary of the Origina Stock Price Requirement (as defined below) has been satisfied the Corporation, at the option committee thereof, may exercise its right to redeem in whole, but not in part, all shares of Se delivery of a Redemption Notice (as defined below) in accordance with the requirements an *Redemption Right*); *provided*, *however*, that if for any day during the period between the preceding the Redemption Date, the closing price of the Corporation s Common Stock on th less than $8.50 (subject to adjustment for stock splits, combinations or stock dividends), the Redemption Right in such instance shall immediately terminate and become null and void (a Corporation shall not be entitled to exercise the Redemption Right again unless and until the requirements and conditions of this Subsection 5 are subsequently satisfied. Notwithstanding Subsection 5 or elsewhere, holders of Series A Preferred Stock shall be entitled to convert th through the close of business on the business day immediately preceding the Redemption Da holder exercises such right after the Corporation has exercised the Redemption Right or deli

For purposes of this Subsection 5, the *Stock Price Requirement* shall be satisfied if the av Stock on the applicable Trading Market for the 30 day period immediately prior to the Exerc (subject to adjustment for stock splits, combinations or stock dividends). For purposes of thi the following markets, exchanges or systems on which the Corporation s Common Stock is question: the OTC Bulletin Board, the American Stock Exchange, the New York Stock Exch Global Market or the Nasdaq SmallCap Market.

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(b) *Redemption Price*. The redemption price for shares of Series A Preferred Stock shall be $ appropriate adjustment in the event of any stock dividend, stock split, combination or other plus any dividends declared pursuant to Subsection 1 above but unpaid thereon (the *Redem*

(c) *Notice of Redemption*. No later than five business days after the Exercise Date, notice of shall be mailed by first class mail, postage prepaid, addressed to the holders of record of suc appearing on the stock register of the Corporation (the *Redemption Notice*). The Redemp more than 60 days before the date fixed for redemption. Each Redemption Notice shall state (ii) the Redemption Price per share and the aggregate Redemption Price payable to such hol for such shares are to be surrendered for payment of the Redemption Price; and (iv) that div accrue on the Redemption Date. If a Redemption Right Termination occurs, the Corporation holders of record of shares of Series A Preferred Stock in the manner contemplated by this S Notices.

(d) *Surrender of Certificates; Payment*. Unless a Redemption Right Termination has subseq Stock has exercised his, her or its right to convert such shares as provided in Subsection 4 h Date, each holder of shares of Series A Preferred Stock shall surrender the certificate or cert Corporation, in the manner and at the place designated in the Redemption Notice, and thereu shares shall be payable to the order of the person whose name appears on such certificate or surrendered certificate shall be canceled and retired.

(e) *Rights Subsequent to Redemption*. Unless a Redemption Right Termination has subseque Stock has exercised his, her or its right to convert such shares as provided in Subsection 4 h duly given, and if on the applicable Redemption Date the applicable Redemption Price paya Stock is paid or tendered for payment, then notwithstanding that the certificates evidencing called for redemption shall not have been surrendered, dividends with respect to such shares after such respective Redemption Date and all rights with respect to such shares shall forthw terminate, except only the right of the holders to receive the applicable Redemption Price wi certificates therefor.

(f) *Redeemed or Otherwise Acquired Shares*. Any shares of Series A Preferred Stock which Corporation or any of its subsidiaries shall be automatically and immediately canceled and s the Corporation nor any of its subsidiaries may exercise any voting or other rights granted to following redemption or repurchase.

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EXHIBIT C

Form of Release

This Release is being executed and delivered in accordance with Section 7.2(f) of the Agree
amended and restated on September 13, 2007, among Digital Music Group, Inc., DMGI Nev
(*TO*, and such agreement, the *Merger Agreement*). Capitalized terms used in this Rele
meanings given to them in the Merger Agreement.

, (*Stockholder*), on behalf of himself and each of [his, her or its] Rela
Party) hereby unconditionally and irrevocably releases and forever discharges, effective as
fullest extent applicable law permits, all parties to the Merger Agreement, and each of their
present and future Affiliates, directors, officers, stockholders, employees, subsidiaries, succe
Released Party and collectively, *Released Parties*) from any and all debts, liabilities,
action, suits, judgments or controversies of any kind whatsoever (collectively, *Pre-Acquisi*
based on any agreement or understanding or act or failure to act *(including any act or failure*
negligence or reckless or willful, wanton misconduct), misrepresentation, omission, transact
the Effective Time (whether based on any requirement of a Governmental Entity or right of
or unforeseen, matured or unmatured, known or unknown, accrued or not accrued) (collectiv
limitation: (i) claims with respect to repayment of loans or indebtedness; (ii) any rights, title
arrangements or understandings; and (iii) claims with respect to dividends, violation of pree
compensation or in any way arising out of or in connection with the Stockholder s employm
(the *TO Group*), the cessation of that employment, such Stockholder s status as an office
Group or otherwise (but excluding any and all claims in respect of: (A) accrued and unpaid
of the TO Group, (B) accrued and unpaid cash compensation owing to the Stockholder at th
consistent with the terms of such employment and (C) benefits accrued under each Orchard

Each Releasing Party hereby irrevocably covenants to refrain from, directly or indirectly, as
instituting or causing to be commenced, any proceeding of any kind against any Released Pa
released pursuant to this Release.

Without in any way limiting any of the rights and remedies otherwise available to any Relea
hold harmless each Released Party from and against all loss, liability, claim, damage (includ
expense (including costs of investigation and defense and reasonable attorney s fees), arisin
behalf of the Stockholder or any of [his, her or its] Related Persons of any claim or other ma
Release.

Each Stockholder (i) acknowledges that [he, she or it] fully comprehends and understands al
and (ii) expressly represents and warrants that: (A) [he, she or it] is competent to effect the r
voluntarily and without reliance on any statement or representation of any Released Party or
opportunity to consult with an attorney of [his, her or its] choice regarding this Release.

If any provision of this Release is held invalid or unenforceable by any court of competent j
will remain in full force and effect. Any provision of this Release held invalid or unenforcea
and effect to the extent not held invalid or unenforceable.

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For purposes of this Release, the following shall be a *Related Person* of the Stockholder:

[If the Stockholder is an individual:

(i) each other member of the Stockholder s Family;

(ii) any individual or entity that is directly or indirectly controlled by the Stockholder or one

(iii) any individual or entity in which the Stockholder or members of such Stockholder s Fa
Material Interest; and

(iv) any individual or entity with respect to which the Stockholder or one or more members
partner, executor, or trustee (or in a similar capacity).]

[If the Stockholder is an entity:

(i) any individual or entity that directly or indirectly controls, is directly or indirectly control
control with the Stockholder;

(ii) any individual or entity that holds a Material Interest in the Stockholder;

(iii) each individual that serves as a director, officer, partner, executor, or trustee of the Stoc

(iv) any individual or entity in which the Stockholder holds a Material Interest;

(v) any entity with respect to which the Stockholder serves as a general partner or a trustee (

(vi) any Related Person of any individual or entity described in clause (ii) or (iii) above].

For purposes of this definition, [(a) the *Family* of an individual includes (i) the Stockhold
natural person who is related to the Stockholder or the Stockholder s spouse within the seco
resides with the Stockholder, and (b)] *Material Interest* means direct or indirect beneficia
Securities Exchange Act of 1934) of voting securities or other voting interests representing a
entity or equity securities or other equity interests representing at least 5% of the outstanding

IN WITNESS WHEREOF, the undersigned has executed and delivered this Release as of th

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EXHIBIT D

Registration Rights Agreement

This Registration Rights Agreement (this *Agreement*) is made and entered into as of [Group, Inc., a Delaware corporation (the *Company*) and certain stockholders of The Orch (*Orchard*) listed on Schedule A (the *Holders*), who are to be issued shares of Commor pursuant to an Agreement and Plan of Merger, dated July 10, 2007, as amended and restated by and between the Company, Orchard Enterprises Inc. (*Orchard*) and DMGI New York Agreement is contemplated in the Merger Agreement and is a condition to the obligations of

The Registrable Securities shall have the registration rights as set forth herein.

The Company and the Holders hereby agree as follows:

1. *Definitions.* As used in this Agreement, the following terms shall have the following mean

Commission means the United States Securities and Exchange Commission.

Common Stock means the Company s common stock par value $0.01 per share.

Demand Notice shall have the meaning set forth in *Section 2(a)*.

Demand Registration Statement shall have the meaning set forth in *Section 2(a)*.

Effective Date shall mean, as to the Registration Statement, the date on which such regist Commission.

Effectiveness Period shall mean from the Effective Date until the earlier to occur of the d Registration Statement either (a) have been sold pursuant to a Registration Statement or an e the Securities Act, and (b) pursuant to a written opinion of Company counsel acceptable to t for the Holders, may be sold pursuant to Rule 144(k).

