

LIQUID AUDIO INC
Form S-4/A
September 05, 2002

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As filed with the Securities and Exchange Commission on September 5, 2002

Registration No. 333-96925

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 1
to
FORM S-4
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

LIQUID AUDIO, INC.

(Exact Name of Registrant as specified in its Charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

7373
(Primary Standard Industrial
Classification Code Number)
800 Chesapeake Drive
Redwood City, California 94063
(650) 549-2000

77-0442752
(I.R.S. Employer
Identification Number)

(Address, including zip code, and telephone number, including area code, of Registrant's principal executive offices)

Gerald W. Kearby
Chief Executive Officer
Liquid Audio, Inc.
800 Chesapeake Drive
Redwood City, California 94063
(650) 549-2000

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

Lawrence Lederman, Esq.
Milbank, Tweed, Hadley & McCloy LLP
1 Chase Manhattan Plaza
New York, New York 10005
(212) 530-5000

Deborah J. Ruosch, Esq.
Milbank, Tweed, Hadley & McCloy LLP
601 South Figueroa Street, 30th Floor
Los Angeles, California 90017
(213) 892-4000

Approximate date of commencement of proposed sale to the public:

Upon consummation of the merger described herein.

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If the securities being registered on this Form are to be offered in connection with the formation of a holding company and there is compliance with General Instruction G, check the following box. o

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

To the stockholders of Liquid Audio, Inc.:

After careful consideration, the board of directors of Liquid Audio has approved a merger between Liquid Audio and Alliance Entertainment Corp. which will result in Alliance becoming a wholly-owned subsidiary of Liquid Audio. In the merger, outstanding shares of Alliance stock and the outstanding options to purchase Alliance stock will be exchanged for shares of Liquid Audio stock and options to purchase Liquid Audio stock. In connection with the merger, Liquid Audio will make a tender offer, conditioned upon the approval of the issuance of shares of Liquid Audio in the merger, for 10,000,000 of its shares at \$3.00 per share, representing a total purchase of up to 44% of its outstanding common stock on August 12, 2002. If all of the eligible Liquid Audio shares are tendered in the tender offer, the effective per share price could be as low as \$1.42.

Following the consummation of the merger, shares of Liquid Audio stock that were outstanding before the merger, and not tendered, will represent approximately 26% of the outstanding voting power of the combined organization. Based on the number of outstanding shares of Liquid Audio common stock as of August 12, 2002, after giving effect to a fully-subscribed tender offer, the maximum aggregate number of shares that would be issued to Alliance stockholders pursuant to the merger is approximately 36,276,000.

Liquid Audio common stock is traded on The Nasdaq National Market under the trading symbol "LQID." The Liquid Audio common stock may be delisted from The Nasdaq National Market as a result of the merger. On _____, 2002, the closing price of Liquid Audio common stock was \$ _____ per share.

After careful consideration, the board of directors of Liquid Audio has unanimously determined that the tender offer and the merger are fair to you and in your best interests. The Liquid Audio board of directors has approved the merger agreement and recommends voting in favor of the issuance of shares of Liquid Audio stock in the merger. In addition, at the annual stockholder meeting, stockholders will consider and vote upon the election of two (2) Class III directors to hold office for three (3) years. The Board has nominated Gerald W. Kearby and Raymond A. Doig to serve as Class III directors. **YOUR BOARD STRONGLY URGES YOU NOT TO RETURN ANY WHITE PROXY CARD SENT TO YOU BY THE MUSICMAKER GROUP. THE BEST WAY TO SUPPORT THE LIQUID NOMINEES AND THE BOARD'S DETERMINATIONS IS TO VOTE "FOR" THE LIQUID NOMINEES ON THE GREEN PROXY CARD.**

Please carefully consider the information contained in this proxy statement/prospectus. In particular, carefully review the risks relating to each of Liquid Audio, Alliance and the merger contained in the section entitled "Risk Factors" on page 24 of this proxy statement/prospectus.

The meeting of Liquid Audio stockholders will be held on September 26, 2002 at 10:00 a.m. local time at the Hotel Sofitel, 223 Twin Dolphin Drive, Redwood City, California 94065. Whether or not you plan to attend the annual Liquid Audio stockholder meeting, please complete, sign, date and return the accompanying proxy in the enclosed self-addressed stamped envelope. Returning the proxy does NOT deprive you of your right to attend the meeting and to vote your shares in person. YOUR VOTE IS VERY IMPORTANT. We appreciate your consideration of these matters.

Gerald W. Kearby
President and Chief Executive Officer,
Liquid Audio, Inc.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of this transaction or the Liquid Audio stock to be issued in the merger or determined whether the proxy statement/prospectus is accurate or adequate. Any representation to the contrary is a criminal offense.

The proxy statement/prospectus is dated [], 2002, and is first being mailed to Liquid Audio stockholders on or about [], 2002.

The proxy statement/prospectus does not constitute an offer to sell, or a solicitation of an offer to purchase, the securities offered by the proxy statement/prospectus, or the solicitation of a proxy, in any jurisdiction to or from any person to whom or from whom it is unlawful to make such offer, solicitation of an offer or proxy solicitation in such jurisdiction.

[LIQUID AUDIO LOGO]

800 Chesapeake Drive
Redwood City, California 94063
(650) 549-9282

NOTICE OF ANNUAL MEETING OF LIQUID AUDIO, INC.

STOCKHOLDERS TO BE HELD ON SEPTEMBER 26, 2002

10:00 A.M.

To the Stockholders of Liquid Audio, Inc.:

A meeting of the stockholders of Liquid Audio, Inc., a Delaware corporation, will be held on September 26, 2002 at 10:00 a.m., local time, at Hotel Sofitel, 223 Twin Dolphin Drive, Redwood City, California 94065, for the purpose of considering and voting upon the following proposals:

1. The election of two (2) Class III directors to hold office for three (3) years.
2. The ratification of PricewaterhouseCoopers LLP as the Company's independent accountants for the fiscal year ending December 31, 2002.
3. The approval of the issuance of Liquid Audio stock in the merger of April Acquisition Corp., a wholly-owned subsidiary of Liquid Audio, with and into Alliance Entertainment Corp. pursuant to an Amended and Restated Agreement and Plan of Merger dated as of July 14, 2002, by and among Liquid Audio, April Acquisition Corp. and Alliance.
4. If properly presented at the annual meeting, to vote on three proposals of a stockholder of Liquid Audio:
 - To amend Liquid Audio's bylaws to expand the size of the Board of Directors;
 - To amend Liquid Audio's bylaws to authorize only stockholders to fill newly created directorships; and
 - Contingent on approval of the above two proposals, to elect four (4) additional nominees to the board of directors.
5. The transaction of such other business as may properly come before the meeting or any adjournment thereof.

August 12, 2002 has been fixed as the record date for the determination of stockholders entitled to notice of, and to vote at, the meeting of Liquid Audio stockholders and any adjournment or postponement thereof. Only holders of record of shares of Liquid Audio common stock at the close of business on the record date are entitled to notice of, and to vote at, the meeting of Liquid Audio stockholders. At the close of business on the record date, Liquid Audio had outstanding and entitled to vote 22,745,624 shares of common stock. Liquid Audio stockholders are not entitled to appraisal rights in connection with the merger.

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Also, in connection with the merger, Liquid Audio has agreed to offer to purchase up to 10 million shares of its outstanding common stock from its current stockholders at \$3.00 per share. The tender offer will expire twenty business days following the date that it is commenced, unless extended by Liquid Audio. Consummation of the tender is conditioned upon, among other things, approval by Liquid Audio's stockholders of the issuance of shares of Liquid Audio in the merger.

The Liquid Audio board of directors has unanimously approved the merger agreement, the tender offer, the merger and the issuance of Liquid Audio stock in the merger and has determined that the tender offer, the merger and the issuance of Liquid Audio stock in the merger are fair to, and in the best interests of, the stockholders of Liquid Audio. Therefore, the Liquid Audio board of directors

unanimously recommends that Liquid Audio stockholders vote FOR approval of the issuance of Liquid Audio stock in the merger.

Additionally, the Liquid Audio board of directors has nominated Gerald W. Kearby and Raymond A. Doig to serve as Class III directors. The Liquid Audio board of directors recommends a vote FOR the election of the director nominees on the enclosed GREEN proxy card and against the other proposals made by the musicmaker.com group. The Liquid Audio board of directors urges you not to vote for any individuals that may be nominated by the musicmaker.com group for election by our stockholders and not to execute any proxy card other than the enclosed GREEN proxy card.

The approval of the issuance of Liquid Audio stock in the merger will require the affirmative vote of a majority of the shares of Liquid Audio common stock voting on this proposal at the annual Liquid Audio stockholder meeting, either in person or represented by proxy, while the approval of the two (2) Class III directors will require a plurality of votes cast by stockholders holding shares entitled to vote in the election at the stockholders meeting.

Shares deemed to be present at the annual stockholder meeting but abstaining from the vote and broker non-votes on either the proposal to approve the issuance of Liquid Audio stock in the merger or the election of the two (2) Class III directors will not be counted for any purpose in determining whether these proposals have been approved. The failure of a Liquid Audio stockholder to return a proxy or to vote in person will have no effect in regards to these proposals.

These proxy solicitation materials and the Annual Report on Form 10-K for the year ended December 31, 2001, including financial statements, were first mailed on or about September , 2002 to all stockholders entitled to vote at the Annual Meeting.

WE SHALL PROVIDE WITHOUT CHARGE TO EACH STOCKHOLDER SOLICITED BY THESE PROXY SOLICITATION MATERIALS A COPY OF THE ANNUAL REPORT ON FORM 10-K TOGETHER WITH THE FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULES REQUIRED TO BE FILED WITH THE ANNUAL REPORT UPON REQUEST OF THE STOCKHOLDER MADE IN WRITING TO LIQUID AUDIO, INC., 800 CHESAPEAKE DRIVE, REDWOOD CITY, CALIFORNIA 94063, ATTN: SECRETARY.

All properly signed and dated proxies that Liquid Audio receives prior to the vote at the annual stockholder meeting of Liquid Audio stockholders, and that are not revoked, will be voted in accordance with the instructions indicated on the proxies. All properly signed and dated proxies received by Liquid Audio prior to the vote at the annual stockholder meeting that do not contain any direction as to how to vote in regards to any or all of the proposals will be voted for adoption of any proposal as to which no directions are provided.

Even if you plan to attend the annual stockholder meeting in person, we request that you sign and return the enclosed proxy card as described in the proxy statement/prospectus and in accordance with the instructions accompanying the proxy card, thus ensuring that your shares will be represented at the annual stockholder meeting. If you do attend the meeting of Liquid Audio stockholders and wish to vote in person, you may withdraw your proxy and vote in person.

By Order of the Board of Directors,

[signature]

Gerald W. Kearby
President and Chief Executive Officer,
Liquid Audio, Inc.

[Date]

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The following annexes also constitute part of this proxy statement/prospectus:

Annex A	Amended and Restated Agreement and Plan of Merger
Annex B	Opinion of Broadview, Financial Advisor to Liquid Audio

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QUESTIONS AND ANSWERS ABOUT THE MERGER

The following section provides answers to frequently asked questions about the annual meeting, the merger, the tender offer and the effect of the merger and tender offer on holders of Liquid Audio common stock. This section, however, only provides summary information. For a more complete response to these questions and for additional information, please refer to the cross-referenced page for each question.

Q:

What is the proposed transaction? (See page 10)

A:

The proposed transaction is to combine the businesses of Liquid Audio and Alliance. To combine the companies, a wholly-owned subsidiary of Liquid Audio will merge with and into Alliance, and Alliance will survive the merger as a wholly-owned subsidiary of Liquid Audio. In connection with the merger, Liquid Audio will make an offer to purchase 10,000,000 shares of its common stock at a purchase price of \$3.00 per share.

Q:

Why are Liquid Audio and Alliance proposing the merger and the tender offer? (See pages 49 and 60)

A:

Liquid Audio and Alliance believe that the combination of their two businesses will permit them to develop effective and efficient means to deliver services to their customers. The merger combines Alliance's physical media distribution base of more than 5,000 retailers operating more than 25,000 physical and online stores, with Liquid Audio's portfolio of technology and intellectual property for digital media distribution and rights management. Alliance and Liquid Audio intend to rationalize the combined organization's cost structure after the merger. In fact, in anticipation of the merger, Liquid Audio has already effected workforce reductions in divisions of its business that are unrelated to the development of Liquid Audio's technology for the digital distribution of music. Liquid Audio plans further reductions in this area.

If all Liquid Audio stockholders (other than the two management stockholders who have committed not to tender their holdings of 1,506,600 shares of Liquid Audio common stock unless the tender offer is undersubscribed) were to tender their shares in the tender offer, approximately 21,239,024 shares of Liquid Audio common stock will have been tendered and only 10 million shares will be accepted in the tender offer. In such case, each tendering stockholder would effectively receive a prorated cash amount of \$1.42 per share and would retain its ownership of shares of Liquid Audio common stock not accepted in the tender offer.

Q:

Why is the tender offer being run concurrently with the merger solicitation?

A:

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The tender offer is being run concurrently with the merger transaction to give Liquid Audio stockholders the opportunity to receive cash consideration for a portion of their shares as part of the transaction. In addition, the concurrent tender offer and merger require a lower percentage of shares be voted to approve the transaction than other contemplated structures. This makes approval of the transaction more likely given the announced opposition by certain stockholders.

Q:

Who can tender their shares of Liquid Audio stock? (See page 65)

A:

Liquid Audio will make a tender offer in which Liquid Audio will offer to purchase up to 10 million shares of its common stock, representing a total purchase of up to 44% of Liquid Audio's outstanding common stock. If more than 10 million shares of Liquid Audio's common stock are tendered, Liquid Audio will purchase a total of 10 million shares of its common stock from Liquid Audio stockholders who have tendered their shares on a pro rata basis. If the tender offer is not fully subscribed, then two members of management, holding 1,506,600 shares of Liquid Audio common stock in the aggregate, may tender their shares. Those members of management have agreed not to tender their shares if the tender offer is fully

1

subscribed. Consummation of the tender offer is conditioned upon, among other things, approval of the issuance of shares of Liquid Audio stock in the merger by Liquid Audio stockholders at the stockholder meeting.

Q:

What will Liquid Audio stockholders receive in the transaction? (See page 63)

A:

Liquid Audio stockholders will continue to hold the Liquid Audio stock that they currently own and do not tender. After the merger, these shares will represent 26% of the voting power in the combined organization.

Q:

What will Liquid Audio stockholders receive if the tender offer is oversubscribed?

A:

If all Liquid Audio stockholders (other than the two management stockholders who have committed not to tender their holdings of 1,506,600 shares of Liquid Audio common stock unless the tender offer is undersubscribed) were to tender their shares in the tender offer, approximately 21,239,024 shares of Liquid Audio common stock will have been tendered and only 10 million shares will be accepted in the tender offer. In such case, each tendering stockholder would effectively receive a prorated cash amount of \$1.42 per share and would retain its ownership of shares of Liquid Audio common stock not accepted in the tender offer.

Q:

What will Liquid Audio stockholders receive if the tender offer is undersubscribed?

A:

While Liquid Audio expects that the tender offer will be fully subscribed if the Liquid Audio stockholders approve the issuance of Liquid Audio stock in the merger, if fewer than 10 million shares are tendered in the tender offer, each tendering stockholder will receive a cash amount of \$3 per tendered share and retain its ownership interest of shares of Liquid Audio common stock that it did not tender. If less than 10 million shares are tendered, Alliance and Liquid Audio have agreed to negotiate in good faith to effect alternative arrangements so that the economic, voting and other material benefits of the transactions contemplated by the merger agreement are preserved for Liquid Audio, Alliance and their respective stockholders.

Q: *What percentage of Liquid Audio will the former Alliance stockholders own collectively immediately following the merger? (See page 63)*

A: Immediately following the merger the former Alliance stockholders will own 74% of the combined organization.

Q: *How can I tender my shares? (See page 65)*

A: If you tender your shares, you will receive detailed instructions regarding the surrender of share certificates, together with a letter of transmittal, promptly after the merger is completed. You should not submit your certificates until you have received these materials. If you tender your shares, you will be paid the tender consideration as promptly as practicable following its receipt of your certificates and other required documents. For more information regarding the tender offer, please read the offer to purchase which has been sent to Liquid Audio stockholders separately.

Q: *What if the issuance of shares of Liquid Audio stock in the merger is not approved?*

A: If the issuance of shares of Liquid Audio stock in the merger is not approved and the other conditions to the merger are not capable of being satisfied, then the tender offer will not be consummated and the stockholders of Liquid Audio will continue to own their shares of common stock and will not receive cash in the tender offer.

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Q: *What Liquid Audio stockholder approvals are needed to complete the merger? (See page 39)*

A: Approval of the issuance of Liquid Audio stock in the merger will require the affirmative vote of a majority of the shares of Liquid Audio stock voting at the Liquid Audio stockholder meeting, not including abstentions, either in person or represented by proxy.

Q: *Does the board of directors of Liquid Audio support the transaction? (See page 40)*

A: Yes. After careful consideration, the Liquid Audio board of directors unanimously recommends that Liquid Audio stockholders vote in favor of the issuance of Liquid Audio stock in the merger.

Q: *Are there risks I should consider in deciding whether to vote for the issuance of Liquid Audio stock in the merger? (See page 24)*

A:

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Yes. In evaluating the issuance of Liquid Audio stock in the merger, you should carefully consider the information contained in and incorporated into this proxy statement/ prospectus and, in particular, the factors discussed in the section entitled "Risk Factors" beginning on page 24.

Q:

What is the spin-off to Alliance stockholders? (See page 151)

A:

In addition to its core distribution and fulfillment business, Alliance operates two other strategic business units collectively referred to as the Digital Media Infrastructure Services Group (the "DMISG"). One business develops and markets e-commerce enabling databases for home entertainment products, while the other offers kiosk-based retail merchandising solutions through Alliance's wholly-owned subsidiary, Digital On-Demand, Inc. These businesses have historically been funded by Alliance either through ordinary course borrowings under its credit agreement or by the proceeds of capital stock investments by Alliance's stockholders. Alliance repays any outstanding amounts under its credit facility with monies generated in the operation of all of its businesses, including the DMISG, in the ordinary course. Nevertheless, the DMISG has been a net borrower under Alliance's credit facility, borrowing approximately \$9.1 million since January 1, 2001.

Prior to consummating the merger transaction with Liquid Audio, Alliance will dispose of all of the operations conducted by the DMISG business lines via a spin-off or other structure for disposition to its existing stockholders. The \$9.1 million borrowed by the DMISG under Alliance's credit facility will not be repaid to Alliance in connection with such spin-off, and will therefore be a liability of Liquid Audio and its subsidiaries after the merger.

Alliance may hold an equity interest in the company formed by the spin-off of the DMISG businesses. Alliance currently has received approval from its lenders to retain a passive minority equity interest in such company with a value of up to \$3.0 million. It is anticipated that such passive minority equity interest will represent no more than 10% of the voting and economic interests of such spun-off company. Other than this minority passive equity interest, Alliance will have no continuing involvement in the day to day management and operation of the DMISG, nor will the DMISG have any continuing involvement in the management and operation of Alliance's core distribution and fulfillment business. Alliance intends to account for the minority passive equity interest using the so-called "cost basis" of accounting because Alliance does not expect to exercise significant influence over the day-to-day management and operations of the DMISG after the spin-off.

3

Q:

What will the commercial relationship be between Alliance and the spun-off DMISG after the merger?(See page 147)

A:

Alliance will enter into a commercial relationship with DMISG after the spin-off. This relationship will provide Alliance and its subsidiaries certain rights in connection with DMISG's database and kiosk products, as well as providing for certain developmental rights pertaining to these databases. This agreement will also establish the non-preferential terms of Alliance's use of the databases and kiosks in connection with Alliance's core distribution and fulfillment business.

Q:

What are the business consequences of such spin-off?(See page 150)

A:

After the spin-off, the DMISG businesses will no longer be included within Alliance nor will these business lines be part of the combined organization after consummation of the merger transaction with Liquid Audio. Alliance's existing stockholders will control these businesses and, subject to limited restrictions contained in the merger agreement, will be free to operate or pursue further strategic transactions with them independently of the operations of the combined organization.

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As described in the immediately preceding answer, Alliance will enter into a commercial trading agreement to utilize the products and services of the spun-off company in Alliance's core distribution and fulfillment business. Alliance's management is currently negotiating the terms of this commercial relationship with representatives of Alliance's stockholders, the persons to whom DMISG will be spun-off. This agreement will be commercially reasonable and on terms at least as favorable to Alliance as could be secured by arm's-length negotiations between unrelated parties.

Q:

What do I need to do now? (See pages 179 and attached proxy card)

A:

After carefully reading and considering the information contained in and incorporated into this proxy statement/prospectus, please submit your proxy card according to the instructions on the enclosed proxy card as soon as possible. If you do not submit a proxy card or attend the stockholder meeting and vote in person, your shares will not be represented or voted at the meeting.