Exchange Act means the Securities Exchange Act of 1934, as amended.

Holder or *Holders* means the holder or holders, as the case may be, from time to time assignee).

Indemnifying Party shall have the meaning set forth in *Section 5(c)*.

Losses shall have the meaning set forth in *Section 5(a)*.

Person shall mean an individual or corporation, partnership, trust, incorporated or uninco company, joint stock company, government (or an agency or subdivision thereof) or other e

Proceeding means an action, claim, suit, investigation or proceeding (including, without such as a deposition), whether commenced or threatened.

Prospectus means the prospectus included in the Registration Statement (including, with information previously omitted from a prospectus filed as part of an effective registration st under the Securities Act), as amended or supplemented by any prospectus supplement, with of the Registrable Securities covered by the Registration Statement, and all other amendmen

post-effective amendments, and all material incorporated by reference or deemed to be incor

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Registrable Securities means (i) the shares of Common Stock issued to the Holders pursu
Common Stock issuable upon conversion of the Series A Preferred Stock of the Company is
Agreement, and (iii) any shares of Common Stock issued or issuable upon any stock split, d
anti-dilution adjustment or similar event with respect to the foregoing.

Registration Statement means any registration statement required to be filed hereunder (v
registration statement of the Company previously filed with the Commission, but not declare
Prospectus, amendments and supplements to the registration statement or Prospectus, includ
exhibits thereto, and all material incorporated by reference or deemed to be incorporated by

Rule 415 means Rule 415 promulgated by the Commission pursuant to the Securities Act
any similar Rule or regulation hereafter adopted by the Commission having substantially the

Rule 424 means Rule 424 promulgated by the Commission pursuant to the Securities Act
any similar Rule or regulation hereafter adopted by the Commission having substantially the

Securities Act means the Securities Act of 1933, as amended.

Trading Day means (a) a day on which the Common Stock is traded on a Trading Market
Trading Market, a day on which the Common Stock is quoted in the over-the-counter marke
Incorporated (or any similar organization or agency succeeding to its functions of reporting
Common Stock is not listed or quoted as set forth in (a), and (b) hereof, then Trading Day sh

Trading Market means the following markets or exchanges on which the Common Stock
question: the OTC Bulletin Board, the American Stock Exchange, the New York Stock Excl
SmallCap Market.

2. *Registration*.

(a) *Demand Registration Rights*. At any time commencing on the date six (6) months follow
Merger Agreement, the Holders shall have a two (2) time right, by written notice, signed by
outstanding Registrable Securities, provided to the Company (the *Demand Notice*), to de
Registrable Securities under and in accordance with the provisions of the Securities Act by f
Statement covering the resale of all of the Registrable Securities (the *Demand Registration*
required hereunder shall be on Form S-3 (except if the Company is not then eligible to regis
S-3, in which case the Demand Registration Statement shall be on a Form S-1 or another ap
law, the Demand Registration Statement required hereunder shall contain the Plan of Distrib
modified to respond to comments, if any, received by the Commission). The Company shall
continuously effective under the Securities Act until the earlier of (i) the date when all Regis
Demand Registration Statement, and (ii) the date the Holders can sell all of their shares, with
Securities Act.

(b) *Piggyback Registrations Rights*. If, at any time commencing on the date twelve (12) mon
contemplated in the Merger Agreement, the Company shall

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determine to prepare and file with the Commission a registration statement relating to an off
Registration) or the account of others under the Securities Act of any of its equity securitie
promulgated under the Securities Act) or their then equivalents relating to equity securities t
acquisition of any entity or business or equity securities issuable in connection with stock op
Company shall send to each Holder a written notice of such determination at least twenty (2
statement and shall automatically include in such registration statement all Registrable Secu
after giving written notice of is intention to register any securities and prior to the Effective
connection with such registration, the Company determines for any reason not to proceed wi
of its obligation to register any Registrable Securities in connection with such registration, (
delay registration of its securities, the Company will be permitted to delay the registration of
delay in registering such other securities, or (iii) if in the written opinion of the Company s
such Company Registration (the Underwriter), the inclusion of such Registrable Securitie
the Company or the selling stockholder(s), will exceed the maximum amount of the Compar
reasonably related to their then current market value, or without materially and aversely affe
to be sold by all stockholders in such public offering (if any) shall be apportioned pro rata ar
holders of the Registrable Securities, according to the total amount of securities of the Comp
stockholders, including all holders of the Registrable Securities.

(c) Notwithstanding the registration rights specified in (a) and (b), if the Commission staff ta
a primary offering, then the Company shall only be required to register an amount of Regist
offering to be conducted without being contrary to Rule 415 and otherwise facilitates the Co
effective. In the event that less than all Registrable Shares may be registered at any one time
(i) unless the Holders agree otherwise, the number of shares shall be reduced pro rata, and (i
additional registration statements or post-effective amendments to a prior related registration
Period to reflect any remaining Registrable Securities.

3. *Registration Procedures*. In connection with the Company s registration obligations here
Company shall:

(a) Not less than five (5) business days prior to the filing of the Registration Statement or an
supplement thereto, the Company shall furnish to Holders, a draft of the Registration Statem
or supplement thereto.

(b)(i) Prepare and file with the Commission such amendments, including post-effective ame
Prospectus used in connection therewith as may be necessary to keep the Registration Stater
Registrable Securities for the Effectiveness Period; (ii) cause the related Prospectus to be am
Prospectus supplement, and as so supplemented or amended to be filed pursuant to Rule 424
from the Commission with respect to the Registration Statement or any amendment thereto.

(c) Notify as promptly as reasonably possible, but no later than three (3) business days, each
Registration Statement: (i) (A) when a Prospectus or any Prospectus supplement or post-effe
has been filed, provided such Holder has previously requested in writing to receive notice of
the Company whether there will be a review of the Registration Statement and

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whenever the Commission comments in writing on the Registration Statement, provided suc
receive notice of such notification; and (C) when the Registration Statement or any post-effe
any request by the Commission or any other Federal or state governmental authority during
Statement for amendments or supplements to the Registration Statement or Prospectus or fo
the Commission or any other federal or state governmental authority of any stop order suspe
Statement covering any or all of the Registrable Securities or the initiation of any Proceedin
Company of any notification with respect to the suspension of the qualification or exemptio
Securities for sale in any jurisdiction, or the initiation of any Proceeding for such purpose; a
of time that makes the financial statements included in the Registration Statement ineligible
Registration Statement or Prospectus or any document incorporated or deemed to be incorpo
respect or that requires any revisions to the Registration Statement, Prospectus or other docu
Statement or the Prospectus, as the case may be, it will not contain any untrue statement of a
required to be stated therein or necessary to make the statements therein, in light of the circu
misleading.

(d) Use its best efforts to avoid the issuance of, or, if issued, obtain the withdrawal of (i) any
Registration Statement, or (ii) any suspension of the qualification (or exemption from qualif
sale in any jurisdiction, at the earliest practicable moment.

(e) Promptly deliver to each Holder no later than three (3) business days after the Effective D
Prospectus or Prospectuses (including each form of prospectus) and each amendment or sup
Holder such additional copies as such Persons may reasonably request in connection with re
Company hereby consents to the use of such Prospectus and each amendment or supplement
offering and sale of the Registrable Securities covered by such Prospectus and any amendm
of any notice pursuant to Section 3(c).

(f) Prior to any resale of Registrable Securities by a Holder, use its best efforts to register or
connection with the registration or qualification (or exemption from the registration or quali
resale by the Holder under the securities or Blue Sky laws of such jurisdictions within the U
writing, to keep such registration or qualification (or exemption therefrom) effective during
other acts or things reasonably necessary to enable the disposition in such jurisdictions of th
Registration Statement; provided, however, that the Company shall not be required (i) to qua
where it is not then so qualified, (ii) subject the Company to any material tax in any such jur
general consent to service of process in any such jurisdiction, or (iii) comply with state secu
registration by coordination is unavailable to the Company.

(g) Upon the occurrence of any event contemplated by Section 3(c)(v), as promptly as reaso
amendment, including a post-effective amendment, to the Registration Statement or a supple
incorporated or deemed to be incorporated therein by reference, and file any other required d
the Registration Statement nor such Prospectus will contain an untrue statement of a materia
be stated therein or necessary to make the statements therein, in light of the circumstances u

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(h) Use its best efforts to comply with all applicable rules and regulations of the Commissio
Securities pursuant to the Registration Statement or otherwise.

(i) Each Holder agrees to furnish to the Company a completed Questionnaire in the form att
Holder agrees further to supplement the Questionnaire as necessary to enable the Company
Commission. The Company shall not be required to include any Holder that does not compl
Questionnaire or supplement promptly.

4. *Registration Expenses*. All fees and expenses incident to the performance of or complianc
borne by the Company whether or not any Registrable Securities are sold pursuant to the Re
of counsel or any other advisor retained by the Holders and discounts and commissions with
by the Holders. The fees and expenses referred to in the foregoing sentence shall include, wi
(including, without limitation, fees and expenses (A) with respect to filings required to be m
Common Stock is then listed for trading, and (B) in compliance with applicable state securit
(including, without limitation, expenses of printing certificates for Registrable Securities an
prospectuses is reasonably requested by the holders of a majority of the Registrable Securiti
(iii) messenger, telephone and delivery expenses, (iv) fees and disbursements of counsel for
insurance, if the Company so desires such insurance,; and (vi) fees and expenses of all other
with the consummation of the transactions contemplated by this Agreement.

5. *Indemnification*

(a) *Indemnification by the Company*. The Company shall, notwithstanding any termination o
the Holders, the officers, directors, agents and employees of it, each Person who controls the
Securities Act or Section 20 of the Exchange Act) and the officers, directors, agents and emp
fullest extent permitted by applicable law, from and against any and all losses, claims, dama
limitation, reasonable attorneys fees) and expenses (including the cost (including without l
relating to an Indemnified Party s actions to enforce the provisions of this Section 5) (collec
out of or relating to any untrue or alleged untrue statement of a material fact contained in the
form of prospectus or in any amendment or supplement thereto or in any preliminary prospe
or alleged omission of a material fact required to be stated therein or necessary to make the s
or form of prospectus or supplement thereto, in light of the circumstances under which they
but only to the extent, that (1) such untrue statements or omissions are based solely upon inf
the case of an omission, not furnished) in writing to the Company by or on behalf of such H
that such information relates to such Holder or such Holder s proposed method of distributi
expressly approved in writing by such Holder expressly for use in the Registration Statemen
in any amendment or supplement thereto (it being understood that the Holder has approved
of an occurrence of an event of the type specified in Section 3(c)(ii)-(v), the use by such Hol
the Company has notified such Holder in writing that the Prospectus is outdated or defective
Advice contemplated in Section 6(b), or (3) the failure of the Holder to deliver a prospectus
shall notify the Holders promptly of the institution, threat or

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assertion of any Proceeding of which the Company is aware in connection with the transacti

(b) *Indemnification by Holder*. The Holder shall indemnify and hold harmless the Company each Person who controls the Company (within the meaning of Section 15 of the Securities directors, officers, agents or employees of such controlling Persons, to the fullest extent per Losses, as incurred, to the extent arising out of or based upon: (x) the Holder s failure to co the Securities Act or (y) any untrue or alleged untrue statement of a material fact contained i any form of prospectus, or in any amendment or supplement thereto or in any preliminary pr omission or alleged omission of a material fact required to be stated therein or necessary to the extent, but only to the extent, that such untrue statement or omission is contained in any omission, not furnished) in writing by or on behalf of such Holder to the Company specifica such Prospectus or (ii) to the extent that (1) such untrue statements or omissions are based s furnished (or in the case of an omission, not furnished) in writing to the Company by or on b to the extent that such information relates to such Holder or such Holder s proposed metho Prospectus or such form of Prospectus or in any amendment or supplement thereto, or (2) in specified in Section 3(c)(ii)-(v), the use by such Holder of an outdated or defective Prospect writing that the Prospectus is outdated or defective and prior to the receipt by such Holder o (3) the failure of the Holder to deliver a Prospectus prior to the confirmation of a sale. In no hereunder be greater in amount than the dollar amount of the Subscription Amount paid by t

(c) *Conduct of Indemnification Proceedings*. If any Proceeding shall be brought or asserted hereunder (an *Indemnified Party*), such Indemnified Party shall promptly notify the Perso *Party*) in writing, and the Indemnifying Party shall have the right to assume the defense th reasonably satisfactory to the Indemnified Party and the payment of all fees and expenses in provided, that the failure of any Indemnified Party to give such notice shall not relieve the I pursuant to this Agreement, except (and only) to the extent that such failure shall have mate

An Indemnified Party shall have the right to employ separate counsel in any such Proceedin fees and expenses of such counsel shall be at the expense of such Indemnified Party or Parti in writing to pay such fees and expenses; (2) the Indemnifying Party shall have failed promp to employ counsel reasonably satisfactory to such Indemnified Party in any such Proceeding (including any impleaded parties) include both such Indemnified Party and the Indemnifying been advised by counsel that a conflict of interest is likely to exist if the same counsel were Indemnifying Party (in which case, if such Indemnified Party notifies the Indemnifying Part counsel at the expense of the Indemnifying Party, the Indemnifying Party shall not have the reasonable fees and expenses of one separate counsel for all Indemnified Parties in any matt expense of the Indemnifying Party). The Indemnifying Party shall not be liable for any settl written consent, which consent shall not be unreasonably withheld. No Indemnifying Party s

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consent of the Indemnified Party, effect any settlement of any pending Proceeding in respec
such settlement includes an unconditional release of such Indemnified Party from all liabilit
Proceeding.

All reasonable fees and expenses of the Indemnified Party (including reasonable fees and ex
investigating or preparing to defend such Proceeding in a manner not inconsistent with this
incurred, within ten (10) Trading Days of written notice thereof to the Indemnifying Party; *p*
promptly reimburse the Indemnifying Party for that portion of such fees and expenses applic
Party is not entitled to indemnification hereunder, determined based upon the relative faults

(d) *Contribution*. If a claim for indemnification under Section 5(a) or Section 5(b) is unavail
policy or otherwise), then each Indemnifying Party, in lieu of indemnifying such Indemnifie
payable by such Indemnified Party as a result of such Losses, in such proportion as is appro
Indemnifying Party and Indemnified Party in connection with the actions, statements or omi
other relevant equitable considerations. The relative fault of such Indemnifying Party and In
to, among other things, whether any action in question, including any untrue or alleged untr
alleged omission of a material fact, has been taken or made by, or relates to information sup
Party, and the parties relative intent, knowledge, access to information and opportunity to
omission. The amount paid or payable by a party as a result of any Losses shall be deemed t
Section 5(c), any reasonable attorneys or other reasonable fees or expenses incurred by suc
extent such party would have been indemnified for such fees or expenses if the indemnificat
such party in accordance with its terms.

6. *Lock-up*. Each Holder agrees that, until the date six (6) months following the closing of th
such Holder will not, directly or indirectly, offer for sale, sell, assign, pledge, issue, distribut
the sale of or otherwise transfer or dispose of any shares of Common Stock or any other sec
instrument which by its terms is convertible into or exercisable or exchangeable for shares o
Company, whether now owned or hereafter acquired by such Holder or with respect to whic
of disposition.

7. *Miscellaneous*.

(a) *Compliance*. The Holder covenants and agrees that it will comply with the prospectus de
applicable to it in connection with sales of Registrable Securities pursuant to the Registratio

(b) *Discontinued Disposition*. Each Holder agrees by its acquisition of such Registrable Sec
Company of the occurrence of any event of the kind described in Section 3(c), such Holder
Registrable Securities under the Registration Statement until such Holder s receipt of the co
amended Registration Statement or until it is advised in writing (the **Advice**) by the Com
resumed, and, in either case, has received copies of any additional or supplemental filings th
by reference in such Prospectus or Registration Statement. The Company may provide appr
paragraph.

(c) *Amendments and Waivers*. The provisions of this Agreement, including the provisions of
supplemented, and waivers or consents to departures from

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the provisions hereof may not be given, unless the same shall be in writing and signed by the
interest of the then outstanding Registrable Securities.

(d) *Notices*. Any and all notices or other communications or deliveries required or permitted
shall be deemed given and effective on the earliest of (i) the Trading Day following the date
nationally recognized overnight courier service, (ii) the third Trading Day following the date
certified mail, postage prepaid, (iii) the Trading Day following transmission by electronic m
(iv) upon actual receipt by the party to whom such notice is required to be given. The addres
delivered and addressed as set forth in the Merger Agreement or to such other address as sha
party hereto.

(e) *Successors and Assigns*. This Agreement shall inure to the benefit of and be binding upo
and shall inure to the benefit of the Holder.

(f) *Execution and Counterparts*. This Agreement may be executed in any number of counter
deemed to be an original and, all of which taken together shall constitute one and the same A
delivered by facsimile transmission, such signature shall create a valid binding obligation of
signature is executed) the same with the same force and effect as if such facsimile signature

(g) *Governing Law*. This Agreement shall be governed by and construed exclusively in acco
York without regard to the conflicts of laws principles thereof. The parties hereto hereby irr
directly and/or indirectly pursuant to or under this Agreement shall be brought solely in a fe
State of New York. By its execution hereof, the parties hereby covenant and irrevocably sub
and state courts located in the City, County and State of New York and agree that any proce
them personally, or by certified mail or registered mail upon them or their agent, return rece
as if personally served upon them in New York City. The parties hereto waive any claim tha
for any such suit or proceeding and any defense or lack of *in personam* jurisdiction with resp
proceeding, the party prevailing therein shall be entitled to payment from the other party her
disbursements.