Q:

Can I, as a Liquid Audio stockholder, submit my proxy by telephone or over the Internet? (See attached proxy card)

A:

If you hold your shares through a bank or brokerage firm, you may be able to submit your proxy by telephone or over the Internet. You should refer to the proxy card included with your materials for instructions about how to vote. If you vote by telephone or over the Internet, you do not need to complete and mail your proxy card.

Q:

If my shares of Liquid Audio common stock are held in "street name" by my bank or broker, will my bank or broker vote my shares for me? (See page 41)

A:

Your bank or broker will vote your shares only if you provide instructions on how to vote by following the information provided to you.

Without instructions from you on how to vote your shares, your bank or broker will not have discretionary authority to vote your shares on the matters currently proposed to be presented at the stockholder meeting. As a result, your bank or broker may deliver a proxy card expressly indicating that it is NOT voting your shares. This indication that a broker is not voting your shares is referred to as a "broker non-vote." Broker non-votes will be counted for the purpose of determining the presence or absence of a quorum at the Liquid Audio stockholder meeting. However, a broker non-vote will not be entitled to vote on the proposal

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to approve the issuance of Liquid Audio stock in the merger, and thus a broker non-vote will not be counted for any purpose in determining whether this proposal has been approved.

Q:

If I am a Liquid Audio stockholder, what happens if I do not vote, or if I submit an incomplete proxy, or abstain from voting? (See page 40)

A:

If you do not submit a proxy, or if you submit a proxy but it is not properly signed or dated, your shares will not be counted as present for purposes of establishing a quorum at the Liquid Audio stockholder meeting and will not be counted for any purpose in determining whether the proposal to approve the issuance of Liquid Audio stock in the merger has been approved.

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If you submit a properly signed and dated proxy and do not indicate how you want to vote, your shares will be counted as present for purposes of establishing a quorum at the stockholder meeting, and your proxy will be counted as a vote to approve the issuance of Liquid Audio stock in the merger.

If you submit a properly signed and dated proxy and affirmatively elect to abstain from voting, your shares will be counted as present for purposes of establishing whether a quorum is present at the stockholder meeting, but your proxy will not be counted for any purpose in determining whether to approve the proposal on the issuance of Liquid Audio stock in the merger.

Q:

When and where will the Liquid Audio stockholder meeting take place? (See page 39)

A:

The Liquid Audio stockholder meeting will take place at the Hotel Sofitel, 223 Twin Dolphin Drive, Redwood City, California 94065 on September 26, 2002, at 10:00 a.m., local time.

Q:

When do you expect the merger and tender offer to be completed? (See page 63)

A:

Liquid Audio and Alliance are working to complete the merger as quickly as possible. Liquid Audio and Alliance hope to complete the merger promptly following receipt of all necessary stockholder approvals. The tender offer will expire twenty business days following the date on which it is commenced, unless extended by Liquid Audio. Liquid Audio stockholders electing to tender their Liquid Audio shares for cash will be paid as soon as practicable after the tender offer is completed.

Q:

What are the consequences to Liquid Audio under the merger agreement if the merger is not consummated? (See page 79)

A:

Pursuant to the merger agreement, Liquid Audio is prohibited from initiating or engaging in discussions with a third party regarding specific types of extraordinary transactions, such as a merger,

business combination or sale of a material amount of assets or capital stock. Therefore, only in limited circumstances would Liquid Audio be permitted to forego consummation of the merger. In addition, Liquid Audio has agreed to pay a termination fee to Alliance in specific circumstances if the merger is not consummated. The amount of the termination fee ranges from \$1 million to \$3 million depending upon the circumstances giving rise to the failure to consummate the merger. See also "Certain Terms of the Merger Agreement."

Q:

What benefits will Liquid Audio's management receive upon consummation of the merger? (See page 95)

A:

In connection with the execution of the original merger agreement, Gerald W. Kearby and Robert G. Flynn have each entered into employment agreements with Alliance which will become effective upon consummation of the merger. In addition, Michael Bolcerek's employment agreement provides that 25% of the vested options to purchase Liquid Audio common stock held by Mr. Bolcerek will vest upon certain changes of control of Liquid Audio and an additional 12.5% of the unvested options to purchase Liquid Audio common stock

held by Mr. Bolcerek will vest in the event that his termination or constructive termination is a result of a change of control of Liquid Audio. The merger will constitute a change of control under the terms of Mr. Bolcerek's employment agreement. For a more detailed description of the above arrangements, please see "Management Employment Contracts and Change-in-Control Arrangements Pre-Merger and Employment Contracts and Change-in-Control Arrangements

Post-Merger."

Q:

What are the tax consequences of the merger to me? (See page 88)

A:

Liquid Audio expects the merger to qualify as a tax-free reorganization for U.S. federal income tax purposes. Please carefully review the information contained in the section entitled "Federal Tax Consequences of the Merger" for a description of the material U.S. federal income tax consequences of the merger.

Q:

Am I entitled to dissenters' or appraisal rights in connection with the merger? (See page 13)

A:

Stockholders of Liquid Audio are not entitled to appraisal rights under Delaware law.

Q:

Whom should I call with questions? (See page 194)

A:

If you have any questions about the merger or any related transaction, please call the investor relations department at Liquid Audio at (650) 549-2000. You may also obtain additional information about Liquid Audio documents filed with the Securities and Exchange Commission without charge upon written or oral request by following the instructions in the section entitled "Where You Can Find More Information."

SUMMARY OF THIS PROXY STATEMENT/PROSPECTUS

This summary highlights selected information from this proxy statement/prospectus and may not contain all of the information that is important to you.

Before voting, you should carefully read this entire document, the appendices and the other documents to which this proxy statement/prospectus refers for a more complete understanding of the merger agreement, the tender offer and the transactions contemplated by the merger. This summary and the balance of this document contain forward-looking statements about events that are not certain to occur, and you should not place undue reliance on those statements. Please carefully read "Cautionary Statements Regarding Forward-Looking Information" on page 37 of this document.

In this proxy statement/prospectus, the term "Alliance" refers to Alliance Entertainment Corp. and its subsidiary, Distribution & Fulfillment Services Group, Inc. and subsidiaries thereof. The financial statements attached hereto present Distribution & Fulfillment Services Group, Inc.'s financial position which sets forth the financial position of Alliance Entertainment Corp. on a consolidated basis after giving effect to the consummation of a spin-off or other disposition of certain assets to the stockholders of Alliance prior to the merger. See "Alliance's Business Additional Background Information."

This proxy statement/prospectus contains trademarks, trade names, service marks, and service names of Liquid Audio, Alliance, and other companies.

The Companies (See pages 105 and 139)

Liquid Audio, Inc.

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Liquid Audio, Inc. was incorporated in California in January 1996 and reincorporated in Delaware in April 1999. In July 1999, Liquid Audio completed its initial public offering of common stock. Liquid Audio's principal executive offices are located at 800 Chesapeake Drive, Redwood City, California 94063, and its telephone number is (650) 549-2000.

Liquid Audio provides an open platform that enables the digital delivery of media over the Internet. Liquid Audio's software products and services are designed to give artists and record companies the ability to create, syndicate and sell recorded music with copy protection and copyright management through websites and retailers. Through its Liquid Music Network, a network of third party music related websites, OEMs, and retailers, Liquid Audio helps artists and record companies distribute, promote and sell their recorded music. From the growing catalog of syndicated music which is available through Liquid Audio's Liquid Music Network affiliates and online stores using its Retail Integration and Fulfillment System ("RIFFS"), and Liquid Store, consumers can preview and purchase digital music. Consumers then can transfer downloaded music to recordable compact discs and to digital audio devices manufactured by consumer electronics companies. Liquid Audio's solution is based on an open technical architecture that is designed to support multiple leading digital music formats, including Liquid Audio, MP3 and Microsoft Windows Media. Numerous record companies and recording artists have used Liquid Audio's distribution system to sell music, including labels such as Atlantic Records, BMG Entertainment, EMI Music Group, Sup Pop Records, Warner Music Group and Zomba Records Group, and artists such as Backstreet Boys, Enya, Mick Jagger, Jewel, matchbox twenty and 'N SYNC, although such services have not, to date, resulted in significant revenues.

Contractual arrangements between Liquid Audio and its related parties, Liquid Audio Korea, Liquid Audio Greater China, Liquid Audio South East Asia and Liquid Audio Japan resulted in approximately 61%, 63% and 48% of Liquid Audio's revenues in 2001, 2000 and 1999, respectively. All of these related party contracts have been terminated due to nonpayment by the customers as a result of their lack of financial resources and Liquid Audio will not receive additional revenues from such parties in the future. Although Liquid Audio has not yet successfully generated significant revenues from third party customers, it continues to pursue its strategy of providing secure digital music delivery

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distribution of major label and independent music content to retail and consumer electronics and personal computer manufacturers through Liquid Audio's Liquid Music Network and through the licensing of its Liquid Player and server technologies. Liquid Audio has not historically generated significant revenue from these business activities and it is uncertain whether these activities will be successful in generating sufficient revenue in the future to fund Liquid Audio's operations. Liquid Audio's efforts to create a successful business plan have been materially adversely impacted by the growth and pervasiveness of free music sharing from companies such as Napster, Kazaa, Morpheus and WinMX, and from the lack of complete and compelling catalogs of music content from its content partners. Liquid Audio cannot be sure that it will be able to overcome the obstacles presented by these factors to develop a profitable business but believes its business strategy will position it for growth opportunities in the future.

April Acquisition Corp.

April Acquisition Corp. is a wholly-owned subsidiary of Liquid Audio that was recently incorporated in Delaware solely for the purpose of the merger. It does not conduct any business and has no material assets. Its principal executive offices have the same address and telephone number as Liquid Audio.

Alliance Entertainment Corp.

Alliance Entertainment Corp. was originally incorporated in Delaware in November 1991. Alliance's principal executive offices are located 4250 Coral Ridge Drive, Coral Springs, Florida 33065, and Alliance's telephone number is (954) 255-4000.

Alliance is one of the largest logistics and supply chain management companies for the home entertainment market in the United States. Alliance manages a comprehensive and diverse product offering comprised of over 335,000 stock keeping units, including: CD's, cassettes, videos, DVD's, video games and related accessories and general merchandise items. Alliance's core competencies are merchandising, technology, information management, supply chain management and customer care services. Alliance utilizes advanced technology and its industry and marketplace expertise to deliver innovative and value-added services to manufacturers and customers and to provide it with additional revenue generating opportunities and increased profitability. Alliance's customers include national chain, specialty and independent retailers, alternative retailers, and e-commerce retailers. Alliance has more than 5,000 brick-and-mortar customers operating more than 25,000 store fronts. These customers include Barnes & Noble, Trans World Entertainment, Musicland, Circuit City, BJ's Wholesale, Toys 'R' Us, CVS and thousands of independent retailers. E-commerce customers include: barnesandnoble.com, CDNow.com, Amazon.com, CircuitCity.com, BestBuy.com, QVC.com, Costco.com and Univision.com.

Merger Integration

Overview

Upon completion of the merger, Eric Weisman, Alliance's President and Chief Executive Officer, will assume the same title and duties for the combined organization. In addition, the combined organization's board will be increased to nine members, six of whom will be designated by Alliance and three of whom will be designated by Liquid Audio.

The combined organization will evaluate the evolving digital media needs of its trading partners and will incorporate Liquid Audio's digital media technology and capabilities into Alliance's portfolio of business solutions. Alliance's existing physical entertainment distribution business will serve as a platform for continued revenue and cash flow growth.

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The combined organization expects to integrate the existing Liquid Audio technology into Alliance's portfolio of business solutions in a manner consistent with maintaining Alliance's stand-alone revenue and cash flow growth trajectory. The combined organization expects to immediately and significantly reduce its cost structure and continue to rationalize such cost structure over time. For instance, in addition to Liquid Audio's July 2002 workforce reduction of thirty-two employees, Liquid Audio intends to eliminate an additional thirty-four positions in September and October. The aggregate annualized direct cost savings of all such reductions is expected to be approximately \$7,660,000. These workforce reductions focus upon the areas of Liquid Audio's business that are not dedicated to the development of digital music distribution technology.

Combined Organization's Strengths

Consistent Growth and Improved Cash Flow

Alliance has historically experienced consistent growth and improved cash flows. Alliance generated net revenues of \$375.3 million, \$464.8 million and \$588.6 million for fiscal years ended December 31, 1999, 2000 and 2001, respectively, representing a compounded annual growth rate of 25.2%. Alliance generated EBITDA of \$12.8 million, \$14.0 million and \$18.7 million for fiscal years ended December 31, 1999, 2000 and 2001, respectively, representing a compounded annual growth rate of 21.1%. Revenues and EBITDA for the six months ended June 30, 2002 were \$353.2 million and \$5.6 million compared to the six months ended June 30, 2001 which were \$231.9 million and \$4.2 million. This represents an improvement of 52.3% and 34.0% in revenue and EBITDA, respectively.

Liquid Audio reported an EBITDA loss of (\$37.6) million in 2001. However, with various cost-cutting measures implemented in recent months, the EBITDA loss for the six months ended June 30, 2002 was (\$10.1) million compared to (\$26.0) million EBITDA loss for the six months ended June 30, 2001. The combined organization expects improved cash flow as a result of the financial growth. As discussed above, Liquid Audio continues to decrease costs in contemplation of the merger with Alliance. While no plan of integration has been fully developed, it is expected that overhead of the Liquid Audio business will continue to be reduced and that opportunities to leverage the Liquid Audio technology will be explored after the merger. While EBITDA is not intended to represent cash flow from operations as defined by GAAP, and should not be considered an indicator of operating performance or an alternative to cash flow as a measure of liquidity, it is included herein to provide additional information with respect to Alliance's ability to meet its future debt service, capital expenditure and working capital requirements.

Strong Market Position

In physical fulfillment, Alliance serves the needs of national retail chains, independent retailers, consumer direct fulfillment services and plug-in e-commerce engines for retail. In digital fulfillment, Liquid Audio provides secure music files and on-line retail integration. Liquid Audio believes that the combined organization would deliver the industry's only end-to-end distribution infrastructure that can transport all types of media in both physical and digital formats. By combining both of these commerce solutions, the combined organization expects to expand its customer base and revenue opportunity as the digital and physical delivery needs of its customers converge.

Strong Trading Relationships

Both companies serve essentially the same entertainment media constituency groups content owners and retailers. Alliance provides an array of commerce and fulfillment solutions to traditional retailers including: Barnes & Noble, Trans World Entertainment, Warehouse Entertainment, Circuit City, Toys 'R' Us, and CVS as well as emerging retail channels including barnesandnoble.com,

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CDNow.com, Amazon.com, and CircuitCity.com. Currently, more than 1,800 record labels and 17,000 artists use Liquid Audio's distribution solutions to deliver digital music.

Value-Added Services and Growth

Additional services and growth opportunities include: business to business logistics and supply chain management services, consumer direct fulfillment services, third party logistic services and vendor managed inventory services. The combined organization will provide trading partners the ability to outsource any part of their physical or digital entertainment distribution process.

Proposal

At the annual stockholder meeting, stockholders will consider and vote upon the election of two (2) Class III directors to hold office for three (3) years; the ratification of PricewaterhouseCoopers LLP as the combined organization's independent accountants for the fiscal year ending December 31, 2002; if properly presented at the annual meeting, proposals of a stockholder of Liquid Audio to amend Liquid Audio's bylaws to expand the size of the Board of Directors and to authorize only stockholders to fill newly created directorships and, contingent on approval of the preceding two proposals, to elect four (4) additional nominees to the board of directors; and the transaction of such other business as may properly come before the meeting or any adjournment thereof. Additionally, the stockholders of Liquid Audio will be asked to consider and vote upon a proposal to approve the issuance of Liquid Audio stock in the merger of April Acquisition Corp., a wholly-owned subsidiary of Liquid Audio, with and into Alliance Entertainment Corp. pursuant to an Amended and Restated Agreement and Plan of Merger dated as of July 14, 2002, by and among Liquid Audio, April Acquisition Corp. and Alliance.

The Merger and the Tender Offer (See pages 42 and 65)

Completion and Effectiveness of the Merger

At the completion of the merger, April Acquisition Corp. will be merged with and into Alliance, and Alliance will continue as the surviving corporation of the merger and a wholly-owned subsidiary of Liquid Audio. Upon completion of the merger, each outstanding share of Alliance common stock will be converted into the right to receive a number of shares of Liquid Audio stock which will result in the former stockholders of Alliance holding 74% of the outstanding voting power of the combined organization after the merger, without giving effect to any then outstanding options or warrants. After converting all outstanding Alliance options and warrants, the options and warrants that would be exercisable at \$2.40 or less (so-called "in the money" options and warrants) would result in pre-merger Liquid Audio stockholders being diluted in their ownership of the combined organization by 1.150%.

Liquid Audio and Alliance expect to complete the merger when all of the conditions to completion of the merger contained in the merger agreement have been satisfied or waived. Please see "Certain Terms of the Merger Agreement Conditions to the Completion of the Merger." The merger will become effective upon the filing of a certificate of merger with the Delaware Secretary of State under applicable Delaware law. Liquid Audio and Alliance are working toward satisfying the conditions to the merger, and hope to complete the merger as soon as practicable following the stockholders meeting.

Tender Offer

In connection with the merger, Liquid Audio will make an offer to purchase 10,000,000 shares of its common stock at a purchase price of \$3.00 per share. If more than 10 million shares of Liquid Audio common stock are tendered, Liquid Audio will purchase 10 million shares of its common stock on a pro rata basis from those stockholders tendering shares. If all Liquid Audio stockholders (other than the two management stockholders who have committed not to tender their holdings of 1,506,600

shares of Liquid Audio common stock unless the tender offer is undersubscribed) were to tender their shares in the tender offer, approximately 21,239,024 shares of Liquid Audio common stock will have been tendered and only 10 million shares will be accepted in the tender offer. In such case, each tendering stockholder would effectively receive a prorated cash amount of \$1.42 per share and would retain its ownership of shares of Liquid Audio common stock not accepted in the tender offer. The tender offer will expire twenty business days after the date it is commenced, unless extended by Liquid Audio. Consummation of the tender offer is conditioned upon, among other things, approval of the issuance of shares of Liquid Audio's stock in the merger by Liquid Audio stockholders at the annual stockholder meeting.

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Liquid Audio's Reasons for the Transaction (See page 49)

In determining that the merger, the tender offer and the issuance of Liquid Audio stock in the merger were in the best interests of Liquid Audio stockholders, the Liquid Audio board of directors considered a number of potential benefits of the transaction, including the following:

opportunities for Liquid Audio stockholders to elect to receive certain cash consideration for their shares of Liquid Audio common stock by participating in the tender offer, to continue to own shares in the combined organization to enjoy potential growth of the combined organization and to obtain greater liquidity in their shares of Liquid Audio stock;

potential synergies and cost reductions that could result from the combination of Liquid Audio and Alliance;

competitive advantages and additional business opportunities that may inure to Liquid Audio as a result of the combination of the complementary businesses of Liquid Audio and Alliance; and

opportunities for future growth and potential greater access by the combined organization to additional capital.

Risks Associated with Liquid Audio, Alliance and the Merger (See page 24)

The merger (including the possibility that the merger may not be completed) poses a number of risks to Liquid Audio and its stockholders. In addition, both Liquid Audio and Alliance are subject to various risks associated with their businesses and their industry. These risks are discussed in greater detail under the caption "Risk Factors" beginning on page 24. Liquid Audio encourages you to read and consider all of these risks carefully.

Recommendation of the Liquid Audio Board of Directors and Opinion of Financial Advisor (See page 53)

After careful consideration, the Liquid Audio board of directors has unanimously approved the merger agreement, the tender offer, the merger and the issuance of Liquid Audio stock in the merger and has determined that the merger agreement, the tender offer, the merger and the issuance of Liquid Audio stock in the merger are fair to, and in the best interests of, the stockholders of Liquid Audio. Therefore, the Liquid Audio board of directors unanimously recommends that Liquid Audio stockholders vote FOR approval of the issuance of Liquid Audio stock in the merger.

In deciding to approve the merger and the tender offer, the Liquid Audio board of directors considered the opinion of its financial advisor, Broadview International LLC, that, as of the date of its opinion, and subject to and based on the considerations reflected in its opinion, the aggregate consideration to be received and retained by the stockholders of Liquid Audio pursuant to the tender offer and the merger is fair to the stockholders of Liquid Audio from a financial point of view. The Broadview opinion addresses only the fairness from a financial point of view of the aggregate consideration payable in the merger and the tender offer assuming that the tender offer is fully

subscribed and does not separately address the fairness from a financial point of view of the consideration to be received in the merger and the consideration to be received in the tender offer or the fairness from a financial point of view of the aggregate consideration payable in the merger and the tender offer if the tender offer is not fully subscribed. The full text of the opinion is attached as Annex B to this proxy statement/prospectus. Liquid Audio urges its stockholders to read the opinion of Broadview in its entirety.