(h) *Severability*. If any term, provision, covenant or restriction of this Agreement is held by
illegal, void or unenforceable, the remainder of the terms, provisions, covenants and restricti
effect and shall in no way be affected, impaired or invalidated, and the parties hereto shall u
and employ an alternative means to achieve the same or substantially the same result as that
or restriction. It is hereby stipulated and declared to be the intention of the parties that they w
provisions, covenants and restrictions without including any of such that may be hereafter de

(i) *Headings*. The headings in this Agreement are for convenience of reference only and sha

[Remainder of page intentionally left blank

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IN WITNESS WHEREOF, the parties have executed this Registration Rights Agreement a

DIGIT

By:
N
T

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HOLDER S SIGNATURE PAGE

By:
Name:
Title:

Address

Facsimile Number

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SCHEDULE A

LIST OF HOLDERS

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ANNEX A

Plan of Distribution

The Selling Stockholders and any of their pledgees, assignees and successors-in-interest ma
of Common Stock on any stock exchange, market or trading facility on which the shares are
be at fixed or negotiated prices. The Selling Stockholders may use any one or more of the fo

ordinary brokerage transactions and transactions in which the broker/dealer solic

block trades in which the broker/dealer will attempt to sell the shares as agent bu
principal to facilitate the transaction;

purchases by a broker/dealer as principal and resale by the broker/dealer for its a

an exchange distribution in accordance with the Rules of the applicable exchang

privately negotiated transactions;

to cover short sales made after the date that this Registration Statement is declare

broker/dealers may agree with the Selling Stockholders to sell a specified numbe

a combination of any such methods of sale; and

any other method permitted pursuant to applicable law.

The Selling Stockholders may also sell shares under Rule 144 under the Securities Act, if av

Broker/dealers engaged by the Selling Stockholders may arrange for other brokers/dealers to
commissions from the Selling Stockholders (or, if any broker/dealer acts as agent for the pu
to be negotiated. The Selling Stockholders do not expect these commissions to exceed what

The Selling Stockholders may from time to time pledge or grant a security interest in some o
them and, if they default in the performance of their secured obligations, the pledgees or sec
common stock from time to time under this prospectus, or under an amendment to this prosp
provision of the Securities Act of 1933 amending the list of Selling Stockholders to include
interest as Selling Stockholders under this prospectus.

The Selling Stockholders and any broker/dealers or agents that are involved in selling the sh
meaning of the Securities Act in connection with such sales. In such event, any commissions
any profit on the resale of the shares purchased by them may be deemed to be underwriting

Stockholders have informed the Company that it does not have any agreement or understanc
distribute the Common Stock.

The Company has advised each Selling Stockholder that it may not use shares registered on
Common Stock made prior to the date on which this Registration Statement shall have been
Selling Stockholder uses this prospectus for any sale of the Common Stock, it will be subjec
Securities Act. The Selling Stockholders will be responsible to comply with the applicable p

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Exchange Act, and the rules and regulations thereunder promulgated, including, without lim
Selling Stockholders in connection with resales of their respective shares under this Registra

The Company is required to pay all fees and expenses incident to the registration of the shar
Selling Stockholders against certain losses, claims, damages and liabilities, including liabilit

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EXHIBIT A

SELLING STOCKHOLDER QUESTIONNA

Ladies and Gentlemen:

I acknowledge that I am a holder of securities of Digital Music Group, Inc. (the *Company* stockholder in the prospectus that forms a part of the registration statement on Form S-3 (or *Statement*) that the Company will file with the Securities and Exchange Commission to reg the securities I expect to sell. The Company will use the information that I provide in this Q registration statement and the prospectus.

Please answer every question.

If the answer to any question is none or not applic

1. **Name.** Type or print your name exactly as it should appear in the Registration Statemen
2. **Manner of Ownership of Shares:**

   Individual _____ Community Property _____ Tenants in Co

   Joint Tenants with Rights of Survivorship _____ Corporate _

   Partnership _____ Trust _____ Other _____
3. **Contact Information**. Provide the address, telephone number and fax number where yo

   Address:

   _____

   Phone:

   _____

   Fax:

4. **Relationship with the Company**. Describe the nature of any position, office or other m with the Company or its affiliates during the past three years, or arrangement with the C future.

   _____

   _____
5. **Organizational Structure.** Please indicate or (if applicable) describe how you are orga

   (a) Are you a natural person?
   (if so, please mark the box and skip to Question 6)

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(b) Are you a reporting company under the 1934 Act?
(if so, please mark the box and skip to Question 6)

(c) Are you a majority-owned subsidiary of a reporting company under the 1934 Act?

(if so, please mark the box and skip to Question 6)

(d) Are you a registered investment fund under the 1940 Act?
(if so, please mark the box and skip to Question 6)

If you have answered no to all of the foregoing questions, please describe: (i) the exact le
partnership, limited liability company, etc.); (ii) whether the legal entity so described is man
description of such entity (repeat this step until the last entity described is managed by a per
one of (a) through (d) above), (iii) the names of each person or persons having voting and in
that the entity owns (e.g., director(s), general partner(s), managing member(s), etc.).

Legal Description of Entity:

Name of Entity(ies) Managing Such Entity (if any):

Name of Entity(ies) Managing Such Entity(ies) (if any):

Name(s) of Natural Persons Having Voting or Investment Control Over the Shares Held by such Entity(ies):

6. **Ownership of the Company s Securities**. This question covers your beneficial owne
the Appendix A to this Questionnaire for information as to the meaning of beneficial
Company s common stock that you beneficially owned as of the date this Questionnai

No. of Shares of Stock: _____

7. **Acquisition of Shares.** Please describe below the manner in which you acquired your
including, but not limited to, the date, the name and address of the seller(s), the purcha
Acquisition Documents). Please forward such documents used to acquire your share

8. **Plan of Distribution**. I have reviewed the proposed Plan of Distribution attached to
and agree that the statements contained therein reflect my intended method(s) of distri
inaccurate or incomplete, I have communicated in writing to one of the parties listed a
Plan of Distribution that are required to make these statements accurate and comple
changes to Annex A)

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9. Broker-Dealer Status.

(a) Are you a broker-dealer?
(if yes, the Commission s staff has indicated that you should be identified as an u
Registration Statement)

(b) Did you acquire the securities to be registered for investment purposes
(if so, please mark the box and skip to Question 6)

(c) Are you an affiliate of a broker-dealer?
(if no, mark the box and skip the remainder of this Question 9)

(d) If you are an affiliate of a broker-dealer, do you certify that you bought the securiti
registered in the ordinary course of business, and at the time of the purchase of the sec
resold, you had no agreements or understandings, directly or indirectly, with any perso
the securities?

(if no, the Commission s staff has indicated that you should be identified as an u
Registration Statement)

10. Short Positions. Do you currently have open, or since the time you became aware of t
any short position in the Company s shares? Yes ¨ No ¨ If yes, please describe

11. Reliance on Responses. I acknowledge and agree that the Company and its legal coun
this Questionnaire in all matters pertaining to the registration statement and the sale of
pursuant to the registration statement.

12. NASD. The National Association of Securities Dealers, Inc. (*NASD*) may request, i
Statement and Prospectus under the Securities Act of 1933, as amended, that the Comp
purchased securities from the Company, together with any affiliations with the NASD
in responding to such request, the undersigned furnishes the following information:

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PART A: DETERMINATION OF RESTRICTED PERSON STATUS:

Please check all appropriate categories.

The undersigned is:

¨ (i) a broker-dealer;

¨ (ii) an officer, director, general partner, associated person[1] or employee of a brok
broker-dealer)[2];

¨ (iii) an agent of a broker-dealer (other than a limited business broker-dealer) that
securities business;

¨ (iv) an immediate family member[3] of a person described in (ii) or (iii) above. Un
checks this category, he/she/it may be able to participate in New Issue investmen
information in order to determine the eligibility of the undersigned under this Re

¨ (v) a finder or any person acting in a fiduciary capacity to a managing underwrite
accountants and financial consultants;

¨ (vi) a person who has authority to buy or sell securities for a bank, savings and lo
company, investment advisor or collective investment account[4] (including a priv
offshore fund);

¨ (vii) an immediate family member of a person described in (v) or (vi) above who
from, the undersigned;

¨ (viii) a person listed or required to be listed in Schedule A, B or C of a Form BD
broker-dealer), except persons whose listing on Schedule A, B or C is related to
than 10% on Schedule A;

¨ (ix) a person that (A) directly or indirectly owns 10% or more of a public reporti
Schedule A of a Form BD or (B) directly or

[1] A person associated with a broker-dealer includes any natural person engaged in the
directly or indirectly controlling or controlled by a broker-dealer, any partner, director

[2] A limited business broker-dealer is any broker-dealer whose authorization to engage in
purchase and sale of investment company/variable contracts securities and direct partic

[3] The term Immediate family includes the investor s: (i) parents, (ii) mother-in-law o
sister, (v) brother-in-law or sister-in-law, (vi) son-in-law or daughter-in-law, (vii) child
directly or indirectly, to a material extent by an officer, director, general partner, emplo
with a broker-dealer.

[4] A collective investment account is any hedge fund, investment corporation, or any o
primarily in the purchase and/or sale of securities. investment clubs (groups of individ
other securities and who are collectively responsible for making investment decisions)
are beneficially owned solely by immediate family members (as defined above)) are n

[5] The term material support means directly or indirectly providing more than 25% o
in the same household with a member of one s Immediate family. indirectly owns 25%
required to be listed in Schedule B of a Form BD, in each case (A) or (B), other than a
securities exchange or is traded on the Nasdaq National Market, or other than with resp

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¨ (x) an immediate family member of a person described in (viii) or (ix) above. Un
places a check next to this category, he/she/it may be able to participate in New I
additional information in order to determine the eligibility of the undersigned un

¨ (xi) any entity (including a corporation, partnership, limited liability company, tr
listed in (i)-(x) above has a beneficial interest[6]; or

¨ None of the above categories apply and the undersigned is eligible to participate

PART B: DETERMINATION OF EXEMPTED ENTITY STATUS:

The undersigned is:

¨ (i) a publicly-traded entity (other than a broker-dealer or an affiliate of a broker-d
engage in the public offering of New Issues either as a selling group member or u
exchange or traded on the Nasdaq National Market or is a foreign issuer whose s
for listing on a national securities exchange or trading on the Nasdaq National M

¨ (ii) an investment company registered under the Investment Company Act of 194

¨ (iii) a corporation, partnership, limited liability company, trust or any other entity
hedge fund or an offshore fund, or a broker-dealer organized as an investment pa

(A) the beneficial interests of Restricted Persons do not exceed in the aggrega

(B) such entity limits participation by Restricted Persons to not more than 10%

¨ (iv) an investment company organized under the laws of a foreign jurisdiction an

(A) the investment company is listed on a foreign exchange or authorized for
authority; and

6 The term beneficial interest means any economic interest such as the right to share
performance based fee for operating a collective investment account, or other fee for a
beneficial interest in the account; however, if such fee is subsequently invested into the
otherwise), it is considered a beneficial interest in that account.

(B) no person owning more than 5% of the shares of the investment company

¨ (v) (A) an employee benefits plan under the U.S. Employee Retirement Income S
under Section 401(a) of the Internal Revenue Code of 1986, as amended (the C
broker-dealer, (B) a state or municipal government benefits plan that is subject to
plan under Section 414(e) of the Code;

¨ (vi) a tax exempt charitable organization under Section 501(c)(3) of the Code;

¨ (vii) a common trust fund or similar fund as described in Section 3(a)(12)(A)(iii)
amended, and the Company

(A) has investments from 1,000 or more accounts, and

(B) does not limit beneficial interests in the Company principally to trust acco

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¨ (viii) an insurance company general, separate or investment account, and

(A) the account is funded by premiums from 1,000 or more policyholders, or, 1,000 or more policyholders, and

(B) the insurance company does not limit the policyholders whose premiums Restricted Persons, or, if a general account, the insurance company does n Persons.

Please acknowledge that your answers to the foregoing questions are true and correct to the dating this Questionnaire where indicated below. Please return the completed executed ques ***XXX-XXXX as soon as possible***.

By signing this Questionnaire you agree to promptly notify the Company of any inaccuracie Questionnaire that may occur subsequent to the date of this Questionnaire and prior to the ef any time you discover that your answer to any question was inaccurate, or if any event occu change in your answer to any questions, please immediately contact _____ at

Date: _____, 2007

(Print name of selling stockholder)

By:

Name:

Title:

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APPENDIX A

1. **Definition of Beneficial Ownership**

(a) *Beneficial Owner* of a security includes any person who, directly or indirectly relationship or otherwise has or shares:

(1) Voting power which includes the power to vote, or to direct the voting of

(2) Investment power which includes the power to dispose, or direct the dispo
Please note that either voting power or investment power, or both, is sufficient for you to be

(b) Any person who, directly or indirectly, creates or uses a trust, proxy, power of at arrangement or device with the purpose or effect of divesting such person of ben vesting of such beneficial ownership as part of a plan or scheme to evade the rep shall be deemed to be the beneficial owner of such security.

(c) Notwithstanding the provisions of paragraph (a), a person is deemed to be the b right to acquire beneficial ownership of such security within 60 days, including b the exercise of any option, warrant or right; (B) through the conversion of a secu discretionary account or similar arrangement; or (D) pursuant to the automatic te similar arrangement; provided, however, any person who acquires a security or p (C) above, with the purpose or effect of changing or influencing the control of th in any transaction having such purpose or effect, immediately upon such acquisit the securities which may be acquired through the exercise or conversion of such

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Schedule 6.10(a)

Greg Scholl Chief Executive Officer, President, Assistant Treasurer and Assistant Secretary

Karen Davis Chief Financial Officer, Vice President, Treasurer and Secretary.

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Schedule 6.10(b)

Greg Scholl President, Assistant Treasurer and Assistant Secretary.

Karen Davis Vice President, Treasurer and Secretary.

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Schedule 6.11(a)

Orchard Nominees

Daniel C. Stein

Michael J. Donahue

Viet D. Dinh

DMGI Nominees

Clayton Trier (Chairman)

Terry Hatchett

David Altschol

Chief Executive Officer

Greg Scholl

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Schedule 6.11(b)

Greg Scholl

Karen Davis

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August 7, 2007

Board of Directors

Digital Music Group, Inc.

2151 River Plaza Drive

Suite 200

Sacramento CA 95833

Members of the Board:

We understand that Digital Music Group, Inc. (DMGI), The Orchard Enterprises Inc. (C
subsidiary of DMGI (Merger Sub), entered into an Agreement and Plan of Merger, dated
provides for the merger of Merger Sub with and into Orchard (the Merger), which shall s
to change its name to The Orchard Inc. and for Orchard to change its name to The Orch
classes of Orchard stock on a combined basis will own (i) 9,064,941 shares of DMGI comm
preferred stock with a $25 million liquidation preference and convertible into 4,488,330 sha
the Consideration). The terms and conditions of the Merger are more fully set forth in the

We have been requested by the Board of Directors of DMGI (the Board) to render our op
a financial point of view, to DMGI shareholders (the Opinion). We have not been request
manner address, DMGI s underlying business decision to proceed with or effect the Merger

In arriving at the Opinion, we have reviewed and analyzed, among other things:

1. Agreement, dated as of July 10, 2007;

2. Publicly available information concerning DMGI that we believe to be relevant t
DMGI S 2006 Annual Report on Form 10-K and its Quarterly Report on Form

3. Certain financial and operating information with respect to the respective busines
Orchard, including financial and operating projections furnished by the managem
(a) projected revenue, cost of revenue, and operating costs for each of DMGI and
savings and operating synergies expected by the management of DMGI and Orch

4. A comparison of the historical financial results and present financial condition o
those of other publicly-traded companies that we deemed relevant;

5. A comparison of the financial terms of the Merger with the financial terms of cer

6. Published estimates of independent research analysts with respect to the future fi
DMGI and Orchard;

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7. Derived valuations of net present values of the businesses, based on projected ca basis and as a combined company;

8. The potential pro forma impact of the Merger on the future financial performanc

9. The potential pro forma impact of the Merger on the current financial condition

10. The relative contributions of DMGI and Orchard to the current and future financ pro forma basis;

11. The views of the respective managements of the strategic impacts of the Merger condition and strategic opportunities of DMGI;

12. DMGI S management s opinions regarding the merger structure relating to the

13. Such other information, financial studies, analyses and investigations as we deem

In arriving at our Opinion, we have assumed and relied upon the accuracy and completeness without assuming any responsibility for independent verification of such information and ha managements of DMGI and Orchard that they are not aware of any facts or circumstances th inaccurate or misleading. With respect to the financial projections of DMGI and Orchard, up we have assumed that such projections have been reasonably prepared on a basis reflecting t judgments of the managements of DMGI and Orchard as to the future financial performance each of DMGI and Orchard will perform substantially in accordance with such projections. properties and facilities of DMGI and Orchard. We have not made or obtained from third pa and liabilities of DMGI or Orchard.