Interests of Directors and Executive Officers (See page 61)

In considering the recommendation of the Liquid Audio board of directors with respect to the merger and the issuance of Liquid Audio stock in the merger, Liquid Audio stockholders should be aware, however, that certain directors and executive officers of Liquid Audio may have interests in the merger that are different from, or are in addition to, the interests of Liquid Audio stockholders. Each of Gerald W. Kearby, Robert G. Flynn and Raymond A. Doig will remain as directors of Liquid Audio after the merger, subject to the reelection of Mr. Kearby and Mr. Doig as Class III directors pursuant to Proposal One. In addition, if the merger is consummated, Mr. Kearby will be appointed president, and Mr. Flynn will be appointed executive vice president, of the Digital Media Services Group of the combined organization.

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Mr. Kearby and Mr. Flynn have entered into employment agreements with Alliance that become effective upon the consummation of the merger. Pursuant to these agreements, each of Mr. Kearby and Mr. Flynn will have a three year term of employment, will be entitled to severance upon termination and may be eligible for discretionary bonuses. In addition, Mr. Kearby is entitled to receive an annual base salary of at least \$238,423 and Mr. Flynn is entitled to receive an annual base salary of at least \$187,646. The combined organization would be obligated to pay each of Messrs. Kearby and Flynn up to \$750,000, in the aggregate, as retention payments as well as up to \$750,000, in the aggregate, as compensation for their agreements not to compete.

In addition to the foregoing employment agreements, Liquid Audio has agreed to pay severance to each of Messrs. Rishniw, Wingate, Blanco and Bolcerek in the event that his employment with Liquid Audio is terminated without cause or he is constructively terminated. Liquid Audio has agreed to pay six months' salary for each of Messrs. Wingate, Blanco and Bolcerek, which amounts to \$115,000, \$87,500 and \$87,500, respectively. In the case of Leon Rishniw, Liquid Audio has agreed to pay \$170,000, which is one year's salary.

Mr. Bolcerek's employment agreement provides that 25% of the unvested options to purchase Liquid Audio stock held by Mr. Bolcerek will vest upon consummation of a change of control, as defined in the employment agreement, and an additional 12.5% of his unvested options to purchase Liquid Audio stock will vest in the event he is terminated or constructively terminated due to a change of control. Pursuant to the terms of such employment agreement, the merger will constitute a change of control that would result in an acceleration of the vesting of options to purchase an aggregate of 50,000 shares of Liquid Audio common stock at an exercise price of \$1.84 per share.

Please see "The Merger Interests of Liquid Audio Directors and Executive Officers" beginning on page 61 of this proxy statement/prospectus.

Restrictions on Solicitation of Alternative Transactions by Liquid Audio (See page 73)

Under the terms of the merger agreement, Liquid Audio may not solicit, initiate or, subject to limited exceptions, engage in discussions or negotiations with, or provide material inside information to, any third party regarding some types of extraordinary transactions involving another party, including a merger, business combination or sale of a material amount of assets or capital stock.

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Termination of the Merger Agreement and Payment of Certain Termination Fees (See page 79)

Liquid Audio and Alliance may terminate the merger agreement by mutual agreement and under certain other circumstances. Under specified circumstances, a termination fee will be payable by Liquid Audio to Alliance if the merger agreement is terminated. The amount of the termination fee will depend on the circumstances giving rise to the termination and may be up to \$3 million.

Federal Tax Consequences of the Merger (See page 88)

The merger is intended to constitute a tax-free reorganization for federal income tax purposes. Completion of the merger is conditioned upon the receipt of legal opinions from Liquid Audio's and Alliance's respective tax counsel that the merger will constitute a reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended.

Accounting Treatment of the Merger

Liquid Audio intends to account for the merger as a reverse acquisition using the purchase method of accounting under generally accepted accounting principles and the rules and regulations of the SEC. For accounting purposes, Alliance will be acquiring Liquid Audio.

Appraisal Rights

Stockholders of Liquid Audio are not entitled to appraisal rights under Delaware law.

Election of Directors

The Election of Two Class III Directors

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At the Liquid Audio stockholder meeting, stockholders will consider and vote upon the election of two (2) Class III directors to hold office for three (3) years. The Board has nominated Gerald W. Kearby and Raymond A. Doig to serve as Class III directors. However, a group of investors, led by musicmaker.com, Inc., has commenced a proxy solicitation to take control of your board of directors by nominating their own two (2) Class III directors, proposing to increase the size of the Liquid Audio board of directors from seven (7) to eleven (11), authorizing only stockholders to fill board of directors vacancies and newly created directorships and electing, contingent on their other proposals being approved, four (4) additional nominees to serve as directors.

Liquid Audio's Reasons for Electing the Nominees for Director of the Liquid Audio Board of Directors (See page 179)

In unanimously concluding that the nominees for director nominated by the Liquid Audio board of directors were in the best interests of Liquid Audio stockholders, the Liquid Audio board of directors determined that:

the collective experience of the nominees nominated by the Liquid Audio board of directors in the entertainment and technology industries makes them best suited to realize the strategic and financial worth of Liquid Audio's assets in order to maximize long-term stockholder value; and

the leadership of the nominees nominated by the Liquid Audio board of directors makes them the best candidates to carry on the plan to effectively reduce operating expenses and enhance stockholder value, as implemented by the current Liquid Audio board of directors, of which the nominees for director are a part.

Recommendation of the Liquid Audio Board of Directors

In addition, after careful consideration, the Liquid Audio board of directors strongly recommends that you support the nominees for director nominated by the Liquid Audio board of directors and

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reject any and all proposals made by the group of investors led by musicmaker.com, Inc. The Liquid Audio board of directors strongly urges you not to return any white proxy card sent to you by the musicmaker group.

General

Voting Power

As of the record date, 22,745,624 shares of Liquid Audio common stock were outstanding. Each record holder of shares of Liquid Audio common stock will be entitled to one vote at the stockholder meeting for each share of Liquid Audio common stock held on the record date.

Annual Stockholder Meeting and Record Date (See page 39)

The annual stockholder meeting of Liquid Audio stockholders will be held on September 26, 2002, at 10:00 a.m., local time, at the Hotel Sofitel, 223 Twin Dolphin Drive, Redwood City, California 94065.

August 12, 2002 has been fixed as the record date for determination of Liquid Audio stockholders entitled to notice of, and to vote at, the annual stockholder meeting of Liquid Audio stockholders and any adjournment or postponement thereof. As of the close of business on the record date for the annual stockholder meeting of Liquid Audio stockholders, there were 22,745,624 shares of Liquid Audio stock outstanding and entitled to vote, held by approximately 126 holders of record.

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COMPARATIVE PER SHARE DATA

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The information below presents certain unaudited historical per share data of Liquid Audio, equivalent per share data of Alliance and pro forma per share data of Liquid Audio and Alliance after giving effect to the merger using the purchase method of accounting and the purchase of 10,000,000 shares of Liquid Audio common stock upon consummation of the Liquid Audio tender offer. The information below assumes the issuance of approximately 36,276,007 shares of Liquid Audio stock (based on an assumed market price of \$2.40 per share of Liquid Audio common stock) for all shares of Alliance capital stock outstanding at the effective time of the merger. The actual number of shares of Liquid Audio to be exchanged for all of the outstanding Alliance capital stock will be determined at the effective time of the merger as set forth in the section "The Merger Agreement." The pro forma data is not indicative of the results of future operations or results that would have occurred had the merger been completed at the beginning of the periods presented.

The following tables should be read in conjunction with the unaudited pro forma combined financial statements of Liquid Audio, the historical consolidated financial statements and the related notes of Liquid Audio, and the historical consolidated financial statements and the related notes of Alliance, each of which are included elsewhere in this proxy statement/prospectus.

Per Share Data (in thousands, except per share data) Liquid Audio Per Share Data

	Year Ended December 31, 2001	Six Months Ended June 30, 2002
Historical Per Common Share Data:		
Income (loss) per share from continuing operations	\$ (1.64)	\$ (0.46)
Book value per share (1)	4.04	3.58

Alliance Per Share Data

	Year Ended December 31, 2001	Six Months Ended June 30, 2002
Historical Per Common Share Data:		
Income (loss) per share from continuing operations	\$ (.12)	\$ (.07)
Book value per share (1)	(.50)	(.57)

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Pro Forma Per Share Data

	Year Ended December 31, 2001	Six Months Ended June 30, 2002
Pro forma loss from continuing operations per share:		
Per combined share basic and diluted	\$ (0.61)	\$ (0.21)
Equivalent per Liquid Audio share basic and diluted (2)	(0.61)	(0.21)
		June 30, 2002
Pro forma book value per share:		
Per combined share basic (3)	\$ 1.76	
Equivalent per Liquid Audio share basic (2)		1.76

(1) The historical book value per share is calculated by dividing stockholders' equity by the number of common shares outstanding at the end of each period presented.

- (2) The number of shares of Liquid Audio stock owned by its stockholders prior to the merger will remain unchanged in the merger. Accordingly the Liquid Audio book value and loss per share in the combined organization is equivalent to the combined per share amount stated above.
- (3) The pro forma combined book value per share is computed by dividing pro forma stockholders' equity by the pro forma number of shares outstanding at the end of the period.

MARKET PRICE AND DIVIDEND INFORMATION

Liquid Audio Common Stock

Liquid Audio common stock has been traded on The Nasdaq National Market under the symbol "LQID" since July 1999. The following table sets forth, for the periods indicated, the high and low sales price per share of Liquid Audio common stock as reported by The Nasdaq National Market:

	<u>High</u>	<u>Low</u>
Fiscal year ending December 31, 2002		
Third Quarter (through August 30, 2002)	\$ 2.56	\$ 2.36
Second Quarter	\$ 2.60	\$ 2.27
First Quarter	\$ 2.47	\$ 2.23
Fiscal year ending December 31, 2001		
Fourth Quarter	\$ 2.72	\$ 2.10
Third Quarter	\$ 2.95	\$ 2.03
Second Quarter	\$ 2.95	\$ 1.81
First Quarter	\$ 3.88	\$ 2.00
Fiscal year ended December 31, 2000		
Fourth Quarter	\$ 6.00	\$ 2.16
Third Quarter	\$ 14.50	\$ 4.25
Second Quarter	\$ 19.00	\$ 6.69
First Quarter	\$ 34.06	\$ 13.25

Alliance Capital Stock

There is no established trading market for Alliance capital stock.

Recent Share Prices of Liquid Audio

The following table sets forth the per share closing price of Liquid Audio common stock on The Nasdaq National Market on June 12, 2002, the last completed trading day prior to the signing and announcement of the Agreement and Plan of Merger, and July 12, 2002, the last completed trading day prior to the signing and announcement of the Amended and Restated Agreement and Plan Merger, and on September 10, 2002 the last trading day prior to the mailing of this proxy statement/prospectus. Also set forth is the implied equivalent value of one share of Alliance common stock on each such date assuming an exchange ratio of 0.251536 shares of Liquid Audio common stock for each share of Alliance common stock and the conversion of all Alliance preferred stock into Alliance common stock. The exchange ratio will change depending on the number of outstanding shares of Alliance and Liquid Audio as of the effective time so as to result in Alliance stockholders owning 74% of the voting power and Liquid Audio stockholders owning 26% of the voting power after the merger.

<u>Liquid Audio stock</u>	<u>Approximate Alliance Equivalent</u>

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	Liquid Audio stock	Approximate Alliance Equivalent
June 12, 2002	\$ 2.56	\$ 0.64
July 12, 2002	\$ 2.40	\$ 0.60
September , 2002	\$	\$

The foregoing table shows only historical comparisons. These comparisons may not provide meaningful information to investors in determining whether to approve the issuance of Liquid Audio stock or any other matters requiring approval by Liquid Audio stockholders.

Stockholders

As of August 12, 2002, Liquid Audio estimates that there were 126 holders of record of Liquid Audio common stock.

Dividends

To date, neither Liquid Audio nor Alliance has ever declared or paid cash dividends on its capital stock.

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**LIQUID AUDIO SELECTED HISTORICAL
CONSOLIDATED FINANCIAL INFORMATION**

The following selected historical financial information should be read in conjunction with Liquid Audio's consolidated financial statements and the related notes thereto and the section entitled "Liquid Audio Management's Discussion and Analysis of Financial Condition and Results of Operations" in this proxy statement/prospectus. The information as of December 31, 1997, 1998 and 1999, has been derived from Liquid Audio's audited financial statements, which are not included herein. The information as of December 31, 2000 and 2001 and for the years ended December 31, 1999, 2000 and 2001, has been derived from Liquid Audio's audited financial statements provided elsewhere in this proxy statement/prospectus. The information as of June 30, 2001 and 2002 and for the six months then ended has been derived from Liquid Audio's unaudited financial statements provided elsewhere in this proxy statement/prospectus, and, in the opinion of the management of Liquid Audio, reflects all adjustments necessary for a fair statement of the financial condition at such date and the results of operations for such periods. Historical results are not necessarily indicative of the results to be obtained in the future.

	Fiscal Year Ended December 31,					Six Months Ended June 30,	
	1997	1998	1999	2000	2001	2001	2002
(in thousands, except per share data)							

Consolidated Statement of Operations Data:

Net revenues:

License	\$ 246	\$ 1,235	\$ 1,537	\$ 1,284	\$ 682	\$ 484	\$ 76
Services	10	268	733	2,977	1,173	787	210
Business development (related party)		1,300	2,137	7,307	2,873	1,414	
Total net revenues	256	2,803	4,407	11,568	4,728	2,685	286

Cost of net revenues:

License	302	235	290	491	159	287	181
Services	91	242	1,122	2,722	1,503	1,075	302
Business development (related party)		2	79	75			
Non-cash cost of revenues	15	36	25	28	349	181	69

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	Fiscal Year Ended December 31,					Six Months Ended June 30,	
	1997	1998	1999	2000	2001	2001	2002
Total cost of net revenues	408	590	1,461	3,115	2,343	1,543	552
Gross profit (loss)	(152)	2,213	2,946	8,453	2,385	1,142	(266)
Operating expenses:							
Research and development	1,880	4,109	11,706	22,917	16,957	9,961	5,937
Non-cash research and development	127	210	371	80		(17)	8
Sales and marketing	2,820	4,035	10,217	17,114	11,404	7,717	2,185
Non-cash sales and marketing	304	741	783	314	(43)	(63)	(21)
General and administrative	898	1,642	2,770	7,131	9,077	6,272	3,011
Non-cash general and administrative	88	254	190	13	(14)	(16)	
Strategic marketing equity instruments			3,130	1,935	607	652	
Restructuring					4,497	3,672	
Total operating expenses	6,117	10,991	29,167	49,504	42,485	28,178	11,120
Loss from operations	(6,269)	(8,778)	(26,221)	(41,051)	(40,100)	(27,036)	(11,386)
Interest income		379	2,271	8,809	4,321	2,852	751
Interest expense		(140)	(193)	(144)	(111)	(40)	(20)
Other income (expense), net	53		(63)	(429)	(40)	23	120
Loss in equity investment				(870)	(1,254)	(1,100)	
Net loss	\$ (6,216)	\$ (8,539)	\$ (24,206)	\$ (33,685)	\$ (37,184)	\$ (25,301)	\$ (10,535)
Basic and diluted net loss per share	\$ (4.95)	\$ (3.60)	\$ (2.28)	\$ (1.52)	\$ (1.64)	\$ (1.12)	\$ (0.46)
Weighted average shares used in per share calculation	1,256	2,371	10,616	22,133	22,614	22,563	22,723

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LIQUID AUDIO SELECTED HISTORICAL
CONSOLIDATED FINANCIAL INFORMATION (Continued)

	As of December 31,					As of June 30,	
	1997	1998	1999	2000	2001	2001	2002
(in thousands, except per share data)							
Consolidated Balance Sheet Data:							
Cash and cash equivalents	\$ 2,387	\$ 14,143	\$ 138,692	\$ 96,398	\$ 91,594	\$ 103,645	\$ 81,018
Short term investments		3,001	19,157	27,378			
Working capital	858	15,060	152,030	119,089	87,233	97,165	78,105
Total assets	3,275	19,913	166,109	138,210	97,415	111,835	85,141
Long term debt, less current portion	218	969	1,321	564		361	
Mandatorily redeemable convertible preferred stock	8,247	29,801					
Total stockholders' equity (deficit)	(6,879)	(14,133)	157,745	128,674	91,825	103,545	81,395

	Fiscal Year Ended December 31,					Six Months Ended June 30,	
	1997	1998	1999	2000	2001	2001	2002

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	Fiscal Year Ended December 31,					Six Months Ended June 30,								
	(in thousands)													
Other Financial Data														
EBITDA (1)	\$	(5,614)	\$	(7,086)	\$	(23,772)	\$	(38,505)	\$	(37,597)	\$	(26,044)	\$	(10,120)
Adjusted EBITDA (1)(2)		(5,614)		(7,086)		(23,772)		(38,505)		(33,100)		(22,372)		(10,120)

(1) EBITDA is defined as net income plus interest, taxes, depreciation and amortization. Liquid Audio believes that in addition to cash flows, EBITDA is a useful financial performance measurement for assessing its operating performance. Together with net income and cash flows, EBITDA provides investors with an additional basis to evaluate Liquid Audio's ability to incur and service debt and incur capital expenditures. To evaluate EBITDA and the trends it depicts, the components should be considered. The impact of interest, taxes, depreciation and amortization, each of which can significantly affect Liquid Audio's results of operations and should be considered in evaluating Liquid Audio's operating performance, cannot be determined from EBITDA. Further, EBITDA does not represent cash flows from operations as defined by generally accepted accounting principles ("GAAP") and does not necessarily indicate cash flows will be sufficient to fund cash needs. It should not be considered as an alternative to net income, as an indicator of Liquid Audio's operating performance or to cash flows as a measure of liquidity. In addition, it should be noted that not all companies that report EBITDA or adjustments to such measures may calculate EBITDA or such adjustments in the same manner as Liquid Audio does, and therefore, Liquid Audio's measure of EBITDA may not be comparable to similarly titled measures used by other companies.

(2) Adjusted EBITDA is defined as EBITDA plus restructuring expense.

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LIQUID AUDIO SUPPLEMENTAL FINANCIAL INFORMATION

The following supplemental financial information should be read in conjunction with Liquid Audio's consolidated financial statements and the related notes thereto and the section entitled "Liquid Audio Management's Discussion and Analysis of Financial Condition and the Results of Operations" in this proxy statement/prospectus. The information regarding the quarters within the fiscal years ended December 31, 2001 and 2000 and the fiscal quarters ended March 31, 2002 and June 30, 2002, respectively, has been derived from Liquid Audio's unaudited financial statements, which are not included herein, and, in the opinion of the management of Liquid Audio, reflects all adjustments necessary for a fair statement of the financial condition at such dates and the results of operations for such periods. Historical results are not necessarily indicative of the results to be obtained in the future.

Fiscal Year Ending December 31, 2000

	Three Months Ended			
	March 31	June 30	September 30	December 31
	(in thousands, except per share data)			
Net revenues	\$ 2,995	\$ 3,454	\$ 3,355	\$ 1,764
Gross profit	2,453	2,463	2,562	975
Net loss	(6,524)	(7,718)	(8,892)	(10,551)
Basic and diluted net loss per share	(0.30)	(0.35)	(0.40)	(0.47)
Weighted average shares used in per share calculation	21,918	22,013	22,304	22,429

Fiscal Year Ending December 31, 2001

	Three Months Ended			
	March 31	June 30	September 30	December 31

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Three Months Ended

(in thousands, except per share data)

Net revenues	\$ 1,661	\$ 1,024	\$ 1,275	\$ 768
Gross profit	708	434	926	317
Net loss	(11,267)	(14,034)	(6,060)	(5,823)
Basic and diluted net loss per share	(0.50)	(0.62)	(0.27)	(0.26)
Weighted average shares used in per share calculation	22,528	22,593	22,640	22,689

Fiscal Quarters Ending March 31 and June 30, 2002

Three Months Ended

March 31 June 30

(in thousands, except per share data)

Net revenues	\$ 135	\$ 151
Gross loss	(123)	(143)
Net loss	(4,893)	(5,642)
Basic and diluted net loss per share	(0.22)	(0.25)
Weighted average shares used in per share calculation	22,709	22,737

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ALLIANCE SELECTED HISTORICAL FINANCIAL INFORMATION

The following selected financial data of Alliance should be read in conjunction with Alliance's financial statements and the related notes thereto and the section entitled "Alliance Management's Discussion and Analysis of Financial Condition and Results of Operations" in this proxy statement/prospectus. Prior to August 1, 1998 Alliance and fourteen of its wholly-owned subsidiaries ("Predecessor") operated under the name Alliance Entertainment Corp. until the filing of a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code. Upon emergence from bankruptcy in August 1998, Alliance adopted fresh start reporting pursuant to the provisions of SOP 90-7 ("Successor"). In addition, the accumulated deficit through that date has been eliminated and the debt and capital structure has been recast in accordance with the plan of reorganization.