With respect to all legal, accounting, and tax matters arising in connection with the Merger, on the accuracy and completeness of the advice provided to DMGI and Orchard by their leg

In arriving at this Opinion, we did not attribute any particular weight to any analysis or facto our analyses must be considered as a whole and that selecting portions of our analyses, with incomplete view of the process underlying this Opinion.

We acted as a financial advisor to DMGI in connection with the Merger and will receive a fe DMGI has agreed to indemnify us for certain liabilities that may arise out of our engagemen affiliates may actively trade in DMGI s securities for our own accounts and for the account time hold a long or short position in such securities.

This Opinion is for the use and benefit of the Board and is provided to the Board in connecti Opinion does not address DMGI s underlying business decision to pursue the Merger, the r alternative business strategies that might exist for DMGI or the effects of any other transacti requested to, and we did not, participate in the negotiation or structuring of the Merger. In ad offer, any opinion as to the terms of the Agreement or the form of the Merger. Our opinion d stockholder as to how such stockholder should vote or act with respect to any matters relatin of the parties to the Merger will comply with all material terms of the Agreement and that th with its terms without waiver,

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modification or amendment of any material term, condition or agreement. We further have a
regulatory or other consents and approvals necessary for the consummation of the Merger w
DMGI, Orchard or the contemplated benefits of the Merger. In addition, we express no opin
stock of DMGI actually will trade following announcement of the Merger.

Our Opinion is subject to the assumptions and conditions contained herein and is based upo
as they exist and can be evaluated on, and on the information available to us as of, the date o
updating or revising our Opinion based on circumstances or events occurring after the date h
purpose, or to be reproduced, disseminated, quoted from or referred to at any time, in whole
provided, however, that we consent to the inclusion of the text of this Opinion in any notice
shareholders of DMGI and in any filing DMGI is required by law to make, if such inclusion

Based upon and subject to the foregoing, it is our opinion that, as of the date hereof, the Con
fair, from a financial point of view, to DMGI shareholders.

SMH Capital Inc.

By: Douglas Hurst

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ANNEX C

INFORMATION WITH RESPECT TO DIRECTOR DESIG

DIGITAL MUSIC GROUP, INC.

INFORMATION STATEMENT PURSUAN

SECTION 14(F) OF THE SECURITIES EXCHANGE

AND RULE 14F-1 THEREUNDER

NOTICE OF CHANGE IN THE COMPOSITION OF THE BO

*This Information Statement is attached to the proxy statement being mailed on or about Inc. (**DMGI**) common stock, par value $0.01 per share, and is being filed with the Securi such holders in accordance with Rule 14f-1 of the Exchange Act. The proxy statement to wh incorporated herein by reference. Capitalized terms used in this Information Statement, but ascribed to such terms in the proxy statement. Under the terms of the merger agreement, the (**Orchard**) to complete the merger is subject to, among other things, the appointment of c directors of DMGI. Orchard has designated the following persons to be appointed to the bo completed: Viet D. Dinh, Michael Donahue, Greg Scholl and Daniel Stein (the **Proposed D***

NO VOTE OR OTHER ACTION BY OUR STOCKHOLDERS IS REQUIRED IN RE STATEMENT. PROXIES ARE NOT BEING SOLICITED. YOU ARE URGED TO R CAREFULLY. YOU ARE NOT, HOWEVER, REQUIRED TO TAKE ANY ACTION

Please read this Information Statement carefully. It contains certain biographical and other i after completion of the merger.

VOTING SECURITIES AND PRINCIPAL STOCKHOLDERS

Voting Securities of the Company

See THE SPECIAL MEETING OF DMGI STOCKHOLDERS Record Date on page 2 Statement is attached.

If the merger is completed, Orchard stockholders will be entitled to receive an aggregate of 448,833 shares of Series A Preferred Stock of DMGI in exchange for all of the outstanding stock of Orchard owned by them, or approximately % of the outstanding shares of voti the closing of the merger, and have the right (after acquiring a majority of the voting capital of directors of DMGI other than at a meeting of the stockholders of DMGI.

Security Ownership of Certain Beneficial Owners

The following table sets forth certain information known to us with respect to the beneficial of the merger by each Proposed Director and all Proposed Directors as a group. We have rel by the Proposed Directors for purposes of determining the number of shares each person wil Beneficial ownership is determined in accordance with the rules and regulations of the SEC voting or investment power with respect to the securities. Except as otherwise indicated, and the persons named in the table have sole voting and investment power with respect to all sha them. For each individual and group included in the table below, percentage ownership is ca beneficially

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owned by such person or group by the sum of the shares of common stock outstandi
common stock we are obligation to issue in the merger. The address for each stockholder lis
Donahue, 405 Mulberry Lane, Haverford, Pennsylvania 19041; Viet D. Dinh, Georgetown U
NW, Washington, DC 20001; Daniel Stein, JDS Capital Management Inc., 1091 Boston Pos
The Orchard Enterprises Inc., 100 Park Avenue, 2nd floor, New York, New York 10017.

Name	Benef
Daniel Stein	
Viet D. Dinh	
Michael Donahue	
Greg Scholl	

Changes in Control

There will be a change in control of DMGI that will occur as a result of the merger. See also
Merger - Upon completion of the Merger, Dimensional Associates, LLC will have significa
and will have effective control over the outcome of actions requiring the approval of DMGI
Board of Directors and executive officers of DMGI after completion of the Merger on Pag
Information Statement is attached.

DIRECTORS

Mr. Clayton Trier (chairman), Mr. David Altschul and Mr. Terry Hatchett, who are each cur
continue to serve in such capacities following the merger. For biographical information conc
statement dated April 27, 2004 for its 2007 annual meeting of stockholders, which was filed

The following table sets forth information regarding the Proposed Directors:

Name	Age	Position with DMGI
Viet D. Dinh	39	Director
Michael Donahue	48	Director
Greg Scholl	38	Chief Executive Officer and
Daniel Stein	38	Director

Viet D. Dinh

Viet D. Dinh has been a Professor of Law at Georgetown University Law School since 1996
Law & Policy Studies Program. He served as Assistant Attorney General of the United State
he has been the principal at Bancroft Associates PLLC, a law and public policy consulting f
compliance, and law enforcement. Mr. Dinh currently serves on the board of directors of Ne
Worldwide (NYSE: MFW). Mr. Dinh has an A.B. degree in government and economics fro
Harvard Law School.

Michael Donahue

Michael Donahue currently serves as an independent advisor to firms in the information and
chairman of Expensewatch.com from 2006 to March 2007. In 2005,

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Mr. Donahue completed a twenty-year career with KPMG LLP, KPMG Consulting and Bea successors, he most recently served as Managing Partner, Technology Solutions (1997 to 20 Chief Operating Officer (2001 to 2005). He also served on the board of directors of KPMG serves on the boards of directors of Air Products and Chemicals, Inc. (NYSE: APD), Arbine Inc. (NASDAQ: GSIC). Mr. Donahue has degrees in economics and history from the Unive

Greg Scholl

Greg Scholl has served as a managing director of Dimensional, the controlling shareholder o officer of Orchard, since 2003. Mr. Scholl was an associate principal at the management cor to 2003 in the media and entertainment practice. From 1999 to 2002, Mr. Scholl served as m private equity fund of Edwin Cohen. From 1993 to 1999, Mr. Scholl served in the technolog the management consulting firm of Booz Allen & Hamilton, and was a principal at the firm. history and science from Harvard College.

Daniel Stein

Daniel Stein serves as President of JDS Capital Management, Inc., an investment firm based debt and equity, and he has held this position since 2003. Mr. Stein also serves as chief exec company that manages the private equity investments made by JDS Capital Management, In been a director of Orchard since April 2003. From May 2001 through October 2002, Mr. Ste Technologies, a company that specialized in copy-protection technologies whose assets were 2001, Mr. Stein was President of Javu Technologies, which licenses software and services to repurpose video assets. From 1999 to May 2000, Mr. Stein was president, chief operating of Company, an Internet company with retail outlets specializing in the wedding gift and regist degree from Cornell University.

Family Relationships

There are no family relationships between any of the directors, executive officers of DMGI

LEGAL PROCEEDINGS

We are not aware of any legal proceedings in which any Proposed Director, or any affiliate to DMGI or has a material interest adverse to DMGI.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Except as described below, there have been no transactions or proposed transactions in whic the beginning of DMGI s last fiscal year, in which any of the Proposed Directors, or any of affiliates, has had or will have any direct or material indirect interest.