The Balance Sheet data as of December 31, 1997, 1998 and 1999 and Consolidated Statement of Operations data for the year ended December 31, 1997 and the five months ended December 31, 1998 has been derived from Alliance's audited financial statements, which are not included herein. The Consolidated Statement of Operations data for the seven months ended July 31, 1998 has been derived from Alliance's unaudited financial statements and is not included herein. The Balance Sheet data as of December 31, 2000 and 2001 and Consolidated Statement of Operation data for the year ended December 31, 1999, 2000 and 2001 has been derived from Alliance's audited financial statements, which are provided elsewhere in this proxy statement/prospectus.

The Balance Sheet data as of June 30, 2002 and December 31, 2001 and Consolidated Statement of Operations data for the six months ended June 30, 2002 and 2001 is included elsewhere in this proxy statement/prospectus and, in the opinion of the management of Alliance, reflects all adjustments necessary for a fair presentation of the financial condition at such date and the results of operations for such periods. Historical results are not necessarily indicative of the results to be obtained in the future.

Fiscal Year Ended December 31, 1997	Period from January 1, 1998 to July 31, 1998	Period from August 1, 1998 to December 31, 1998	(SUCESSOR)			Six Months Ended June 30,	
			Fiscal Year Ended December 31, 1999	2000	2001	2001	2002

(in thousands, except per share data)

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(PREDECESSOR)(1)

(SUCCESSOR)

Consolidated Statement of Operations Data:																
Net sales	\$	411,097	\$	181,678	\$	138,687	\$	375,345	\$	464,751	\$	588,604	\$	231,925	\$	353,178
Cost of goods sold		385,677		160,456		119,409		320,258		401,933		512,264		202,680		311,573
Gross profit		25,420		21,222		19,278		55,087		62,818		76,340		29,245		41,605
Operating expenses:																
Sales, general and administrative expense		112,569		35,728		16,036		45,605		55,968		64,294		29,274		39,970
Amortization of intangible assets		29,522		4,732		1,196		2,872		2,616		2,622		1,308		
Asset impairment charge		109,194		20,002												
Cost of unrealized acquisitions								1,016				600				
Total operating expenses		251,285		60,462		17,232		49,493		58,584		67,516		30,582		39,970
(Loss) income from operations		(225,865)		(39,240)		2,046		5,594		4,234		8,824		(1,337)		1,635
Reorganization items		(14,476)		372,903												
Other expense (income)		(1,970)		(206)		(110)		(5)				(600)				20
Interest, net		(29,121)		(11,935)		(1,443)		(4,940)		(7,022)		(4,978)		(2,761)		(1,465)

(1)

As a result of Alliance's reorganization in 1998, Alliance adopted fresh start accounting in accordance with SOP 90-7. Thus, the successor entity reflects a new reporting entity, which is not comparable to the predecessor. Included in the predecessor's results in 1998 is a benefit of \$380 million related to the discharge of indebtedness.

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ALLIANCE SELECTED HISTORICAL FINANCIAL INFORMATION (Continued)

(PREDECESSOR)

(SUCCESSOR)

	Fiscal Year Ended December 31, 1997	Period from January 1, 1998 to July 31, 1998	Period from August 1, 1998 to December 31, 1998	Fiscal Year Ended December 31,			Six Months Ended June 30,	
				1999	2000	2001	2001	2002
(in thousands, except per share data)								
Loss (income) before provision for taxes	(271,432)	321,522	493	649	(2,788)	3,246	(4,098)	190
(Benefit from) provision for income taxes	11,025		645	1,188		2,113	(2,421)	68
Net (loss) income	\$ (282,457)	\$ 321,522	\$ (152)	\$ (539)	\$ (2,788)	\$ 1,133	\$ (1,677)	\$ 122
(Loss) earnings per share data:								
Net (loss) income	\$ (282,457)	\$ 321,522	\$ (152)	\$ (539)	\$ (2,788)	\$ 1,133	\$ (1,677)	\$ 122
Less: preferred stock dividend	(3,723)			(1,843)	(7,457)	(9,476)	(4,289)	(5,213)
Loss/Earnings applicable to common stockholders	(286,180)	321,522	(152)	(2,382)	(10,245)	(8,343)	(5,966)	(5,091)

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(PREDECESSOR) (SUCCESSOR)

	(PREDECESSOR)		(SUCCESSOR)					
Basic EPS weighted average shares	44,940	44,940	12,915	32,778	70,125	71,739	71,739	71,739
Diluted effect: stock options & warrants								
Diluted EPS weighted average shares	44,940	44,940	12,915	32,778	70,125	71,739	71,739	71,739
Basic (loss) earnings per share	\$ (6.37)	\$ 7.15	\$ 0.01	\$ (0.07)	\$ (0.15)	\$ (0.12)	\$ (0.08)	\$ (0.07)
Diluted (loss) earnings per share	\$ (6.37)	\$ 7.15	\$ 0.01	\$ (0.07)	\$ (0.15)	\$ (0.12)	\$ (0.08)	\$ (0.07)

(in thousands)

As of December 31,		As of June 30,
2000	2001	2002
		(unaudited)

Consolidated Balance Sheet Data:

Cash and cash equivalents	\$ 7,890	\$ 2,845	\$ 13,560
Working capital	1,660	(4,251)	(1,363)
Total assets	255,529	298,691	280,509
Long-term debt	5,532	4,521	9,085
Redeemable preferred stock	70,267	91,547	96,760
Stockholders' deficit	(17,001)	(36,029)	(41,120)

Period from August 1, 1998 to December 31, 1998	Fiscal Year Ended December 31,			Six Months Ended June 30,	
	1999	2000	2001	2001	2002
	(in thousands)				

Other Financial Data

EBITDA (1)	\$ 4,883	\$ 12,774	\$ 14,010	\$ 18,727	\$ 4,157	\$ 5,590
Adjusted EBITDA (1)(2)	\$ 4,993	\$ 13,795	\$ 14,010	\$ 19,927	\$ 4,157	\$ 5,570

(1) EBITDA is defined as net income plus interest, taxes, depreciation and amortization. Alliance believes that EBITDA is a widely accepted financial indicator of an entity's ability to incur and service debt. While EBITDA is not intended to represent cash flow from operations as defined by GAAP, and should not be considered an indicator of operating performance or an alternative to net income or to cash flow as a measure of liquidity, it is included herein to provide additional information with respect to Alliance's ability to meet its future debt service, capital expenditure and working capital requirements. Interest, taxes, depreciation and amortization can each by itself or all collectively impact Alliance's results of operations, and should be considered in evaluating Alliance's financial performance. It should also be noted that not all definitions of EBITDA are the same. For additional disclosures relating to cash flow and other financial performance metrics, please see "Alliance Management's Discussion and Analysis of Financial Condition and Results of Operations."

(2) Adjusted EBITDA is defined as net income plus interest, taxes, depreciation, amortization, other expenses and non-recurring expenses.

ALLIANCE SUPPLEMENTAL FINANCIAL INFORMATION

The following supplemental financial information should be read in conjunction with the consolidated financial statements of the Distribution and Fulfillment Services Group of Alliance Entertainment Corp. and the related notes thereto and the section entitled "Alliance Management's Discussion and Analysis of Financial Condition and the Results of Operations" in this proxy statement/prospectus. The information regarding the quarters within the fiscal years ended December 31, 2000 and 2001 and the fiscal quarters ended March 31 and June 30, 2002 have been derived from Alliance's unaudited financial statements and, in the opinion of the management of Alliance, reflects all adjustments necessary for a fair statement of the financial results of operations for such periods. Historical results are not necessarily indicative of the results to be obtained in the future.

Fiscal Year Ending December 31, 2000 (unaudited)

	Three Months Ended			
	March 31	June 30	September 30	December 31
	(in thousands except per share data)			
Net sales	\$ 107,845	\$ 99,686	\$ 101,574	\$ 155,646
Gross profit	13,350	13,552	14,001	21,915
Operating (loss) income.	(2,013)	(256)	(457)	6,960
Net (loss) income	(3,470)	(2,228)	(2,183)	5,093
Basic and diluted net (loss) income per share	\$ (0.08)	\$ (0.06)	\$ (0.06)	\$ 0.05

Fiscal Year Ending December 31, 2001 (unaudited)

	Three Months Ended			
	March 31	June 30	September 30	December 31
	(in thousands except per share data)			
Net sales	\$ 113,263	\$ 118,662	\$ 124,324	\$ 232,355
Gross profit	13,843	15,402	16,644	30,451
Operating (loss) income.	(2,116)	779	1,019	9,142
Net (loss) income	(1,267)	(410)	(292)	3,102
Basic and diluted net (loss) income per share	\$ (0.05)	\$ (0.04)	\$ (0.04)	\$ 0.01

Fiscal Quarters Ending March 31 and June 30, 2002 (unaudited)

	Three Months Ended	
	March 31	June 30
	(in thousands except per share data)	
Net sales	\$ 169,124	\$ 184,054
Gross profit	18,924	22,681
Operating loss	(274)	1,909
Net (loss) income	(555)	677
Basic and diluted net loss per share	\$ (0.04)	\$ (0.03)

RISK FACTORS

By voting in favor of the issuance of stock to Alliance stockholders in the merger, Liquid Audio stockholders will be choosing to become equityholders in the surviving organization to the extent their shares are not purchased in the tender offer, which could expose the stockholders to a high degree of risk. In addition to the other information contained in this proxy statement/prospectus, you should carefully consider the following risk factors in deciding whether to vote for the issuance of stock to Alliance stockholders in the merger. If any of the following risks actually occur, the business and prospects of Alliance, Liquid Audio or the surviving organization may be seriously harmed. In such case, the trading price of Liquid Audio stock would decline, and you may lose all or part of your investment.

Risks Related to the Merger and the Combined Organization

The tender offer and the merger will require substantial expenditures, which may adversely affect the results of operations of the combined organization or, if the merger is not completed, each of Liquid Audio and Alliance.

Liquid Audio and Alliance estimate that they will incur aggregate pre-tax costs of approximately \$6.6 million associated with the merger, in addition to the \$30 million that will be paid upon completion of the tender offer, assuming that 10 million shares of Liquid Audio common stock are tendered. In addition, the combined organization expects to incur certain costs in connection with the integration of the two companies. Such costs cannot now be reasonably estimated, because they depend on future decisions to be made by management of the combined organization, but they could be material. These costs and expenses will affect results of operations in the quarter in which the merger is completed. Even if the merger is not completed, Alliance and Liquid Audio will each incur their respective portions of these total costs and expenses, other than the cost of paying the consideration for shares of Liquid Audio common stock tendered in the tender offer. Additionally, if the merger is terminated, Liquid Audio will incur termination fees under certain conditions. See "Certain Terms of the Merger Agreement Expenses and Termination Fees."

Because the lack of a public market for the Alliance capital stock makes it difficult to evaluate the fairness of the merger, the stockholders of either Liquid Audio or Alliance may receive below fair market value consideration in the merger.

The capital stock of Alliance is privately held and is not traded in any public market. The lack of a public market makes it extremely difficult to determine the fair market value of Alliance's capital stock. Since the percentage of Liquid Audio equity to be received by Alliance stockholders was determined based on negotiations between the parties, it is possible that either the Liquid Audio or the Alliance stockholders will receive consideration in the merger that is below the fair market value of the common stock they currently hold.

The termination fee and other restrictions in the merger agreement may discourage other companies from trying to acquire Liquid Audio.

Until the completion of the merger, with limited exceptions, Liquid Audio is prohibited from initiating or engaging in discussions with a third party regarding specified types of extraordinary transactions, such as a merger, business combination or sale of a material amount of assets or capital stock. In addition, Liquid Audio agreed to pay a termination fee to Alliance in specific circumstances. These provisions of the merger agreement could discourage other companies from trying to acquire Liquid Audio even though those other companies might be willing to offer greater value to Liquid Audio stockholders than Alliance has offered in the merger agreement.

Some of Liquid Audio's officers and directors have conflicts of interest that may influence their decision to support or approve the merger.

Gerald W. Kearby, president, chief executive officer and director of Liquid Audio, and Robert G. Flynn, senior vice president of business development, secretary and director of Liquid Audio, have interests in the merger that are different from your interests. In connection with the execution of the original merger agreement in June 2002, Messrs. Kearby and Flynn each entered into employment agreements with Alliance. These agreements will become effective upon the consummation of the merger. Pursuant to these agreements, each of Mr. Kearby and Mr. Flynn will have a three (3) year term of employment. In addition, each of Mr. Kearby and Mr. Flynn will receive a retention payment of \$750,000, in the aggregate, to be paid over a two (2) year period and a payment of \$750,000, in the aggregate, to be paid over a three (3) year period as compensation for an agreement not to compete. Each of Mr. Kearby and Mr. Flynn may also be eligible for discretionary bonuses granted by the combined organization's board of directors or by its compensation committee.

Other officers of Liquid Audio also may have conflicts of interest that may influence them to support or approve the merger. In addition to the foregoing employment agreements, Liquid Audio has agreed to pay severance to each of Messrs. Rishniw, Wingate, Blanco and Bolcerek in the event that his employment with Liquid Audio is terminated without cause or he is constructively terminated. Liquid Audio has agreed to pay six months' salary for each of Messrs. Wingate, Blanco and Bolcerek, which amounts \$115,000, \$87,500 and \$87,500, respectively. In the case of Leon Rishniw, Liquid Audio has agreed to pay \$170,000, which is one year's salary.

Mr. Bolcerek's employment agreement provides that 25% of the unvested options to purchase Liquid Audio stock held by Mr. Bolcerek will vest upon consummation of a change of control, as defined in the employment agreement, and an additional 12.5% of his unvested options to purchase Liquid Audio Stock will vest in the event he is terminated or constructively terminated due to a change of control. Pursuant to the terms of such employment agreement, the merger will constitute a change of control that would result in an acceleration of the vesting of options to purchase an aggregate of 50,000 shares of Liquid Audio common stock at an exercise price of \$1.84 per share. See "Management Employment Contracts and Change-in-Control Arrangements Post-Merger."

For the foregoing reasons, some of the officers and directors of Liquid Audio could be more likely to vote to approve the merger than if they did not have these interests. You should consider whether these interests may have influenced these officers and directors to vote in favor of the merger and related transactions and to recommend that Liquid Audio stockholders vote in favor of the merger and related transactions.

The combined organization's management and internal systems might be inadequate to handle its potential growth.

To manage future growth and existing resources, management of the combined organization must continue to improve operational and financial systems and expand, train, retain and manage its employee base. The combined organization's management may not be able to manage the combined organization's growth effectively. If the combined organization's systems, procedures and controls are inadequate to support its operations, its expansion could be halted and it could lose opportunities to gain significant market share. Any inability to manage growth effectively may harm the combined organization's business.

Liquid Audio may not meet the requirements for initial listing on The Nasdaq National Market upon completion of the merger which may adversely impact Liquid Audio's stock price, its general business reputation, its ability to raise additional funds and your ability to purchase and sell Liquid Audio's shares in an orderly manner.

The Nasdaq staff has determined that the proposed merger would constitute a "reverse merger" under National Association of Securities Dealers Rule 4330(f). Following the announcement of the merger in June 2002, Liquid Audio received correspondence from the Nasdaq staff indicating that the staff believed that the merger might result in a change of control that would require Liquid Audio to submit an initial listing application following the consummation of the merger and, at the time of the application, meet all of the criteria applicable to a company initially requesting inclusion in The Nasdaq National Market. On August 15, 2002, Liquid Audio received correspondence from the Nasdaq staff stating that the staff had determined that the merger would indeed result in a change of control requiring Liquid Audio to satisfy the requirements for initial inclusion on The Nasdaq National Market and that Liquid Audio does not satisfy the minimum bid requirements of the initial listing criteria. Liquid Audio has appealed the determination of the Staff and at the hearing for such appeal intends to present a plan pursuant to which a reverse split of the Liquid Audio common stock would be effected following the merger in order to meet the minimum bid price requirement and satisfy the criteria for initial inclusion on the Nasdaq National Market. If the Nasdaq appeal board does not accept such a proposal or otherwise denies Liquid Audio's appeal and Liquid Audio does not meet these requirements upon completion of the merger, Liquid Audio common stock will be delisted from The Nasdaq National Market following the completion of the merger. If Liquid Audio is delisted from The Nasdaq National Market System, it may be allowed to transfer its securities from The Nasdaq National Market to The Nasdaq SmallCap Market.

Any of the foregoing may adversely impact Liquid Audio's stock price, as well as its liquidity and the ability of Liquid Audio's stockholders to purchase and sell Liquid Audio's shares in an orderly manner, or at all. Furthermore, a delisting of Liquid Audio's shares could damage Liquid Audio's general business reputation and impair its ability to raise additional funds. Any of the foregoing events could have a material adverse effect on Liquid Audio's business, financial condition and operating results.

Liquid Audio and Alliance may not be able to obtain the required regulatory approvals for completion of the merger and the tender offer.

As a condition to Liquid Audio's and Alliance's obligation to complete the merger, expiration or early termination of the thirty day waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 must have occurred. Liquid Audio and Alliance will make the initial notification and report filing with the Department of Justice and the Federal Trade Commission. There can be no assurance that these consents

and approvals will be obtained without the FTC or DOJ raising any substantive concerns about possible anti-competitive effects of the proposed transaction.

Also, Liquid Audio must request an exemption from the SEC from the requirements of Rule 102 of Regulation M in connection with the tender offer and the merger. Liquid Audio submitted a no-action request to the SEC seeking an exemption from these Rule 102 requirements. If the SEC does not grant this exemption or Liquid Audio does not receive an opinion from its counsel that it may proceed with the tender offer, both Liquid Audio and Alliance are entitled to terminate the merger agreement and Liquid Audio will be obligated to pay a break-up fee of at least \$1 million. There can be no assurance that the SEC will grant the exemption.

Liquid Audio stockholders may not realize a benefit from the merger commensurate with the ownership dilution they will experience in connection with the merger.

If the combined organization is unable to realize the strategic and financial benefits currently anticipated from the merger, Liquid Audio stockholders will have experienced substantial dilution of their ownership interest without receiving any commensurate benefit. In connection with the merger, Liquid Audio will issue shares of its stock representing 74% of its voting power following the merger. In addition, the exercise of options assumed by Liquid Audio in the merger will further dilute the ownership interests of current Liquid Audio stockholders. After converting all outstanding Alliance options and warrants, the options and warrants that would be exercisable at \$2.40 or less (so-called "in the money" options and warrants) would result in pre-merger Liquid Audio stockholders being diluted in their ownership of the combined organization by 1.150%.

The combined organization does not have a fully developed integration plan and may have difficulty integrating the management, operations and personnel of the two companies and, as a result, may not realize the expected benefits from the merger.

Liquid Audio and Alliance believe that the merger of Alliance and Liquid Audio will result in benefits to the combined organization that outweigh the costs and expenses related to the merger and will increase stockholder value. Achieving these benefits, however, will depend on a number of factors, including:

- effectively and efficiently integrating the operations, information systems and personnel of the two companies to achieve operating efficiencies;
- beneficially exploiting the increased complexity and diversity of operations of the combined organization;
- retaining key management, marketing, sales and technical personnel;
- averting the potential diversion of management's attention from other business concerns to the combination of the companies;
- retaining key customers;
- increasing the combined organization's customer base and product sales;
- keeping step with industry trends and technological advances;
- adjusting to changing market conditions;
- successfully pursuing anticipated revenue opportunities in emerging channels of distribution; and
- effectively addressing unanticipated problems or legal liabilities.

In anticipation of the merger, Liquid Audio made a workforce reduction in July of 2002 of thirty-two employees and several independent contractors. This reduction focused on those employees and contractors of Liquid Audio that are not dedicated to developing the technology which enables the digital distribution of music. Furthermore, in connection with its pre-merger rationalization of expenses, Liquid Audio intends to make additional workforce reductions in this same area totaling twenty-two employees in September and twelve employees in October of 2002. The expected annualized aggregate direct cost savings of these workforce reductions will be approximately \$7,660,000. Additionally, Liquid Audio and Alliance believe that the merger will result in business synergies that will create additional revenue and cost savings

opportunities. Nevertheless, they have not fully developed a plan of integration and cannot be sure of the amount, if any, of such additional revenue opportunities or cost savings. In addition, integrating the two companies may require substantial changes to the way their business is conducted and there can be no assurance that any such changes to the way that the

combined organization conducts its business will successfully achieve the cost savings and revenue opportunities that Liquid Audio and Alliance believe could result from the merger.

In addition, successful integration of the operations of Liquid Audio and Alliance may place a significant burden on the management and internal resources of the combined organization. The diversion of management's attention and any difficulties encountered in the transition and integration process could have a material adverse effect on the future business, financial condition and operating results of the combined organization.

Liquid Audio has never been profitable and Alliance has recently incurred net losses. You cannot be sure that the combined organization will achieve profitability.