On July 10, 2007, Greg Scholl entered into a three-year employment agreement with DMGI Employment Agreement). Under the terms of the agreement, Mr. Scholl s employment w at any time, with or without cause, by either him or DMGI. Mr. Scholl will receive (i) an ini restricted stock grant under DMGI s Amended and Restated 2005 Stock Plan to purchase 1 purchase price of $0.01, subject to a DMGI repurchase option at the original purchase price

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respect to 16,666 shares three months following closing of the merger, 16,666 shares six mo
shares nine months following closing of the merger, 16,666 shares on the first anniversary o
months following closing of the merger and the remaining 16,670 shares 18 months followi
remains employed by DMGI; (iii) an option to purchase 100,000 shares of DMGI common s
value of DMGI s common stock on the date of grant, vesting in the same amounts and at th
2007 discretionary cash bonus in an amount determined by the compensation committee of t
base salary. Under the terms of the employment agreement, if Mr. Scholl is terminated by D
employment for good reason, he will be entitled to (i) continued payment of his then base sa
year; (ii) a pro rata share of any annual incentive bonus that he would have otherwise been e
by DMGI of continuation benefits for one year. The employment agreement includes provis
DMGI confidential information and trade secrets, assigns all intellectual property developed
and prohibits him from soliciting DMGI s employees during the term of the agreement and
employment.

In connection with the election of Mr. Scholl as Chief Executive Officer, DMGI and Mr. Sc
indemnification agreement for directors and officers of DMGI, which generally requires DM
Mr. Scholl to the maximum extent that Delaware law permits a Delaware corporation to ind
the corporation. A copy of the form of indemnification agreement for directors and officers

Daniel Stein is a director and chairman of eMusic.com, Inc. During the year ended Decembe
revenue to DMGI.

Compensation of Directors

Directors who are also employees of DMGI or any of our subsidiaries do not receive additio
director who is not also an employee receives a fee of $36,000 per year, except that the chai
and the chairman of the board receives $50,000 per year. Each non-employee director also r
From time-to-time, special committees of the board may be formed and additional compensa
special committees. Our directors are reimbursed for reasonable out-of-pocket expenses incu
committees thereof, and for other expenses reasonably incurred in their capacity as directors
directors is responsible for periodically reviewing and assessing the adequacy and appropria
this committee may adjust the compensation as set forth above if necessary or warranted un

The timing and terms of stock option grants to non-employee directors are set forth in DMG
are automatic and non-discretionary with respect to the number and terms. Any new non-em
nominees named above, will be entitled to receive an automatic stock option grant to purcha
exercise price per share equal to the fair market value of our common stock on the date of gr
the following 12 months. On each date of our annual meeting of stockholders, we will grant
served on the board for at least the preceding six months an additional option to purchase 6,
exercise price per share equal to the fair market value of our common stock on the date of gr
the following 12 months.

Dated: , 2007

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ANNEX D

DIGITAL MUSIC GROUP, INC.

STOCKHOLDER VOTING AGREEMEN

STOCKHOLDER VOTING AGREEMENT, dated as of July 5, 2007 (this *Agreement*), a (each, a *Stockholder* ; collectively, the *Stockholders*) and The Orchard Enterprises, Inc

WHEREAS, Digital Music Group, Inc., a Delaware corporation (DMGI), DMGI New Yo owned subsidiary of DMGI (*Merger Sub*), and Orchard have entered into an Agreement a of the date of this Agreement, pursuant to which, on the Closing Date, Merger Sub will merg

WHEREAS, as a condition to its willingness to enter into the Merger Agreement, Orchard h agreements with respect to the outstanding shares of Common Stock, par value $.01 per sha as set forth in Schedule I and Shares and shares of other voting securities of DMGI hereafter acquired pursuant to the exercise of any options or warrants held by the Stockholders) (colle subject to the conditions of this Agreement; and

WHEREAS, in order to induce Orchard to enter into the Merger Agreement, the Stockholde respect to the Subject Shares;

NOW, THEREFORE, in consideration of the promises and the mutual covenants and agreem as follows:

1. *Voting Agreements; Proxy*.

(a) For so long as this Agreement is in effect, in any meeting (or any adjournment or postpo any action by consent of the stockholders of DMGI, each Stockholder shall vote (or cause to given) consents with respect to, all of the Subject Shares that are owned by that Stockholder (or cause to be delivered) a consent, in any such case (i) in favor of the adoption of the Merg transaction contemplated by the Merger Agreement, as the Merger Agreement may be modi not adverse to the Stockholders or with the written consent of the Stockholders, (ii) against a which would reasonably be expected to result in a breach of any covenant, representation, or DMGI under the Merger Agreement or of such Stockholder under this Agreement, and (iii) agreement that would compete with or would delay, discourage, materially adversely affect (a *Competing Proposal*). Each Stockholder shall use its commercially reasonable efforts give that Stockholder s consent in accordance with the procedures communicated to that St or consent shall be duly counted for purposes of determining that a quorum is present and fo consent. No Stockholder (in his or her capacity as such) shall be required to independently i consent that is not brought before the stockholders of DMGI generally in order to comply w

(b) Upon the reasonable written request of Orchard, in furtherance of the transactions conte Agreement and in order to secure the performance of each Stockholder s obligations under execute, in accordance with the provisions of Section 212 of the Delaware General Corporat proxy, substantially in the form attached as Exhibit A, and irrevocably appoint Orchard or it

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substitution, its attorney and proxy to vote, or, if applicable, to give consent with respect to, with regard to any of the matters referred to in Section 1(a) at any meeting of the stockholde written consent by the stockholders of DMGI. Each Stockholder acknowledges and agrees th with an interest sufficient in law to support an irrevocable proxy, shall revoke any prior prox among other things, an inducement for Orchard to enter into the Merger Agreement, shall be operation of law or otherwise upon the occurrence of any event and that no subsequent prox given (and if given shall not be effective); *provided, however*, that any such proxy shall term behalf of the Stockholders upon the termination of this Agreement.

2. *Covenants*.

(a) For so long as this Agreement is in effect, each Stockholder agrees not to directly or indi hypothecate, encumber, tender or otherwise dispose of, or enter into any contract with respe hypothecation, encumbrance, tender or other disposition of (each such disposition or contrac Shares (or options or warrants to purchase Shares) except to Orchard or, with prior written n such Transfer, except to Orchard or to another Stockholder, shall be null and void); (ii) gran deposit any of the Subject Shares into a voting trust or enter into a voting or option agreeme enter into any other agreement inconsistent with or violative of this Agreement; (iii) subject facilitate the submission of any Competing Proposal or enter into, initiate or participate in ar cooperate in any way with, or assist or knowingly encourage any effort by any third party th Proposal, or furnish any nonpublic information or data to, or have any discussions with any (iv) take any action which would make any representation or warranty of any Stockholder in materially burden or delay the consummation of the transactions contemplated by this Agree

(b) Each Stockholder agrees that in the event any Shares or other voting securities of DMGI split, recapitalization, reclassification, combination or exchange of shares of capital stock of such Stockholder; (such Shares and other voting securities of DMGI, collectively, the *New* Shares in the same manner as the Subject Shares and to notify Orchard and then deliver pron respect to such New Shares, substantially in the form of Exhibit A attached hereto. Stockhol constitute Subject Shares.

(c) No Stockholder shall issue any press release or make any other public statement with res other transaction contemplated hereby or by the Merger Agreement without the prior written by applicable law or court process after consultation with, and having provided an opportuni or other public statement by, Orchard to the extent practicable.

(d) Each Stockholder hereby waives, and agrees not to exercise or assert, any appraisal right Corporation Law in connection with the Merger.

3. *Representations and Warranties of Stockholders.* Each Stockholder severally but not joint that:

(a) *Authority; Enforceability; No Conflicts.* The Stockholder has the legal capacity to enter i transactions contemplated by this Agreement. This Agreement has been duly executed and d valid and binding agreement of the Stockholder enforceable against the Stockholder in accor enforceability

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may be limited by applicable bankruptcy, insolvency and similar laws affecting creditors r
(whether considered in a proceeding in equity or at law). The execution, delivery and perfor
not (i) conflict with, require a consent, waiver or approval under, or result in a breach or def
commitment or other obligation to which the Stockholder is a party or by which the Stockho
injunction, decree or statute, or any law, rule or regulation applicable to the Stockholder or t
or impose any obligation on the Stockholder to create, any Lien upon the Subject Shares tha
Subject Shares (other than as set forth herein), except for any of the foregoing that would no
individually or in the aggregate, materially impair the ability of such Stockholder to perform
transactions contemplated hereby. In this Agreement, *Lien* shall mean any lien, pledge, se
encumbrance.