In each of the years Liquid Audio has been in business it has experienced net losses. Liquid Audio's net losses were \$24,206,000, \$33,685,000 and \$37,184,000, respectively for years ended December 31, 1999, 2000 and 2001. Alliance had net income of \$677,000 for the six months ended June 30, 2002. Alliance experienced a net loss of \$555,000 for the quarter ended March 31, 2002. It is expected that the Liquid Audio business will continue to incur net losses for the remainder of the 2002 fiscal year. There can be no assurance that the Liquid Audio business or the combined organization will achieve profitability. See "Liquid Audio Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Alliance Management's Discussion and Analysis of Financial Condition and Results of Operations."

The combined organization will be leveraged and limited in its ability to incur additional debt, which may adversely affect its ability to compete in the marketplace.

Liquid Audio and Alliance currently anticipate that the available cash resources and available financing will be sufficient to meet the anticipated working capital and capital expenditure requirements of the combined organization for the foreseeable future. However, the combined organization may need to raise additional funds through public or private debt or equity financing in order to:

- take advantage of opportunities, including acquisitions of complementary businesses or technologies;
- develop new products or services;
- respond to competitive pressures; and/or
- finance the purchase of inventory in peak seasons.

Alliance has a revolving, asset-based credit facility that is secured by substantially all of the assets of several of its key operating subsidiaries. Borrowings under this facility fluctuate due to the seasonality of Alliance's business. The range of outstanding borrowings for the twelve-month period ending June 30, 2002 varied from a low of \$10.9 million to a high of \$65.2 million with an average outstanding borrowing of \$43.3 million. As of June 30, 2002, borrowings of approximately \$24.6 million were outstanding under the credit facility. The credit facility will remain in place following the merger and will be used for general working capital purposes of the Distribution and Fulfillment Services Group. The credit facility expires in August of 2003. If Alliance is unable to renew the credit facility or secure other similar financing then there could be a material adverse effect on Alliance's business.

As a result of this leverage:

- the combined organization will incur significant interest expense and principal repayment obligations;
- the combined organization's ability to obtain additional financing in the future may be limited; and

the combined organization's ability to compete through expansion, capital improvements and flexibility in response to changing industry conditions may be limited.

The credit facility contains numerous restrictive covenants, including provisions that will limit the ability of Alliance to acquire or invest in other businesses and require Alliance to comply with certain financial covenants. If Alliance fails to comply with the terms of the credit facility or other agreements related to the credit facility, or fails to obtain waivers from such obligations, an event of default under the credit facility or related agreements could be triggered. An event of default could permit acceleration of indebtedness under the credit facility or related agreements that contain cross-acceleration or cross-default provisions.

If the combined organization is unable to attract, motivate and retain high quality management, its business may be harmed.

The future success of the combined organization will depend to a significant extent on the continued service of certain key technical, sales and senior management personnel and their ability to execute the combined organization's growth strategy, some of whom do not have employment agreements. The loss of the services of any member of senior management, or other key employee, could harm the business of the combined organization. Future performance of the combined organization will also depend, in part, on the ability of the executive officers to work together effectively. The executive officers of the combined organization may not be successful in carrying out their duties or running the company. Any dissent among executive officers could impair the combined organization's ability to make strategic decisions quickly in a rapidly changing market.

In addition, the combined organization's success depends in part upon its ability to attract, motivate and retain high quality management. While the combined organization's management brings experience and vision to the business, the growth of the combined organization will depend upon its success attracting additional high quality management. If the combined organization is unable to retain and motivate existing management or to attract additional high quality management, its results of operations may suffer.

The combined organization will have a significant stockholder whose interests may conflict with yours.

Upon completion of the merger, the combined organization's largest stockholder, AEC Associates, LLC, will beneficially own approximately 57% of the combined organization's outstanding voting power. As a result, this stockholder will be able to exercise effective control over all matters requiring stockholder approval.

The combined organization may face intellectual property infringement claims that may be costly to resolve.

Because the combined organization will digitally deliver recorded music and video and other music products to third parties, the combined organization might be subject to litigation based on claims of negligence, copyright, trademark infringement, patent infringement or other intellectual property rights. In the past, these types of claims have been brought, sometimes successfully, against competitors of the combined organization and, in particular, providers of online products and services. Others could also sue the combined organization for the content that is accessible from the combined organization's website through links to other websites. These claims might include, among others, claims that by hosting, directly or indirectly, the websites of third parties, the combined organization is liable for copyright or trademark infringement or other wrongful actions by these third parties through these websites. With respect to distribution of video and music product generally, substantially all such products sold are subject to copyright laws and licenses that limit the manner and geographic area in which these products may be sold and provide royalties to the copyright owners. Any sales of these

products in violation of these laws and licenses by anyone in the chain of distribution, including suppliers of the combined organization, may subject the combined organization to monetary damages and confiscation of the products. The combined organization's insurance may not adequately protect it against these types of claims and, even if these claims do not result in liability, the combined organization could incur significant costs and diversion of management resources in investigating and defending against these claims, which could harm its business.

In addition, Liquid Audio has been sued by Network Commerce, Inc. ("NCI") and Sightsound, Inc. ("Sightsound"). Each of NCI and Sightsound allege that Liquid Audio has infringed one or more patents held by NCI and Sightsound, respectively. Liquid Audio cannot estimate the total potential liability to which it and the combined organization might be exposed as a result of either of these lawsuits. Liquid Audio believes that its business, and that of the combined organization, could be materially adversely affected by an adverse judgment in, or upon

settlement of, either or both of these lawsuits.

In addition, Muze, Inc. sued Alliance in December 1999, alleging that Alliance's marketing of the AMG business violates California's unfair business practice statutes and federal antitrust law and seeking unspecified monetary damages and injunctive relief. Alliance cannot estimate the total potential liability to which it and the combined organization might be exposed as a result of these suits. Alliance believes that if these suits result in a judgment against Alliance, its business and results of operations, and that of the combined organization, could be materially adversely affected.

Liquid Audio and Alliance face potential liability as defendants in a lawsuit challenging the merger.

On July 23, 2002, MM Companies, Inc. (formerly musicmaker.com, Inc.), a shareholder of Liquid Audio, filed an action against Liquid Audio, the members of its board of directors and Alliance to enjoin the merger. The lawsuit was filed in the Delaware Chancery court. MM Companies, Inc. has alleged that Liquid Audio and its directors breached their fiduciary duties to the shareholders in connection with the proposed merger and that Alliance aided and abetted such breaches. Liquid Audio, its directors and Alliance have denied these allegations and have stated that they will defend the lawsuit vigorously. However, should the plaintiffs be successful in this action, the merger could be enjoined.

In connection with the action, MM Companies, Inc. filed a motion for a preliminary injunction and a motion for expedited proceedings. On July 31, 2002, MM Companies, Inc. withdrew its motion for a preliminary injunction and for expedited proceedings, and stated that it would file an amended complaint. To date, no amended complaint has been filed.

On August 26, 2002, MM Companies, Inc. filed an additional action in Delaware Chancery court alleging that an action taken by Liquid Audio's board of directors to increase the size of the board violated their fiduciary duties. The court has set a trial date for October 21, 2002.

Fluctuations in the combined organization's quarterly revenues and operating results might lead to reduced prices for the combined organization's stock.

The quarterly results of operations of the combined organization may be impacted by fluctuations in results of operations of the combined organization and seasonality that Alliance's business has historically experienced, and will likely experience in the future, as a result of seasonal shopping patterns. Historically Alliance's results of operations have depended significantly on fourth quarter performance. For instance, in the respective years of 2001, 2000 and 1999, 38.86%, 32.76% and 36.42% of Alliance's gross sales were generated in the fourth quarter, while 39.89%, 34.89% and 37.77% of Alliance's respective annual gross profit was generated in the fourth quarter.

Provisions in the combined organization's charter documents and Delaware law could prevent or delay a change in control of the combined organization, which could reduce the market price of its common stock.

The combined organization will retain Liquid Audio's charter documents, which contain provisions that may have the effect of delaying or preventing a change of control or changes in the combined organization's management, including a third-party takeover, acquisition or merger. These provisions could limit the price that investors might be willing to pay in the future for shares of the combined organization's common stock.

The extremely competitive nature of the businesses of the full-line distribution of music and video and digital delivery of music may prevent the combined organization from successfully establishing itself in the market.

The full-line distribution of music and video is an intensely competitive business. Existing competitors of Alliance include Baker & Taylor and Ingram Entertainment, in addition to the distribution arms of several of the major labels. Alliance also faces competition from music category management and distribution companies, including Handleman Corp. Several of Alliance's retail chain customers have elected to buy a substantial volume of their inventory directly from the major labels and studios rather than from Alliance. For instance, in 2000, BJ'S Wholesale Club decided to purchase home entertainment products directly from BMG. To the extent other customers increase their direct purchases from the major labels and studios or the independent distribution companies, Alliance's financial results could be adversely affected.

Competition among companies in the business of digital delivery of music over the Internet is also intense. Liquid Audio expects that present competitors will increase competitive pressure in the market for digital delivery of music. Competition is likely to increase further as new companies enter the market and current competitors expand their products and services or merge with other competitors. Many of these potential competitors are likely to enjoy substantial competitive advantages, including the following:

larger audiences;

larger technical, production and editorial staffs;

greater brand recognition;

access to more recorded music content;

a more established Internet presence;

a larger advertiser base; and

substantially greater financial, marketing, technical and other resources.

If the combined organization does not compete effectively or if it experiences pricing pressures, reduced margins or loss of market share resulting from increased competition, its business and operating results would be harmed.

If the combined organization fails to develop and introduce new products and services, it may be unable to effectively compete in the market.

The success of the combined organization depends in part on its ability to develop new or enhanced products and services, such as Liquid Audio's subscription-based service offering, in a timely manner and bring to market services that achieve rapid and broad market acceptance. The combined organization may fail to identify and bring to market new product and service opportunities in a timely

manner. In addition, product innovations may not achieve the market penetration or price stability necessary for profitability.

As the online medium continues to evolve, the combined organization may plan to leverage its technology by introducing complementary products and services as additional sources of revenue. Accordingly, the combined organization may enter into new lines of business or adapt existing lines of business to take advantage of new business opportunities, including business areas in which Liquid Audio does not have extensive experience. If the combined organization fails to develop these or other businesses successfully, its business could be harmed.

The business and results of operations of the combined organization could be adversely affected if it is required to make substantial payments in connection with pending litigation.

Both Liquid Audio and Alliance are defendants in various cases. The combined organization will be liable for costs and expenses arising in connection with these cases. See "Liquid Audio's Business Legal Proceedings" and "Alliance's Business Legal Proceedings."

Risks Related to Liquid Audio that Could Adversely Affect the Combined Organization

In addition to certain risks described above that affect each of Alliance, Liquid Audio and the combined organization, Liquid Audio is subject to the following risks that could adversely affect the combined organization.

Liquid Audio depends on proprietary rights to develop and protect its technology, which Liquid Audio may not be able to develop or protect.

Liquid Audio's success and ability to compete substantially depends on its internally developed technologies and trademarks, which it protects through a combination of patent, copyright, trade secret and trademark laws. Liquid Audio holds sixteen existing patents and currently has ten patents pending in the United States and eight patents pending in other countries. Its patents expire between October 2015 and

October 2018. Liquid Audio has had claims allowed on five of Liquid Audio's patent applications. Liquid Audio is presently pursuing the registration of its trademarks. Liquid Audio's patent applications or trademark registrations in the United States may not be approved. Even if they are approved, Liquid Audio's patents or trademarks may be successfully challenged by others or invalidated. If its trademark registrations in the United States are not approved because third parties own these trademarks, Liquid Audio's use of these trademarks would be restricted unless Liquid Audio enters into arrangements with the third-party owners, which might not be possible on commercially reasonable terms or at all.

The primary forms of intellectual property protection available for Liquid Audio's products and services internationally are patents and copyrights. Patent protection throughout the world is generally established on a country-by-country basis. To date, Liquid Audio has applied for eight patents outside the United States. Copyrights throughout the world are protected by several international treaties. Despite these international laws, the level of practical protection for intellectual property varies among countries and United States government officials have criticized countries such as China and Brazil, two countries in which Liquid Audio does business, for inadequate intellectual property protection. If Liquid Audio's intellectual property is infringed in any country in which it does business without a high level of intellectual property protection, Liquid Audio's business and operating results could be harmed.

If devices that play digitally downloaded music are not developed or do not achieve mass customer acceptance, Liquid Audio may not be able to grow its business.

The market for digitally recorded music delivered over the Internet is relatively new and may not achieve mass customer acceptance. Several consumer electronics companies have introduced devices

that allow digital music delivered over the Internet to be played away from the personal computer. However, if additional devices such as wireless broadband devices and in-home connected set-top boxes are not developed or do not achieve mass customer acceptance or Liquid Audio's products and services are incompatible with these devices, the business may not grow or could be otherwise harmed.

If Liquid Audio's platform does not provide sufficient rights reporting information, record companies and artists are unlikely to digitally deliver their recorded music using Liquid Audio's platform.

Record companies and artists must be able to track the number of times their recorded music is downloaded so that they can make appropriate payments to music rights organizations, such as the American Society of Composers, Authors and Publishers, Broadcast Music Incorporated and SESAC, Inc. If Liquid Audio's products and services do not accurately or completely provide this rights reporting information, record companies and artists might not use its platform to digitally deliver their recorded music, and Liquid Audio's business might be harmed.

Liquid Audio might not have sufficient content to attract consumers if artists and record labels are not satisfied that they can profitably digitally deliver their music over the Internet or if record labels enter into license agreements with Liquid Audio's competitors.

Liquid Audio's success depends on its ability to aggregate a sufficient amount and variety of digitally recorded music for syndication. Liquid Audio currently does not create its own content; rather, it relies on record companies and artists for digitally recorded music to be syndicated using Liquid Audio's distribution platform. Liquid Audio believes record companies will remain reluctant to distribute their recorded music digitally unless they are satisfied that the digital delivery of their music over the Internet will result in overall profitability. If record companies believe that recorded music cannot be profitably delivered over the Internet or that such delivery will cannibalize sales through other channels, they may not allow the digital distribution of their recorded music and Liquid Audio might not have sufficient content to attract consumers. If Liquid Audio cannot offer a sufficient amount and variety of digitally recorded music for syndication, its business will be harmed.

In addition, the major U.S. record labels have recently formed ventures for the licensing of their digital music subscription services to online music service providers. BMG Entertainment, EMI, Real Networks and Warner Music Group have formed a venture called "MusicNet." Also, Universal Music Group (a unit of Vivendi Universal) and Sony Music Entertainment have formed a venture called "pressplay." MusicNet and pressplay have recently launched their services, and may license their services to other third party online music service providers. If Liquid Audio's competitors obtain licenses for digital music subscription services from MusicNet and pressplay and Liquid Audio is unable to obtain similar content provided by those services on commercially reasonable terms, these competitors may be able to develop a more compelling consumer product and Liquid Audio's business could be harmed.

Liquid Audio might be unable to license or acquire technology.

Liquid Audio relies on certain technologies that it licenses or acquires from third parties, including Dolby Laboratories Licensing Corporation, Fraunhofer Institut, RSA Data Security, Inc. and Thomson Consumer Electronics Sales GmbH. These technologies are integrated

with Liquid Audio's internally developed software and used in Liquid Audio's products, to perform key functions and to enhance the value of Liquid Audio's platform. These third party licenses or acquisitions may not continue to be available to Liquid Audio on commercially reasonable terms or at all. Any inability to acquire these licenses or software on commercially reasonable terms might harm Liquid Audio's business.

Liquid Audio might not be successful in its attempts to keep up with rapid technological change and evolving industry standards.

The markets for Liquid Audio's products and services are characterized by rapidly changing technology, evolving industry standards, changes in customer needs, emerging competition, and frequent new product and service introductions. Liquid Audio may not be successful in effectively using new technologies, developing new products or services, ascertaining customer demand or enhancing its existing products or services on a timely basis. These new technologies or enhancements may not achieve market acceptance. Liquid Audio's pursuit of necessary technological advances may require substantial time and expense. Finally, Liquid Audio may not succeed in adapting Liquid Audio's services to new technologies as they emerge.

Risks Related to Alliance that Could Adversely Affect the Combined Organization

In addition to certain risks described above that affect each of Alliance, Liquid Audio and the combined organization, Alliance is subject to the following risks that could adversely affect the combined organization.

Alliance's sales would be hurt if it lost any of its largest customers.

If Alliance's largest customer was to stop purchasing or reduce the quantity of its purchases, Alliance's financial results would be seriously damaged. During 2001, Alliance's top customer accounted for approximately 31% of net sales. No other customer accounts for greater than 5% of net sales.

If Alliance's suppliers stopped providing a significant amount of credit, Alliance's business could be harmed.

Alliance purchases its inventory from the major labels and studios as well as from a host of independents. These suppliers historically have extended favorable credit and payment terms to Alliance, which have enabled Alliance to preserve working capital and maintain liquidity. If Alliance's suppliers altered these terms in a way adverse to Alliance, its business and results of operations could be harmed.

Alliance's reliance on a few key suppliers makes it vulnerable to not being able to obtain the products required by its customers.

The major labels and studios produce most of the music and video product that Alliance distributes. Alliance's success depends upon Alliance's ability to obtain product in sufficient quantities on competitive terms and conditions from each of the major labels and studios as well as from thousands of smaller suppliers. If Alliance's suppliers do not provide Alliance with sufficient quantities of the products Alliance sells, sales and profitability will suffer. Products supplied to Alliance by its top ten suppliers represented approximately 72% of Alliance's sales in 2001. Alliance's dependence on its principal suppliers involves risk, and if there is a disruption in supply from a principal manufacturer or publisher, Alliance may be unable to obtain the merchandise it desires to sell. If the discounts Alliance receives from its suppliers were discontinued or reduced, its sales could be adversely affected. Finally, some of the products Alliance distributes are available only from a single supplier, and if that supplier refused to provide Alliance with the product, Alliance's sales could decrease.

Because Alliance's business depends upon its key shippers' ability to deliver its products, if these shippers' operations ceased or became prohibitively expensive, Alliance's business would be harmed.

Alliance depends upon a number of commercial freight carriers and the United States Postal Service to deliver its products. While the choice of carriers is a fact-based determination depending upon a customer's characteristics, Alliance currently relies upon the United States Postal Service and

United Parcel Service Inc. to deliver the substantial majority of its products. The cost of net shipping after customer reimbursement represents approximately 1.4% of sales. If shipping costs were to increase, and given the competitive landscape, if Alliance were unable to pass that increase along to its customers, Alliance's financial results would suffer. Additionally, if the operations of these carriers were disrupted for any reason, Alliance would not be able to deliver its products on a timely basis, thereby causing its sales and profitability to suffer.

If Alliance is unable to accurately anticipate consumer demand, it will be unable to fully support its customers, and its business would be harmed.

Alliance's success depends in part upon its ability to anticipate and respond to changing product trends and consumer demands in a timely manner. If Alliance fails to identify and respond to emerging trends, its ability to support its customers with appropriate amounts and selections of products could be impaired.

The sales of videos and music products historically have been dependent upon discretionary consumer spending, which may be affected by general economic conditions, consumer confidence and other factors beyond Alliance's control. In addition, spending on these items is affected significantly by the consumer trends, timing, pricing and success of new releases, which are not within Alliance's control.

Alliance's sales may suffer due to the shift in the retail music and video markets to larger retailers.

Studios and other full-line distributors recently have instituted programs to increase the quantity of copies of popular music and video titles stocked by retailers. Alliance believes that this type of program will further the shift in the retail market away from independent stores and small chains in favor of the larger chains such as Target and Wal-Mart. Since, in general, Alliance plays a larger role with independent retailers than with the larger chains, Alliance believes that this shift to larger retailers could cause the market for full-line distribution of music and video products to shrink, which will negatively affect the results of Alliance's operations.

Inventory risk due to an inability to return product is a constant aspect of Alliance's business.

Alliance bears inventory risk associated with the financial viability of its suppliers. If a label or studio cannot provide refunds in cash for the inventory sought to be returned, Alliance may be forced to expense such inventory costs. Further, Alliance often experiences higher return rates for products of financially troubled labels and studios. If Alliance fails to manage its inventory to avoid accumulating substantial product that cannot be returned, its financial results could be adversely affected.

Alliance assumes credit risks by maintaining a high concentration of accounts receivable and by engaging in business with foreign customers.

Alliance performs ongoing credit evaluations of its customers financial conditions because there is a heavy concentration of receivables outstanding at any given time to major retail and mass merchant customers. An accounts receivable write off, as a result of a major customer's insolvency, would have a material adverse effect on Alliance's financial results.

Alliance also takes on additional credit risks through sales to foreign customers whose credit worthiness is dependent in large part by the strength of their foreign currency against the dollar. If one of these countries, in which a foreign customer resides, experiences economic adversity and a weakening currency, it will negatively affect the customer's ability to repay outstanding balances.

Increased consolidation in the entertainment/media business may reduce the number of Alliance's customers.

The trend toward consolidation of customers in the entertainment media industry could have a significant adverse impact on Alliance's financial results. Consolidated companies may choose to terminate their relationship with Alliance and purchase products from its competitors or directly from the major labels. Additionally, if Alliance's customers grow larger and/or consolidate at the same time that the number of customers in the market shrinks, Alliance's existing customers may demand lower pricing and more favorable terms, which may adversely affect Alliance's business. If Alliance fails to adequately respond to these trends, its volume growth could slow or it may need to lower its prices or increase promotional support, any of which would adversely affect profitability.

Alliance assumes the risk that some of its significant customers and suppliers will not renew their short-term contracts.

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Some of Alliance's customers and suppliers operate through purchase orders or short-term contracts. Alliance cannot assure that any of these customers or suppliers will continue to do business with Alliance on the same basis in the future. Additionally, although Alliance tries to renew these contracts as they come due, there can be no assurance that the customers or suppliers will renew the contracts on favorable terms, if at all. The termination of any number of these contracts may have a material adverse effect on Alliance's business and prospects, including its financial performance and results of operations.

The failure of the information systems upon which Alliance's business depends could materially and adversely impact its results of operations.

Alliance's information systems are an integral part of its operations. Alliance is continually upgrading these systems and developing new applications. The failure or inoperability of these systems could have a material adverse impact on the results of operations of the Alliance business.

Because Alliance's business is prone to seasonal fluctuations, Alliance may be unable to fully recover from factors that adversely affect its sales in certain periods.

Seasonal shopping patterns affect the business of Alliance's retail clients. In 2001, 39.5% of its aggregate sales occurred in the fourth calendar quarter, coinciding with the Christmas holiday shopping season. This causes Alliance's results of operations for the entire year to depend more heavily on fourth quarter results. Factors that could adversely affect sales and profitability in the fourth quarter include:

unavailability of, and low customer demand for, particular products;

unfavorable economic conditions;

inability to hire adequate temporary personnel;

inability to anticipate consumer trends; and

inability to maintain adequate inventory levels.

Alliance may be prevented from distributing music internationally.

Most of the major labels have adopted policies restricting the export of their merchandise by domestic distributors. However, consistent with industry practice, Alliance distributes music of the major labels internationally. Alliance would be adversely affected if a major label enforced any restriction on Alliance's ability to sell music outside the United States.

CAUTIONARY STATEMENTS REGARDING FORWARD-LOOKING INFORMATION

The Securities and Exchange Commission encourages companies to disclose forward-looking information so that investors can better understand a company's future prospects and make informed investment decisions. This proxy statement/prospectus contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. All statements included in this proxy statement/prospectus or made by management of Liquid Audio or Alliance other than statements of historical fact regarding Liquid Audio or Alliance are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. These statements may include statements regarding the period following completion of the merger and the tender offer.

This proxy statement/prospectus contains forward-looking statements based on current projections about operations, industry, financial condition and liquidity. Words such as "will," "anticipate," "estimate," "expect," "project," "intend," "plan," "believe" and words and terms of similar substance used in connection with any discussion of future operating or financial performance, the merger or the business of the combined organization identify forward-looking statements. The discussion of the Liquid Audio board of directors' reasons for the merger and the description of the opinion of Liquid Audio's financial advisor contain many forward-looking statements that describe beliefs, assumptions

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and estimates as of the indicated dates and those forward-looking statements may have changed as of the date of this proxy statement/prospectus. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances, including any underlying assumptions, are forward-looking statements. Those statements are not guarantees and are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, actual results could differ materially and adversely from these forward-looking statements.

All forward-looking statements reflect present expectations of future events by Liquid Audio and Alliance's management and are subject to a number of factors and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. In addition to the risks related to the businesses of Liquid Audio and Alliance, the uncertainty concerning the completion of the merger and the matters discussed under "Risk Factors," among others, could cause actual results to differ materially from those described in the forward-looking statements. These factors include: relative valuations of Liquid Audio and Alliance, the market's difficulty in valuing the combined business, the possible failure to realize the anticipated benefits of the merger and conflicts of interest of directors recommending the merger. Investors are cautioned not to place undue reliance on the forward-looking statements, which speak only of the date of this proxy statement/prospectus. Neither Liquid Audio nor Alliance is under any obligation, and each expressly disclaims any obligation, to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise.

Certain statements contained or incorporated in this document are forward-looking statements concerning the operations, economic performance and financial condition of Liquid Audio and Alliance. Forward-looking statements are included, for example, in the discussions about:

the market for music and video sales

our strategy

future technology

growth of Internet music and video sales

change in music and video distribution industry

change of credit terms by Alliance's suppliers

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Those forward-looking statements involve risks and uncertainties and actual results may differ materially from those expressed or implied in those statements. Liquid Audio and Alliance disclaim any intention or obligation to revise any forward-looking statements whether as a result of new information, future developments or otherwise. Factors that could cause differences include, but are not limited to, those discussed under "Risk Factors" and "Liquid Audio Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Alliance Management's Discussion and Analysis of Financial Condition and Results of Operations."

All subsequent forward-looking statements attributable to Liquid Audio or Alliance or any person acting on their behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section.

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THE MEETING OF LIQUID AUDIO STOCKHOLDERS

Date, Time and Place

The meeting of Liquid Audio stockholders will be held on September 26, 2002, at 10:00 a.m. local time, at the Hotel Sofitel, 223 Twin Dolphin Drive, Redwood City, California 94065.

Matters to be Considered at the Meeting of Liquid Audio Stockholders

At the Liquid Audio annual stockholder meeting, and any adjournment or postponement thereof stockholders will consider and vote upon the election of two (2) Class III directors to hold office for three (3) years. The Liquid Audio board of directors has nominated Gerald W. Kearby and Raymond A. Doig to serve as the Class III directors. However, a group of investors, led by musicmaker.com, Inc., has commenced a proxy solicitation to take control of your board of directors by nominating their own two (2) Class III Directors, proposing to increase the size of the Liquid Audio board of directors from seven (7) to eleven (11), authorizing stockholders only to fill board of directors vacancies and newly created directorships and electing, contingent on their other proposals being approved, four (4) additional nominees to serve as directors. Stockholders will also consider and vote upon the ratification of PricewaterhouseCoopers LLP as Liquid Audio's independent accountants for the fiscal year ended December 31, 2002. **YOUR BOARD OF DIRECTORS STRONGLY URGES YOU NOT TO RETURN ANY WHITE PROXY CARD SENT TO YOU BY THE MUSICMAKER GROUP. YOUR BOARD OF DIRECTORS STRONGLY URGES YOU TO VOTE "FOR" THE NOMINEES FOR DIRECTOR NOMINATED BY THE BOARD OF DIRECTORS ON THE GREEN PROXY CARD AND AGAINST THE OTHER MUSICMAKER PROPOSALS.**

At the annual meeting of Liquid Audio stockholders, and any adjournment or postponement thereof, Liquid Audio stockholders will be asked to consider and vote upon a proposal to approve the issuance of Liquid Audio stock in the merger of April Acquisition Corp., a wholly-owned subsidiary of Liquid Audio, with and into Alliance Entertainment Corp. pursuant to the Amended and Restated Agreement and Plan of Merger dated as of July 14, 2002, by and among Liquid Audio, April Acquisition Corp. and Alliance.

Record Date

The Liquid Audio board of directors has fixed August 12, 2002, as the record date for determination of Liquid Audio stockholders entitled to notice of, and to vote at, the meeting of Liquid Audio stockholders and any adjournment or postponement thereof. As of the close of business on the record date for the meeting of Liquid Audio stockholders, there were 22,745,624 shares of Liquid Audio common stock outstanding and entitled to vote, held by approximately 126 holders of record.

Votes Required

Holders of Liquid Audio common stock are entitled to one vote for each share of Liquid Audio common stock held as of the record date.

Approval of the issuance of Liquid Audio stock in the merger will require the affirmative vote of a majority of the outstanding shares of Liquid Audio stock voting on the proposal at the Liquid Audio meeting, either in person or represented by proxy, while the approval of the two (2) Class III directors nominated by the Liquid Audio board of directors will require a plurality of votes cast by stockholders holding shares entitled to vote in the election at the stockholder meeting. The ratification of PricewaterhouseCoopers, LLP as Liquid Audio's independent accounts for the fiscal year ended December 31, 2002, and any other matters that may properly come before the meeting, will require the affirmative vote of the holders of a majority of the shares represented and entitled to vote at the meeting.

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Quorum; Abstentions and Broker Non-Votes

A majority of the shares of Liquid Audio common stock issued and outstanding on the record date, present in person or represented by proxy, constitutes the required quorum for the transaction of business at the annual meeting of Liquid Audio stockholders. Abstentions and broker non-votes each will be included in determining the number of shares present and voting at the annual meeting of Liquid Audio stockholders for the purpose of determining the presence of a quorum.

On the record date for the annual stockholders meeting, directors and executive officers of Liquid Audio and their affiliates held approximately 1,994,302 shares of Liquid Audio common stock representing approximately 8.8% of all outstanding shares of Liquid Audio common stock as of the record date.

Shares abstaining from the vote on the proposal to elect two (2) Class III directors and broker non-votes will not be counted for any purpose in determining whether this proposal has been approved. However, shares abstaining from the vote on the proposal to approve the issuance of Liquid Audio stock in the merger and the proposal to ratify PricewaterhouseCoopers, LLP as Liquid Audio's independent accountants for the fiscal year ending December 31, 2002 will be counted toward the tabulation of votes cast on these proposals and will have the same effect as negative votes, while broker non-votes will not be counted for any purpose in determining whether this proposal has been approved. The failure of a Liquid Audio stockholder to return a proxy or to vote in person will have the effect of a non-vote in regards to this proposal.

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Brokers holding shares for beneficial owners cannot vote on any of the proposals without the owners' specific instructions. Accordingly, Liquid Audio stockholders are encouraged to return the enclosed proxy card marked to indicate their vote as described in the instructions accompanying the proxy card. Under applicable rules of conduct, brokers do not have discretionary authority over any proposal to be presented at the annual meeting when the matter to be voted upon is being opposed by management or subject to a contest.

Board Recommendation

All members of the board of directors of Liquid Audio were present at the meetings where the merger was considered and unanimously concluded that the merger agreement, the tender offer and the merger are fair to and in the best interests of Liquid Audio's stockholders and recommend that the Liquid Audio stockholders vote FOR the approval of the issuance of Liquid Audio stock in the merger.

In deciding to approve the merger and the tender offer, the Liquid Audio board of directors considered the opinion of its financial advisor, Broadview International LLC, that, as of the date of its opinion, and subject to and based on the considerations reflected in its opinion, the aggregate consideration to be received and retained by the stockholders of Liquid Audio pursuant to the tender offer and the merger is fair to the stockholders of Liquid Audio from a financial point of view. The full text of the opinion is attached as Annex B to this proxy statement/prospectus. Liquid Audio urges its stockholders to read the opinion of Broadview in its entirety.

In addition, after careful consideration, the Liquid Audio board of directors strongly recommends that you support the nominees for director nominated by the Liquid Audio board of directors and reject any and all proposals made by the group of investors led by musicmaker.com, Inc. The Liquid Audio board of directors strongly urges you not to return any white proxy card sent to you by the musicmaker group.

In considering such recommendations, Liquid Audio stockholders should be aware that some Liquid Audio directors and officers may have interests in the merger that are different from, or in addition to, those of other Liquid Audio stockholders generally. Among other things, Alliance has entered into employment arrangements with two officers effective on the merger and has agreed to

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continue certain indemnification and insurance arrangements in favor of directors and officers of Liquid Audio. See "The Merger Interests of Liquid Audio Directors and Executive Officers."

Solicitation of Proxies

Liquid Audio and Alliance will share the expenses incurred in connection with the printing and mailing of this proxy statement/prospectus equally. Liquid Audio will also request banks, brokers and other intermediaries holding shares of Liquid Audio common stock beneficially owned by others to send this proxy statement/prospectus to, and obtain proxies from, such beneficial owners and will, upon request, reimburse such banks, brokers and other intermediaries for their reasonable expenses in complying with such requests. Solicitation of proxies by mail may be supplemented by telephone, facsimile and other electronic means, advertisements and personal solicitation by the directors, officers or employees of Liquid Audio. No additional compensation will be paid to directors, officers or employees for those solicitation efforts.

Voting of Proxies

Liquid Audio requests that its stockholders complete, date and sign the enclosed proxy card and promptly return it by mail in the accompanying envelope in accordance with the instructions accompanying the proxy card. All properly signed and dated proxies that Liquid Audio receives prior to the vote at the meeting of Liquid Audio stockholders, and that are not revoked, will be voted in accordance with the instructions indicated on the proxies. All properly signed and dated proxies received by Liquid Audio prior to the vote at the annual stockholders meeting that do not contain any direction as to how to vote in regards to any or all of the proposals will be voted for adoption of any proposal in regards to which no directions are provided. No proxy will be voted on any proposal to adjourn or postpone the stockholder meeting that is submitted to the stockholders for a vote.

Liquid Audio does not expect that any matter other than (i) the election of directors, (ii) the approval of the issuance of shares in the merger and related transactions (iii) the ratification of PricewaterhouseCoopers, LLP as Liquid Audio's independent accountants for the fiscal year ending December 31, 2002 and (iv) the musicmaker proposals will be brought before the annual stockholder meeting. If, however, other matters are properly presented, the persons named as proxies will vote in accordance with their judgment with respect to those matters, unless authority to do so is withheld on the proxy card.

Brokers holding shares in "street name" may vote such shares only if the stockholder provides specific instructions on how to vote. Brokers will provide directions on how to instruct the broker to vote the shares.

Stockholders may revoke their proxies at any time prior to their use:

by delivering to the secretary of Liquid Audio a signed notice of revocation;

by delivering to the secretary of Liquid Audio a later-dated, signed proxy; or

by attending the annual stockholder meeting of Liquid Audio stockholders and voting in person.

Attendance at the meeting of Liquid Audio stockholders does not in itself constitute the revocation of a proxy.

Even if a stockholder of Liquid Audio plans to attend the annual stockholder meeting in person, Liquid Audio requests that the stockholder sign and return the enclosed proxy card as described in the proxy statement/prospectus and in accordance with the instructions accompanying the proxy card, thus ensuring that the shares held by the stockholder will be represented at the stockholders meeting. If a Liquid Audio stockholder does attend the annual meeting of Liquid Audio stockholders and wishes to vote in person, he or she may withdraw the proxy and vote in person.

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THE MERGER

This section of the proxy statement/prospectus describes certain matters related to the merger and the tender offer. This summary may not contain all of the information that is important to Liquid Audio stockholders. For a more complete understanding of the merger and the tender offer, investors should carefully read this entire document and the other documents referred to in this proxy statement/prospectus.

Background of the Merger

On a regular basis, Liquid Audio management considers potential acquisitions, business combinations, or other transactions that might be available to Liquid Audio. From time to time, Liquid Audio management has received preliminary, informal expressions of interest regarding potential acquisitions, business combinations, or other transactions.

In October 2000, as an outgrowth of discussions concerning the business relationship between Liquid Audio and Alliance, Gerry Kearby of Liquid Audio and Eric Weisman, President and Chief Executive Officer of Alliance discussed the potential acquisition of certain operating assets of Alliance's All Music Guide and RedDotNet businesses. In November 2000, Liquid Audio and Alliance executed a non-disclosure agreement relating to the exchange of information related to All Music Guide and RedDotNet to facilitate Liquid Audio's analysis of a potential acquisition of those assets. Beginning with the execution of the non-disclosure agreement and extending through March 2001, Liquid Audio conducted a due diligence investigation of All Music Guide and RedDotNet and engaged in discussions with Alliance relating to the potential acquisition of certain operating assets.

In February 2001, representatives of Alliance, including Mr. Weisman and Alliance's legal and financial advisors, met with Liquid Audio and its representatives, including Mr. Kearby, to discuss the terms of a potential stock for assets acquisition by Liquid Audio of Alliance's All Music Guide and RedDotNet businesses.

On March 21, 2001, the Liquid Audio board of directors met and discussed various alternatives for developing Liquid Audio's business and maximizing the value of Liquid Audio for all of its stockholders. After extensive discussion, the Liquid Audio board resolved to explore strategic alternatives for the company, including but not limited to a potential merger with a third party, the sale of all of Liquid Audio's business or assets or a recapitalization. On March 21, 2001, Liquid Audio informed Alliance that it would not pursue an acquisition of the operating assets of All Music Guide and RedDotNet in light of the decision by Liquid Audio's board to explore potential strategic alternatives.

Following Liquid Audio's board decision, Liquid Audio management took actions to implement the board of director's decision by trying to identify potential strategic partners and meeting with various investment bankers, including Lehman Brothers and Broadview International LLC. On June 18, 2001, pursuant to the authorization of the board of directors, Liquid Audio engaged Broadview International LLC to assist Liquid Audio in exploring potential strategic alternatives. Liquid Audio selected Broadview because of its experience in mergers and acquisitions in the industry in which Liquid Audio operates and its familiarity with Liquid Audio's business.

Beginning in June 2001, Broadview assisted Liquid Audio in exploring strategic alternatives. Broadview and Liquid Audio management had discussions with approximately fifteen parties to determine whether they had an interest in acting as potential strategic partners with Liquid Audio or in pursuing potential transactions or other strategic alternatives involving Liquid Audio. Initially, Liquid Audio and Broadview focused

on parties with businesses that were complementary to Liquid Audio's business. As a result of such contacts, Liquid Audio received several indications of interest relating to the acquisition of Liquid Audio through both stock for stock and recapitalization transactions.

Beginning in June 2001, the Liquid Audio board met on a number of occasions to review the efforts of Broadview and Liquid Audio management in exploring potential strategic alternatives, to consider the preliminary expressions of interest that were received, and to direct and oversee the process.

On October 22, 2001, Steel Partners II, L.P., which then held 8.2% of Liquid Audio's common stock, sent a letter to the Liquid Audio board of directors in which it indicated a willingness to offer to acquire Liquid Audio for \$3.00 per share in cash. This proposal was conditioned on, among other things, satisfactory completion of due diligence. On October 26, 2001, musicmaker.com, Inc. sent a letter to the Liquid Audio board of directors in which it indicated a willingness to offer to acquire Liquid Audio on terms at least comparable to the Steel Partners proposal. On November 2, 2001, the Liquid Audio board of directors met with management, Broadview, and outside counsel to discuss the proposals made by Steel Partners and musicmaker.com. After extensive discussion, the Liquid Audio board of directors concluded that Liquid Audio had no interest in pursuing either proposal at that time. The board of directors based its decision on its determination that the \$3.00 price per share offered in the Steel Partners and musicmaker.com proposals was below the value per share of the cash on Liquid Audio's books, even after deducting Liquid Audio's then outstanding indebtedness. The board of directors and management of Liquid Audio also believed that, based on ongoing discussions with various potential strategic acquirers, the equity value of Liquid Audio exceeded the value of the cash on Liquid Audio's books and that the value of Liquid Audio in a potential strategic transaction was enhanced by retaining the cash balance instead of distributing all or a portion of it to Liquid Audio's stockholders.

On December 18, 2001, musicmaker.com delivered a notice to Liquid Audio describing its intention to propose nominees for election as directors and certain other proposals at Liquid Audio's next annual meeting.

On January 23, 2002, Messrs. Kearby and Flynn advised the board of directors that they were interested in exploring a potential management buyout of Liquid Audio, subject to securing additional financing. At the January 23, 2002 meeting, the Liquid Audio board of directors formed a special committee consisting of Raymond Doig, Stephen Imbler and Ann Winblad and authorized the special committee to review and evaluate any proposals for a management buyout made by Messrs. Kearby and Flynn and, on behalf of Liquid Audio, negotiate the terms of any such transaction and evaluate the terms of other proposed transactions.

From January 23, 2002 to February 22, 2002 the special committee met regularly to discuss and review the proposed management buyout and other alternatives available to Liquid Audio and on February 7, 2002, the special committee retained Broadview and expanded the scope of its engagement to act as the financial advisor to the special committee.

On or about February 15, 2002, Mr. Flynn contacted Eric Weisman, President and Chief Executive Officer of Alliance, to explore whether Alliance might be interested in participating in the financing of a management buyout of Liquid Audio. On or about February 22, 2002, Mr. Weisman called Mr. Flynn to inform him that Alliance was not interested in participating in such a financing, but that if Liquid Audio were interested, Alliance preferred to discuss a potential business combination between Liquid Audio and Alliance. After further discussions and several meetings, Mr. Flynn asked Mr. Weisman to prepare a written expression of interest that could be presented to the Liquid Audio board of directors.

On February 22, 2002, musicmaker.com sent a letter to Liquid Audio indicating its willingness to acquire Liquid Audio for \$2.50 per share, subject to, among other things, satisfactory completion of due diligence. The members of the board of directors discussed the proposal made by musicmaker.com and concluded that Liquid Audio had no interest in pursuing the proposal at that time because, among other reasons, a \$2.50 proposal was substantially below the value per share of the cash on Liquid Audio's books, even after deducting Liquid Audio's then outstanding indebtedness.