(b) *Ownership of Shares.* As of the date of this Agreement, the Stockholder is the beneficial
voting of the Shares set forth on Schedule I free and clear of any Liens that would prevent th
date of this Agreement, the Shares set forth on Schedule I are the only shares of any class of
the right, power or authority (sole or shared) to sell or vote, and, other than the warrants and
Stockholder as of this date, the Stockholder does not have any right to acquire, nor is it the b
of capital stock of DMGI or any securities convertible into or exchangeable or exercisable fo
DMGI. The Stockholder is not a party to any contracts (including proxies, voting trusts or vo
delay the Stockholder from voting or giving consent with respect to the Shares set forth on S

4. *Expenses.* Each party to this Agreement shall pay its own expenses incurred in connection

5. *Stockholder Capacity.* No natural person bound by this Agreement who is or becomes dur
makes any agreement or understanding herein in such person s capacity as such director or
capacity as the beneficial owner of, the managing member of a limited liability company or
beneficial owner of, that Stockholder s Subject Shares, and nothing herein shall limit or affe
Stockholder s capacity as an officer or director of DMGI in facilitation of the exercise of D
to the extent specifically permitted by the Merger Agreement or required by applicable law.
constitute a transfer of the beneficial ownership of the Subject Shares by any Stockholder, o
Stockholder of Exhibit A would be deemed to be such.

6. *Termination.* This Agreement shall terminate automatically and without further action on
effective time of the Merger and (b) the date the Merger Agreement is validly terminated in

7. *Assignment; Binding Effect.* This Agreement and the rights hereunder are not assignable (
such assignment is consented to in writing by each of Orchard and the Stockholders and any
such consent shall be null and void; *provided, however*, that Orchard may without such cons
respective rights (but not its respective obligations) hereunder to any of its respective wholly
assignment shall relieve Orchard of its obligations hereunder). Subject to the preceding clau
shall be binding upon and shall inure to the benefit of the parties and their respective succes

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8. *Choice of Law; Jurisdiction.* This Agreement, and all disputes between the parties under c
circumstances leading to its execution, whether in contract, tort or otherwise, shall be gover
of the State of New York, without reference to conflict of laws principles. Each of the partie
the exclusive personal jurisdiction of any New York State court located in New York Count
York in the event any dispute arises out of or relates to this Agreement or any transaction co
respect of such action may be heard and determined in any such court; (iii) agrees that it wil
jurisdiction by motion or other request for leave from any such court; (iv) agrees that it will
any transaction contemplated hereby in any court other than the New York State court locate
sitting in the State of New York; and (v) waives any right to trial by jury with respect to any
this Agreement or any transaction contemplated hereby. Each of the parties hereto waives an
maintenance of any action or proceeding so brought.

Each of the parties further agrees to waive any bond, surety or other security that might be re
action or proceeding, including an appeal thereof. Any party hereto may make service on an
process to the party to be served at the address and in the manner provided for the giving of
this Section 8, however, shall affect the right of any party to serve legal process in any other

9. *Notices.* All notices, requests, demands and other communications under this Agreement s
been duly given (a) if delivered personally, when received, (b) if sent by cable, telecopy, tele
the intended recipient), when sent, (c) if sent by overnight courier service, on the next busine
certified or registered mail, return receipt requested, with postage prepaid five business days
the following addresses (or at such other address for a party as shall be specified by like noti

If to the Stockholders, to the address set forth opposite such Stockholder s name below.

If to Orchard, to:

The Orchard Ente
100 Park Avenue
2nd Floor
New York, NY 10
Attn: Chief Execu
Fax: (212) 201-92

with a copy to:

Reed Smith LLP
599 Lexington Av
New York, NY 10
Attn: David M. G
Fax: (212) 521-54

10. *Headings.* The headings contained in this Agreement are inserted for convenience only a
construing any of the provisions contained in this Agreement.

11. *Entire Agreement.* This Agreement (including the Schedule and Exhibit hereto), constitu
with respect to the subject matter hereof and supersedes all prior agreements, arrangements,
by or among the parties hereto, or any of them, written or oral, with respect to the subject ma

12. *Waiver and Amendment.* This Agreement may be amended, modified or supplemented o
delivered by the parties hereto. Except as otherwise provided in this Agreement,

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any failure of any party to comply with any obligation, covenant, agreement or condition he
benefits thereof only by a written instrument signed by the party granting such waiver, but s
estoppel with respect to, any subsequent or other failure. The failure of any party to this Agr
Agreement or otherwise shall not constitute a waiver of such rights.

13. C*ounterparts; Facsimile Signatures.* This Agreement may be executed in any number of
shall be deemed to be an original and all of which together shall be deemed to be one and th
notwithstanding the fact that all of the parties are not signatory to the original or the same co
facsimile signatures shall be deemed originals.

14. *Third-Party Beneficiaries.* This Agreement is for the sole benefit of the parties and their
herein express or implied shall give or be construed to give to any Person, other than the par
any legal or equitable rights hereunder.

15. *Specific Performance.* The Stockholder agrees that if any of its obligations under this Ag
their specific terms or were otherwise breached, irreparable damage would occur to Orchard
damages would be difficult to determine, and that Orchard shall be entitled to an injunction
terms hereof**,** this being in addition to any other remedy at law or in equity, without the nece
connection therewith. Accordingly, if Orchard should institute an action or proceeding seeki
provisions of this Agreement, the Stockholder hereby waives the claim or defense that Orch
agrees not to assert in that action or proceeding the claim or defense that a remedy at law ex
absence of a waiver, a bond or undertaking may be required by a court and the Stockholder
or undertaking.

16. *Severability.* If any term, covenant, restriction or provision of this Agreement or the appl
provision to any Person or circumstance shall be held invalid, illegal or unenforceable in any
such invalidity, illegality or unenforceability shall not affect any other term, covenant, restri
or legal substance of the transactions contemplated hereby is not affected in any manner ma
engage in good faith negotiations to replace any term, covenant, restriction or provision whi
with a valid, legal and enforceable term, covenant, restriction or provision, the economic eff
the invalid, illegal or unenforceable term, covenant, restriction or provision which it replace

17. *No Joint and Several Liability.* Notwithstanding anything to the contrary in this Agreem
liabilities and obligations under this Agreement are several, and not joint, to each Stockhold
breach, default, liability or other obligation of the other Stockholders party to this Agreemen

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IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed the

THE ORCHARD ENTERPRISE

By: /s/ Greg Scholl
Name: Greg Scholl
Title: Chief Executive Officer

/s/ Mitchell Koulouris

Mitchell Koulouris

/s/ Mitchell Koulouris

Mitchell Koulouris, Custodian f/b/o Katherine Elene Koulouris

/s/ Mitchell Koul

Mitchell Kouloури

/s/ Richard Rees

Richard Rees

RIO BRAVO ENTERTAINMENT LLC

By: /s/ Richard Rees
Name: Richard Rees

Title: President

AUSTIN TRUST

By: /s/ Steve C
Name:

Title:

/s/ Steve Colmar

Steve Colmar

/s/ Craig Colmar

Craig Colmar

/s/ Tuhin Roy

Tuhin Roy

/s/ Cliff Haigler

Cliff Haigler

/s/ Clayton Trier

Clayton Trier

/s/ Karen Davis

Karen Davis

/s/ Terry Hatchett

Terry Hatchett

/s/ John Kilcullen

John Kilcullen

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SCHEDULE I

STOCKHOLDER NAME AND ADDRESS
Mitchell Koulouris
Mitchell Koulouris, custodian f/b/o Sara Maria Koulouris
Mitchell Koulouris, custodian f/b/o Katherine Elene Koulouris
Richard Rees
Rio Bravo Entertainment LLC
Tuhin Roy
Craig Colmar
Steve Colmar
Austin Trust
Cliff Haigler
Clayton Trier
Karen Davis
John Kilcullen
Terry Hatchett

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IRREVOCABLE PROXY

In order to secure the performance of the duties of the undersigned pursuant to the Voting A
Agreement), between the undersigned and The Orchard Enterprises, Inc., a New York corp
attached hereto and incorporated by reference herein, the undersigned hereby irrevocably ap
attorneys, agents and proxies, with full power of substitution in each of them, for the unders
undersigned, to vote or, if applicable, to give written consent, in such manner as each such a
his sole discretion deem proper to record such vote (or consent) in the manner set forth in Se
all shares of Common Stock, par value $.01 per share (the *Shares*), of Digital Music Grou
undersigned is or may be entitled to vote at any meeting of DMGI held after the date hereof,
adjourned meeting, or, if applicable, to give written consent with respect thereto. This Proxy
support an irrevocable proxy, shall be irrevocable and binding on any successor in interest o
operation of law or otherwise upon the occurrence of any event (other than as provided in Se
without limitation, the death or incapacity of the undersigned. This Proxy shall operate to re
granted by the undersigned. This Proxy shall terminate upon the termination of the Voting A
accordance with Section 212 of the Delaware General Corporation Law.

Dated: , 2007

[NAM

By:
N

T