Between February 22, 2002 and March 14, 2002, representatives of Alliance and Liquid Audio spoke regarding a possible transaction. On March 14, 2002, Robert Flynn had an introductory meeting with Erika Paulson and Maggie Wojtaszek of The Yucaipa Companies, which is affiliated with Alliance's controlling stockholder, AEC Associates, LLC. Ms. Paulson is also a director of Alliance. On March 14, 2002, Alliance sent a letter to Liquid Audio indicating its interest in pursuing a potential transaction with Liquid Audio in which Alliance and Liquid Audio would combine in a tax-free reorganization in which Alliance stockholders would receive a 70% equity interest in Liquid Audio and Liquid

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Audio stockholders would retain a 30% interest. The letter stated that it was based upon Liquid Audio maintaining capitalization of \$90 million in cash and was subject to execution of definitive documentation, obtaining of financing and the absence of any material adverse change in the business of Liquid Audio. The letter also included general business information and summary financial information about Alliance.

On March 26, 2002, Messrs. Kearby (who was on the telephone) and Flynn met with Eric Weisman (who was on the telephone) and Erika Paulson to discuss Alliance's expression of interest.

On March 27, 2002, the Liquid Audio board of directors met to receive an update on the exploration of strategic alternatives by Broadview and management of the Liquid Audio. Broadview provided the directors with an update of its discussions with potential strategic partners, including its discussions with another public company that had expressed interest in a potential business combination. The board of directors then discussed Broadview's presentations. Messrs. Kearby and Flynn then advised the Liquid Audio board that they had engaged in discussions with Alliance regarding a possible business combination and described the terms of the March 14, 2002 proposal. Mr. Kearby advised the directors that there were significant strategic benefits to a combination with Alliance because, among other things, of Alliance's significant presence in the market for physical distribution of music and DVD's. Mr. Weisman then joined the meeting telephonically and provided the Liquid Audio board with an overview of Alliance's business, including financial information. Mr. Weisman then left the meeting, and the Liquid Audio board of directors discussed the Alliance proposal. Following an extensive discussion of the various proposed transactions, the Liquid Audio board of directors then directed management to continue their discussions with Alliance and to include Broadview in the discussions and to continue discussions with the potential public company acquirer. The board also directed Liquid Audio's management to retain a valuation firm to provide the board with an analysis of the fair market value of the equity of Liquid Audio, expressed on an orderly liquidation basis and taking into account all contingencies and obligations of Liquid Audio. In addition, the Liquid Audio board of directors directed Broadview and management to continue to explore strategic alternatives involving potential strategic partners other than Alliance, including investigating whether potential strategic partners were interested in a business combination involving Liquid Audio. In light of the board of directors' decision to continue discussions with Alliance and the public company acquirer and the fact that the management buyout did not appear to be a viable alternative, the board of directors dissolved the special committee and determined that the entire board of directors would participate in future deliberations on the potential acquisition of Liquid Audio by a third party.

From March 27 through April 8, 2002, Broadview continued to explore strategic alternatives involving potential strategic partners other than Alliance. Among other things, Broadview contacted certain parties that previously had been contacted and expanded its search to include additional parties. Liquid Audio and Broadview had discussions with numerous potential acquiring companies and received indications of interest from several companies, most of which did not develop into serious negotiations.

Pursuant to a letter agreement executed by Liquid Audio on April 1, 2002 and dated as of March 13, 2002, the Liquid Audio board of directors engaged Houlihan Lokey Howard & Zukin Financial Advisor, Inc. ("Houlihan Lokey") to prepare a report regarding the fair value of Liquid Audio's equity,

expressed on an orderly liquidation basis, for the board to use as part of its review of various strategic alternatives. Liquid Audio agreed to pay Houlihan Lokey a fee of \$40,000 for the preparation of the report and reimburse it for its out of pocket expenses. Such report was not prepared in anticipation of any particular transaction and Houlihan Lokey was not asked to and did not compare the equity value of Liquid Audio based on an orderly liquidation to the value attributable to the Liquid Audio equity as a result of any proposed transaction.

During the period from June 2001 through April 2002, Liquid Audio received qualified proposals for transactions from three parties other than Alliance. Based on discussions with Broadview and Liquid Audio management, the Liquid Audio board of directors determined that such proposals were not in the best interests of the stockholders of Liquid Audio because of concerns regarding liquidity of securities offered, overall health of the potential acquiring company's business or uncertainty of consummation due to concerns as to feasibility of the structure of the transaction. The first proposal involved a transaction in which Liquid Audio stockholders would receive stock in exchange for their Liquid Audio stock. In February 2002, the Liquid Audio board of directors decided not to pursue this transaction because of concerns regarding the state of the potential acquirer's business and likelihood of achieving long term value. In addition, the securities proposed to be exchanged for Liquid Audio stock were not actively traded and there was a concern that the Liquid Audio stockholders would not have a meaningful ability to obtain cash by selling stock. The second proposed transaction involved a financial restructuring and recapitalization. In February 2002, the Liquid Audio board of directors decided not to pursue this transaction due to concerns regarding the value of the restructured entity and the uncertainty of agreeing on a transaction structure and consummating a transaction caused by the acquiring party's objective of preserving certain Liquid Audio tax attributes. The third proposed transaction involved the acquisition of Liquid Audio for combination of cash and stock consideration. In April 2002, the Liquid Audio board of directors decided not to pursue this transaction because of concerns about the health of the acquiring company's core business and the associated volatility of the stock consideration proposed to be received by the Liquid Audio stockholders.

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On April 5, 2002, Alliance and Yucaipa representatives met and Alliance presented Liquid Audio a draft of a term sheet proposing, among other things, a 70% interest by Alliance stockholders on a fully diluted basis.

On April 8, 2002, Broadview updated the Liquid Audio board of directors on its exploration of potential strategic alternatives, including the discussions with Alliance and discussions with other potential strategic partners, including a proposal for the acquisition of certain of Liquid Audio's technology assets and proposals for stock-for-stock transactions. The board of directors then engaged in an extensive discussion of the relative benefits of the proposals made by Alliance, other potential strategic acquirers, Steel Partners and musicmaker.com, including a discussion of the likelihood of reaching a definitive agreement with Alliance and the other potential strategic partners, a comparison of the potential value to shareholders of \$3.00 per share reflected in the proposals made by Steel Partners and musicmaker.com and the preliminary range of values of \$2.15 to \$3.91 per share of Liquid Audio common stock based on the proposal made by Alliance (which range of values was determined based on preliminary information and solely for purposes of facilitating negotiations of the proposed transaction with Alliance) and a discussion of the opportunities for growth of Liquid Audio's business as a result of a strategic transaction. Following this discussion, the Liquid Audio board concluded that the terms proposed by the potential strategic partners other than Alliance did not offer sufficient value to warrant additional consideration. Following such discussion the Liquid Audio board of directors authorized management to continue discussions with Alliance.

From April 10, 2002 until April 30, 2002, Liquid Audio and Alliance negotiated the terms of a non-binding term sheet for a transaction. The parties outlined the broad structure of a transaction in which Alliance would merge into a subsidiary of Liquid Audio and 67% of Liquid Audio's equity would be issued to Alliance's stockholders. The non-binding term sheet contemplated, as conditions to

entering into a definitive agreement, the parties' conducting due diligence and negotiating definitive documents, including a voting agreement of AEC Associates and Alliance's obtaining of a consent from its lender, General Electric Capital Corporation. The parties agreed to an exclusive period of negotiation for twenty-one days. The term sheet also set forth the understanding that Liquid Audio would have cash of \$82.5 million upon signing of definitive agreements and that the definitive agreements would include covenants concerning Liquid Audio's use of cash. The board of directors of the combined organization was to be a nine member board, with six members to be designated by Alliance and three by Liquid Audio.

On April 25, 2002, the Liquid Audio board of directors held a meeting at which representatives of Houlihan Lokey and Broadview were present. Houlihan Lokey presented its report on the fair market value of Liquid Audio's equity, expressed on an orderly liquidation basis, as of March 30, 2002. The enterprise equity value indicated by Houlihan Lokey's orderly liquidation analysis ranged from \$73.5 million to \$89.5 million, subject to certain qualifications, assumptions and limitations that were contained in the report. Houlihan Lokey's report was not prepared or rendered in anticipation of any particular transaction and Houlihan Lokey was not asked to and did not compare the equity value of Liquid Audio based on an orderly liquidation to the value attributable to Liquid Audio's equity as a result of any proposed transaction. Houlihan Lokey was not asked to and did not update its analysis following April 24, 2002, either in connection with any transaction considered by the Liquid Audio board of directors or otherwise.

On April 30, 2002, Mr. Kearby provided Liquid Audio's board of directors with an update on the discussions with Alliance. Mr. Flynn presented the Alliance term sheet. The board of directors then discussed the term sheet and provided guidance to management on certain open items. After further discussion, the board approved the term sheet, subject to modifications identified by the board including clarification that the percentage of equity ownership would be based on outstanding, and not fully diluted, shares of common stock of Liquid Audio, definitive documents would be executed within fourteen days and Alliance would retain a nationally recognized investment bank to advise it in the proposed transaction. The board authorized management to enter into a non-binding term sheet reflecting the terms of the transaction approved by the board. A non-binding term sheet was executed by Liquid Audio and Alliance on May 1, 2002.

On May 4, 2002, Liquid Audio submitted the first draft of a merger agreement to Alliance. Between May 4, 2002 and June 12, 2002, Liquid Audio, Alliance and their respective legal and financial advisors participated in extensive negotiation of the definitive merger agreement, including with negotiations over the break-up fees payable by Liquid Audio and the circumstances under which such fees would be due, the representations and warranties to be made in the agreement, and the conditions to the closing of the merger. During this same time period both companies conducted an extensive due diligence investigation into each other's respective businesses.

On May 10, 2002, Liquid Audio's board of directors reviewed and discussed the analysis of the fair market value of the equity of Liquid Audio that they had previously requested. Mr. Kearby updated the board on Liquid Audio's discussions with Alliance and advised the board of Alliance's proposal to spin-off the assets of Alliance's All Media Guide and Digital On-Demand assets to Alliance's stockholders. Mr. Weisman of Alliance and Ms. Paulson of The Yucaipa Companies then joined the meeting and provided the Liquid Audio board with an overview of Yucaipa. Messrs. Weisman and Kearby provided the board with a presentation of pro forma projections reflecting the combination of the existing forecasts for each company and the business opportunities of the combined organization. Mr. Weisman also provided an update on

Alliance's customer relationships, including those of a contractual nature. Next, Alliance's financial advisor made a presentation to Liquid Audio's board and responded to questions raised by the board. Broadview then provided the board of directors of Liquid Audio with a summary of its analysis of the potential transaction and a preliminary draft of Broadview's fairness opinion. The board then discussed Broadview's presentation. After discussion and review of the

presentations made to the board, it concluded that continued pursuit of a transaction with Alliance was promising and authorized the officers to continue to pursue a transaction.

On May 23, 2002, musicmaker.com submitted a preliminary proxy statement to the SEC with respect to its nominees for election as directors and its other proposals.

On May 30, 2002, Messrs. Kearby and Flynn provided the Liquid Audio board of directors with an update of its recent discussions with Alliance. Broadview provided the board of directors with an update of its financial due diligence on Alliance and the preparation of its fairness opinion. Mr. Kearby discussed with the board issues with Alliance's proposed spin-off of its All Media Guide and Digital On-Demand assets. Mr. Flynn discussed with the board of directors the open issues in the merger agreement. Mr. Kearby discussed with the board of directors management's discussions with Alliance's largest customer. Management and Broadview then responded to questions from the board of directors.

On June 5, 2002, Mr. Kearby provided Liquid Audio's board of directors an update of management's business due diligence on Alliance, including the status of Alliance's contractual relationships with certain customers. The board then considered the open issues in the merger agreement and the possibility of discussing the contemplated transaction with Liquid Audio's primary stockholders prior to signing. Messrs. Kearby and Flynn presented to the board a summary of their respective compensation arrangements with Alliance after the close of the transaction with Alliance and the terms of severance for other executive officers of Liquid Audio. Broadview provided the board with an update on the status of the analysis underlying its fairness opinion. After these presentations and discussions, the board discussed potential alternatives available to Liquid Audio and then provided direction to management regarding the open issues in the merger agreement and potential discussions with Liquid Audio's primary stockholders.

On June 10, 2002, musicmaker.com commenced soliciting proxies with respect to its nominees and other proposals.

On June 12, 2002, Mr. Kearby informed the Liquid Audio board of directors of a preliminary proposal received by Liquid Audio for potential sale of a portion of Liquid Audio's assets. The proposal contemplated that following such sale, Liquid Audio would receive a license for use of the transferred technology. Mr. Kearby informed the board of directors that the potential acquirer would need to conduct due diligence. Mr. Kearby advised the board of directors that the potential acquirer had not yet received all necessary internal approvals for the proposed transaction and that the approval of a number of the acquiring company's divisions in several different countries would be required prior to entering into a definitive agreement with respect to the proposed transaction. Mr. Kearby indicated that Liquid Audio's prior experience in business dealings with the potential acquirer suggested that it was unlikely that the potential acquirer would be able to complete its diligence and obtain all of the necessary internal approvals in a timely manner. Mr. Kearby then informed the board of directors that another company had been in discussions with Liquid Audio regarding a potential sale of certain Liquid Audio patents. Based on his discussions with this second company, Mr. Kearby believed that it would take two months to complete the proposed sale. The board of directors asked various questions concerning both potential transactions and a general discussion ensued. Afterwards, Broadview presented to the board of directors its fairness opinion for the transaction with Alliance. Michael Bolcerek, Liquid Audio's Chief Financial Officer, then provided the board information regarding the liquidation value of Liquid Audio based on the liquidation analysis previously received by the board of directors and after giving effect to the cash expended by Liquid Audio since the time that it originally received the liquidation analysis. The board asked numerous questions regarding the liquidation value of Liquid Audio and a general discussion ensued. Finally, Liquid Audio's legal counsel presented the terms of the negotiated merger agreement with Alliance and discussed the board of director's fiduciary duties with respect to the transaction. The Liquid Audio board of directors discussed whether it was appropriate to receive a break-up fee from Alliance upon the occurrence of certain events giving rise to

termination of the merger agreement but, following discussions with counsel to Liquid Audio, determined that shareholders of Liquid Audio already had protection because there was no uncertainty as to approval of the merger by Alliance stockholders and limited termination rights for Alliance. The holder of a majority of the outstanding shares of Alliance voting stock had indicated that it was willing to execute agreements

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obligating it to vote in favor of the merger. Therefore, the merger agreement did not provide Alliance with the ability to terminate the agreement if it was offered an alternative transaction and, in the event of a breach of the terms of the merger agreement by Alliance, it was not certain that liquidated damages would be a sufficient remedy. At this point in the meeting, the representatives of Broadview departed. The board of directors then engaged in a full discussion of the proposed merger with Alliance and the other potential alternatives available to Liquid Audio, including pursuit of the offers made by the two public companies and a potential liquidation of Liquid Audio. Following the discussion, by a majority vote, the board of directors approved and adopted the merger agreement with Alliance and recommended that the Liquid Audio stockholders adopt the merger agreement. Messrs. Kearby, Flynn, Imbler and Doig voted for approval of the merger agreement while Ms. Winblad voted against approval of the merger agreement.

On June 12, 2002, Liquid Audio and Alliance executed the merger agreement and issued a joint press release announcing the execution of the merger agreement. In addition, AEC Associates executed a voting agreement pursuant to which it agreed to vote in favor of the transaction. Representatives of Liquid Audio, Mr. Weisman and Alliance's financial advisors had conversations with certain Liquid Audio stockholders subsequent to the announcement, and had meetings with certain Liquid Audio stockholders during June 19th and 20th.

On June 14, 2002, Steel Partners sent a letter to the board of directors which included an offer to acquire Liquid Audio's shares for \$2.75 per share in cash. The offer purported to be a superior proposal as defined in the merger agreement. The letter asked for ten days to complete due diligence and stated that the offer was not subject to any financing contingency. On June 26, 2002, Steel Partners sent a letter to the board of directors reiterating its \$2.75 per share offer.

On July 2, 2002, the Liquid Audio board of directors discussed potential strategies with respect to the merger agreement and the structure of the transactions contemplated thereby and directed Liquid Audio management to approach Alliance about the possibility of negotiating an amendment to the merger agreement.

From July 8, 2002 through July 14, 2002, Liquid Audio and its legal counsel and financial advisor engaged Alliance and its respective legal counsel and financial advisor in discussions and negotiations with respect to whether or not Alliance would agree to possible alternative scenarios, including potential changes to the merger agreement and the terms and structure of the transaction. Possible alternative scenarios that were considered included restructuring the transaction as a cash-election merger or incorporating a self tender offer by Liquid Audio.

On July 10, 2002, Liquid Audio submitted to Alliance a first draft of an amended and restated merger agreement. Between July 10, 2002 and July 14, 2002, Liquid Audio, Alliance and their respective legal counsel and financial advisors continued to discuss whether an amendment to the merger agreement would be made and participated in further discussions and negotiations arising from the draft of the restated merger agreement which included a proposed cash tender offer by Liquid Audio for shares of its common stock. During the course of these negotiations, the respective managements of Liquid Audio and Alliance and their financial advisors discussed the proposed size and price per share of a self tender offer that would be part of the overall transaction with Alliance, and whether or not certain management members of Liquid Audio would participate in such tender offer. They also discussed the proposed equity split between the Alliance stockholders and the Liquid Audio stockholders in light of the reduced value of Liquid Audio after a self tender offer. During the course of these discussions, the parties agreed to present to their respective boards of directors for

consideration amending the original transaction to a transaction structure that included a tender offer by Liquid Audio for 10 million shares of its common stock at \$3.00 per share and a revised equity split in the merger pursuant to which the former Liquid Audio stockholders would retain 26% of the combined company. Liquid Audio did not contact Steel Partners prior to entering into the amended merger agreement because it believed that the \$2.75 per share of consideration offered by Steel Partners in its proposal was insufficient, which belief was subsequently confirmed by an opinion of Broadview as to the inadequacy of the Steel Partners proposal.

On July 14, 2002, the Liquid Audio board of directors met telephonically to consider the Steel Partners proposal and to determine whether to approve and adopt the amended and restated merger agreement and recommend the merger agreement to Liquid Audio's stockholders. Counsel to the Liquid Audio board of directors discussed the board of directors' fiduciary duties in considering the Steel Partners proposal and the amended and restated merger agreement. Broadview made a presentation to the Liquid Audio board of directors as to the adequacy of the Steel Partners proposal. Broadview then rendered its opinion to the Liquid Audio board of directors that, as of July 14, 2002, from a financial point of view, the Steel Partners proposal was inadequate to the Liquid Audio stockholders, other than Steel Partners and its affiliates. At the conclusion of these presentations and after discussion, the Liquid Audio board of directors unanimously determined that the Steel Partners proposal was inadequate. Counsel to Liquid Audio then reviewed the changes to the merger agreement and ancillary agreements from the terms that had been approved at the June 12, 2002 meeting of the Liquid Audio board of directors. Broadview made a presentation to the Liquid Audio board of directors in which it presented the information described under "*Merger Opinion of Liquid Audio's Financial Advisors*." Broadview then rendered its opinion to the Liquid Audio board of directors that, as of July 14, 2002, the aggregate consideration to be received and retained by the Liquid Audio stockholders in the transaction was fair, from a financial point of view, to the Liquid Audio stockholders. At the conclusion of

these presentations and after discussion, the Liquid Audio board of directors unanimously determined to approve and adopt the merger agreement, the tender offer, the merger and the share issuance, determined the merger agreement fair to and in the best interests of the Liquid Audio stockholders, and approved resolutions recommending that Liquid Audio's stockholders adopt the merger agreement. Counsel to Liquid Audio then reviewed proposed changes to the Liquid Audio rights plan pursuant to which the beneficial ownership threshold at which a person or group of persons becomes an "acquiring person" and triggers certain provisions under the Liquid Audio rights agreement would be revised from beneficial ownership of 15% of the outstanding shares of Liquid Audio common stock to beneficial ownership of 10% of the outstanding shares. The board of directors considered the fact that such reduction was designed to be supportive of the proposed transaction and give stockholders of Liquid Audio the chance to vote on the proposed transactions without the unbalanced impact that any accumulation of common stock by one or more parties could have. Following such discussion, the board of directors unanimously approved the proposed revisions to the Liquid Audio rights plan.

Subsequent to the board meeting, on July 14, 2002, Liquid Audio, April Acquisition Corp. and Alliance entered into the merger agreement and AEC Associates LLC confirmed the applicability of the voting agreement to the amended and restated merger agreement. Liquid Audio issued a press release in the morning of July 15, 2002 announcing the execution of the amended and restated merger agreement and the terms of the tender offer.

Liquid Audio's Reasons for the Merger

In reaching its decision to approve and adopt the merger agreement and approve the tender offer, the merger and the share issuance, the Liquid Audio board of directors consulted with Liquid Audio's management and legal counsel. Liquid Audio retained Broadview International LLC to provide a fairness opinion. The Liquid Audio board of directors believed that the combined experience of its

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members and Liquid Audio management enabled the Liquid Audio board of directors to make an informed decision regarding the merger agreement, the tender offer, the merger and share issuance. In addition, the Liquid Audio board of directors reviewed and evaluated several factors, including, but not limited to, the following:

the judgment, advice and analysis of Liquid Audio's senior management with respect to the potential strategic, financial and operational benefits of the merger, based in part on the business, technical, financial, accounting and legal due diligence investigations performed with respect to Alliance;

historical information concerning Alliance's and Liquid Audio's respective businesses, financial performance and condition, including Liquid Audio's historical and projected losses, funding ability, operations, technology, management and competitive position, including the impact on Liquid Audio of the discontinuation of its technology reseller agreements with affiliated parties;

presentations by the Alliance management team to the senior management of Liquid Audio and the Liquid Audio board of directors;

current financial market conditions and historical market prices, volatility and trading information with respect to the common stock of Liquid Audio and the historical capital raising experience of Alliance;

uncertainty related to the costs of pending litigation in which Liquid Audio is a defendant and other contingencies on the amount of cash that would be available for distribution to Liquid Audio stockholders if the board of directors ultimately determined to liquidate the company in lieu of pursuing one of the strategic alternatives available to Liquid Audio;

the results of substantial efforts made over a significant period of time by Liquid Audio's senior management and the company's financial advisors to solicit indications of interest from third parties regarding a possible strategic partnership or acquisition of Liquid Audio or the assets related to one or more of its product lines;

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the view of Liquid Audio senior management that the proposed tender offer and merger represented an opportunity for Liquid Audio stockholders to realize short-term value through participation in the tender offer for 10 million shares at a price of \$3.00 per share and participate in potential long-term growth of the combined organization which was not offered by other strategic alternatives available to Liquid Audio;

the belief that the terms of the merger agreement, including the parties' representations, warranties and covenants, and the conditions to their respective obligations, are reasonable;

detailed financial analysis and other information with respect to the companies presented by Liquid Audio's financial advisor in presentations to the Liquid Audio board of directors;

the risks and potential rewards associated with continuing to execute Liquid Audio's strategic plan as an independent entity as opposed to as part of the combined organization; and

the marketplace for the digital distribution of music, including the impact of free file sharing services and joint ventures formed by major recording companies for digital music subscription, expectations that market demand for music over the Internet will shift from free service to pay service over time and the belief that Liquid Audio would be stronger in the short and long-term in combination with a company that services the physical distribution needs of both the record labels and the retailers, Liquid Audio's two main industry constituents.

The Liquid Audio board of directors has determined that the merger, the tender offer and the terms of the merger agreement are fair to, and in the best interests of, the stockholders of Liquid Audio. Accordingly, the Liquid Audio board of directors recommends that the Liquid Audio

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stockholders approve the issuance of Liquid Audio stock in the merger. In reaching its determination, the board of directors of Liquid Audio considered, among other things, a number of the potential benefits of the merger and the tender offer, including the following:

the merger would provide Liquid Audio stockholders the opportunity to participate in the potential growth of the combined organization after the merger;

the combined organization could benefit from the potential synergies created in combining the research and development and technological offerings and strengths of Liquid Audio with the technology strengths and market reach of Alliance;

the combined organization could benefit from potential cost reductions created by increased operating efficiencies and work force reductions;

the financial strength that would result for the combined organization by combining Alliance's ability to generate significant positive EBITDA with Liquid Audio's significant cash reserves;

the complementary primary focus of the two companies on the same set of industry partners, namely, the record labels and the retailers with both companies having strong positions with the independent record labels in addition to the major record labels, and the same set of media formats including audio and video;

the extensive trading relationships that Alliance enjoys with the major record labels and the amount of their business that Alliance represents thereby increasing the attention that these record labels would pay to Liquid Audio's digital distribution business;

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the significantly greater number of retail partners with whom Alliance does business and the potential for these greater number of relationships to result in increased business opportunities for Liquid Audio;

the current nature of the market for digital distribution of entertainment products through the Internet and the belief that greater size, product offerings and resources are optimal for companies to compete successfully in the industry;

the potential for the combination with Alliance to open new revenue streams for Liquid Audio from existing operations including, for example, in the area of increasing promotional revenues from record labels through the offering of a greater set of products to Liquid Audio's database of music consumers, through utilizing Liquid Audio's Liquid Store and Alliance's Store24 for outsourcing the on-line physical and digital Internet needs for a number of retailers who are not able to efficiently manage the costs of such operations at this time, and through being able to provide other existing channel partners such as consumer electronics OEM's with a complete physical and digital Internet retailing operation;

the potential for the combination with Alliance to penetrate new markets and to open new revenue streams for Liquid Audio in contemplated future operations, such as, for example, in the expansion of Liquid Audio's distribution platform to include digital video to complement Alliance's distribution of VHS and DVD products;

the continued competition in Liquid Audio's markets from both existing and potential competitors, and the ability of the combination with Alliance to focus Liquid Audio's operations on its distribution platform in contrast to its technology development expertise;

the intent to operate Liquid Audio in such a way as to preserve and extend the brand equity that Liquid Audio has built for its name as a premier source of digital distribution technology products and services;

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the ability of the combined organization to preserve Liquid Audio's long-term viability by allowing it to continue deployment of its higher-margin digital distribution platform while awaiting the factors that will spark mass adoption of this new means of entertainment consumption among consumers;

the complementary cultures that both companies share and especially the common focus on the use of technology to increase the efficiencies of their respective forms of distribution services;

the opportunity for the holders of Liquid Audio common stock to receive cash in the transaction, while at the same time participating in a larger company, and as stockholders of the combined organization having greater liquidity in their shares;

the opportunity for holders of Liquid Audio common stock to receive cash consideration for a portion of their shares of Liquid Audio stock in the tender offer;

the range of options available to the combined organization to access private and public equity markets should additional capital be needed in the future would likely be greater than the options available to Liquid Audio alone;

the potential for consolidation in Alliance's core business associated with the backing by an equity sponsor experienced in the consolidation of lower margin, high volume businesses; and

the structure of the transaction requiring a lower number of votes for the transaction than the original merger transaction.

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The Liquid Audio board of directors also identified and considered a number of potentially negative factors concerning the merger and the tender offer, including the following:

the risk that the potential benefits sought in the merger might not be fully realized, or realized at all under certain circumstances;

the possibility that the merger might not be completed in a timely manner or at all, the negative effects of which would be compounded by the reorganization of Liquid Audio's operations in anticipation of the integration of Liquid Audio and Alliance following the completion of the merger;

the short tenure of the Alliance management group as a team and its relative inexperience in managing a publicly held company;

the risk that despite the efforts of management of the combined organization, key personnel might not remain employed by the combined organization;

the risks related to Alliance's business and how they would affect the operations of the combined organization; and

the other risks described in the section entitled "Risk Factors" of this proxy statement/prospectus.

The Liquid Audio board of directors concluded that, on balance, the potential benefits of the merger and the tender offer to Liquid Audio and its stockholders outweighed the potentially negative factors associated with the merger and the tender offer. In considering the proposed merger and tender offer, the Liquid Audio board of directors considered the election contest for control of the Liquid Audio board of directors that had been initiated by musicmaker.com and attempted to structure the proposed transaction to address certain concerns voiced by musicmaker.com by including a tender offer for a portion of the outstanding Liquid Audio common stock. The tender offer was intended to result in the distribution of a portion of Liquid Audio's cash on hand to its stockholders. The Liquid Audio board of directors did not conclude that the musicmaker.com election contest should be a determinative factor in its decision to enter into the merger agreement, in part because Liquid Audio

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stockholders would have the opportunity to vote on the merger and Liquid Audio stockholder approval is a condition to the consummation of the merger.

This discussion of the information and factors considered by the Liquid Audio board of directors is not intended to be exhaustive, but is believed to include all of the material factors considered by the board of directors. In view of the variety of factors considered in connection with its evaluation of the merger, the Liquid Audio board of directors did not find it practicable to, and did not, quantify or otherwise assign relative weight to, the specific factors considered in reaching its determination. In addition, the Liquid Audio board of directors did not reach a specific conclusion on any single factor considered, or any aspect of any particular factor, but rather it conducted an overall analysis of these factors. Individual members of the Liquid Audio board of directors may have given different weight to different factors.

Recommendation of Liquid Audio's Board of Directors

After careful consideration, the Liquid Audio board of directors has approved the merger agreement, the tender offer, the merger and the issuance of Liquid Audio stock in the merger and has determined that the tender offer, the merger and the issuance of Liquid Audio stock in the merger are fair to, and in the best interests of, the stockholders of Liquid Audio.

Therefore, the Liquid Audio board of directors recommends that Liquid Audio stockholders vote FOR approval of the issuance of Liquid Audio stock in the merger.

In considering the recommendation of the Liquid Audio board of directors with respect to the merger and the issuance of Liquid Audio stock in the merger, Liquid Audio stockholders should be aware, however, that certain directors and executive officers of Liquid Audio may have interests in the merger that are different from, or are in addition to, the interests of Liquid Audio stockholders. Please see "The Merger Interests of Liquid Audio Directors and Executive Officers" beginning on page 61 of this proxy statement/prospectus.

Opinion of Liquid Audio's Financial Advisor

Pursuant to a letter agreement dated as of June 18, 2001, Broadview International LLC was engaged to act as financial advisor to the Liquid Audio board and to render an opinion to the Liquid Audio board regarding the fairness of the aggregate consideration from a financial point of view, to Liquid Audio stockholders. The Liquid Audio board selected Broadview to act as financial advisor based on Broadview's reputation and experience in the information technology, communication and media sector. At the meeting of the Liquid Audio board on July 14, 2002, Broadview delivered its written opinion that, as of July 14, 2002, based upon and subject to various factors and assumptions, the aggregate consideration was fair, from a financial point of view, to Liquid Audio stockholders. The aggregate cash received by Liquid Audio stockholders in the tender offer and the retained 26% of the outstanding common stock of the combined organization are herein collectively referred to as the "aggregate consideration."

Broadview's opinion, which describes the assumptions made, matters considered and limitations on the review undertaken by Broadview, is attached as Annex B to this document. Liquid Audio stockholders are urged to, and should, read the Broadview opinion carefully and in its entirety. The Broadview opinion is directed to the Liquid Audio board of directors and addresses only the fairness of the aggregate consideration payable in connection with the tender offer and merger from a financial point of view to the holders of shares of Liquid Audio common stock as of the date of the opinion and assumes that the tender offer is fully subscribed. The Broadview opinion does not constitute a recommendation to any holder of Liquid Audio common stock as to whether such stockholder should tender all or any portion of its shares in the tender offer or as to how such holder should vote on the issuance of Liquid Audio common stock in the merger. The Broadview opinion addresses only the

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fairness from a financial point of view of the aggregate consideration payable in the merger and the tender offer, assuming that the tender offer is fully subscribed, and does not separately address the fairness from a financial point of view of the consideration to be received in the merger and the consideration to be received in the tender offer or the fairness from a financial point of view of the aggregate consideration payable in the merger and the tender offer if the tender offer is not fully subscribed. The summary of the Broadview opinion set forth in this proxy statement, although materially complete, is qualified in its entirety by reference to the full text of such opinion.

In connection with rendering its opinion, Broadview, among other things:

reviewed the terms of the draft of the merger agreement furnished to Broadview by Liquid Audio on July 13, 2002;

reviewed certain publicly available financial statements and other information of Liquid Audio;

reviewed certain financial projections for Liquid Audio prepared and provided to Broadview by Liquid Audio management;

participated in discussions with Liquid Audio and Alliance management concerning the operations, business strategy, financial performance and prospects for Liquid Audio and Alliance, respectively;

discussed the strategic rationale for the merger with Liquid Audio and Alliance management, respectively;

reviewed valuation materials prepared by a third party financial advisor retained by Liquid Audio management;

reviewed the reported closing prices and trading activity for Liquid Audio common stock;

compared certain aspects of the financial performance of Liquid Audio with other comparable public companies;

analyzed available information, both public and private, concerning other comparable mergers and acquisitions;

reviewed equity research analyst reports covering Liquid Audio;

analyzed the anticipated effect of the merger on the future financial performance of the consolidated entity;

assisted in negotiations and discussions related to the merger among Liquid Audio, Alliance and their respective financial and legal advisors; and

conducted other financial studies, analyses and investigations as Broadview deemed appropriate for purposes of its opinion.

In rendering its opinion, Broadview relied, without independent verification, on the accuracy and completeness of all the financial and other information, including without limitation the representations and warranties contained in the merger agreement, that was publicly available or furnished to Broadview by Liquid Audio, Alliance or Alliance's advisors. With respect to the financial projections examined by Broadview, Broadview assumed that they were reasonably prepared and reflected the best available estimates and good faith judgments of the management of Liquid Audio and Alliance, as to the future performance of Liquid Audio and Alliance, respectively, and in the case of Alliance, where applicable, taking into account the anticipated effects of the Potential Transactions (as defined below) on the future financial performance of Alliance.

For purposes of the opinion, Broadview assumed that neither Liquid Audio nor Alliance is involved in any material transaction other than (i) the merger and tender offer, (ii) other publicly

announced transactions, (iii) certain potential transactions confidentially disclosed to Broadview by Liquid Audio management (the "Potential Transactions"), and (iv) those activities undertaken in the ordinary course of conducting their respective businesses. In rendering the opinion, Broadview assumed, with the Board's permission, that the Potential Transactions will be consummated and on terms materially similar to those disclosed to Broadview by Liquid Audio management. The opinion is necessarily based upon market, economic, financial and other conditions as they existed and could be evaluated as of July 14, 2002, and any change in such conditions would require a reevaluation of Broadview's opinion. The Broadview opinion did not express any opinion as to the price at which shares of Liquid Audio common stock would trade at any time or as to the value of such securities. In that regard, Broadview understands that Liquid Audio will be required to meet Nasdaq initial listing requirements. Broadview assumed that shares of Liquid Audio common stock will remain listed on The Nasdaq National Market. Broadview expressed no opinion as to the relative value of the aggregate cash received by Liquid Audio stockholders and the 26% of the voting power in the combined organization retained by Liquid Audio stockholders.

The following is a brief summary of some of the sources of information and valuation methodologies employed by Broadview in rendering Broadview's opinion. Broadview compared the public market value of Liquid Audio to the Aggregate Consideration in the transaction. In addition, Broadview used various methodologies to analyze a hypothetical stand-alone value of Liquid Audio and compared the resulting range of values to the Aggregate Consideration. The range of values implied by these analyses is \$27.7 million to \$305.3 million. These analyses were orally presented to the Liquid Audio board at its meeting on July 14, 2002 and delivered with the opinion on July 15, 2002. This summary includes the financial analyses used by Broadview and deemed to be material, but does not purport to be a complete description of analyses performed by Broadview in arriving at its opinion. Broadview did not explicitly assign any relative weights to the various factors of analyses considered. Broadview expressed no opinion as to the relative value to holders of Liquid Audio common stock of the consideration to be received in the merger and tender offer and the net proceeds to be received by such holders in the event of a liquidation of Liquid Audio. This summary of financial analyses includes information presented in tabular format. In order to fully understand the financial analyses used by Broadview, the tables must be read together with the text of each summary. The tables alone do not constitute a complete description of the financial analyses. Data other than multiple data is presented in thousands.

Liquid Audio Stock Performance Analysis Broadview compared the recent stock performance of Liquid Audio with that of the NASDAQ Composite and the Liquid Audio Comparable Index. The Liquid Audio Comparable Index is comprised of public companies that Broadview

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deemed comparable to Liquid Audio. Broadview selected six public company comparables in the Digital Media Distribution and Digital Rights Management Industries, with Trailing Twelve Month ("TTM") revenue of less than \$50 million. The Liquid Audio Comparable Index consists of the following companies: Intertrust Technologies Corporation; Digimarc Corporation; SonicFoundry, Inc.; ScreamingMedia Inc.; ARTISTDIRECT, INC.; and Loudeye Technologies, Inc.

Public Company Comparable Analysis Broadview considered ratios of market capitalization, adjusted for cash and debt when necessary, to selected historical and projected operating results in order to derive multiples placed on a company in a particular market segment. In order to perform this analysis, Broadview compared financial information of Liquid Audio with publicly available information for the companies comprising the Liquid Audio Comparable Index. For this analysis, as well as other analyses, Broadview examined publicly available information, as well as a range of estimates based on securities research analyst reports.

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The following table presents, as of July 14, 2002, the median multiples and the range of multiples for the Liquid Audio Comparable Index of total market capitalization (defined as equity market capitalization plus total debt minus cash and cash equivalents) divided by selected operating metrics:

	Median Multiple	Range of Multiples
Total Market Capitalization to Last Twelve Months Revenue	0.76	NM 30.00
Total Market Capitalization to Projected 12/31/02 Revenue	1.67	NM 39.57
Total Market Capitalization to Last Quarter Revenue Annualized	0.72	NM 27.14
Equity Market Capitalization to Book Value	1.49	0.32 2.93

The following table presents, as of July 14, 2002, the median implied values and the range of implied values of Liquid Audio, calculated by using the multiples shown above and the appropriate Liquid Audio operating metric:

	Implied Median Value	Range of Implied Values
Total Market Capitalization to Last Twelve Months Revenue	\$ 88,405	NM \$182,046
Total Market Capitalization to Projected 12/31/02 Revenue	\$ 89,611	NM \$171,997
Total Market Capitalization to Last Quarter Revenue Annualized	\$ 86,369	NM \$100,633
Equity Market Capitalization to Book Value	\$ 129,595	\$27,686 \$254,534

No company utilized in the public company comparables analysis as a comparison is identical to Liquid Audio. In evaluating the comparables, Broadview made numerous assumptions with respect to Digital Media Distribution and Digital Rights Management Industries performance and general economic conditions, many of which are beyond the control of Liquid Audio. Mathematical analysis, such as determining the median, average, or range, is not in itself a meaningful method of using comparable company data.

Transaction Comparables Analysis Broadview considered ratios of equity purchase price, adjusted for the seller's cash and debt when appropriate, to selected historical operating results in order to indicate multiples strategic and financial acquirers have been willing to pay for companies in a particular market segment. In order to perform this analysis, Broadview reviewed a number of transactions that they considered similar to the merger. Broadview selected these transactions by choosing transactions since January 1, 2001 involving sellers in the Digital Music Industry, excluding equity investments and divestitures. For this analysis, as well as other analyses, Broadview examined publicly available information, as well as information from Broadview's proprietary database of published and confidential merger and acquisition transactions in the information technology, communication and media industries. These transactions consisted of the acquisition of MP3.com, Inc. by Vivendi Universal S.A.; EMusic.com, Inc. by Vivendi Universal S.A.; and Launch Media, Inc. by Yahoo! Inc.

The following table presents, as of July 14, 2002, the median multiple and the range of multiples of Adjusted Price (defined as equity price plus total debt minus cash and cash equivalents) divided by the seller's revenue in the last reported twelve months prior to acquisition for the transactions listed above:

Median Multiple	Range of Multiples
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	<u>Median Multiple</u>	<u>Range of Multiples</u>
Adjusted Price to Last Reported Twelve Months Revenue	0.80	0.46 2.85

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The following table presents, as of July 14, 2002, the median implied value and the range of implied values of Liquid Audio's common stock, calculated by multiplying the multiples shown above by the appropriate Liquid Audio operating metric for the twelve months ended March 31, 2002:

	<u>Median Implied Value</u>	<u>Range of Implied Values</u>
Adjusted Price to Last Reported Twelve Months Revenue	\$ 88,531	\$87,400 \$95,111

No transaction utilized as a comparable in the transaction comparables analysis is identical to the merger. In evaluating the comparables, Broadview made numerous assumptions with respect to the Digital Music Industry's performance and general economic conditions, many of which are beyond the control of Liquid Audio or Alliance. Mathematical analysis, such as determining the average, median, or range, is not in itself a meaningful method of using comparable transaction data.

Liquid Audio Present Value Of Future Potential Share Price Analysis Broadview calculated the present value of the future potential share price of shares of Liquid Audio common stock on a standalone basis using management revenue estimates for the twelve months ending December 31, 2002 and December 31, 2003. The implied share price calculated using the median Total Market Capitalization to Last Reported Twelve Months Revenue ratio for Liquid Audio public company comparables applied to management estimates and discounted based on the Capital Asset Pricing Model using the median capital-structure adjusted beta for the public company comparables is \$3.06 for the projected 12/31/02 TTM Revenue and \$3.08 for the projected 12/31/03 TTM Revenue.

The analysis implies the following medians and ranges for value:

	<u>Implied Median Value</u>	<u>Range of Implied Values</u>
Projected 12/31/02 Last Twelve Months Revenue	\$ 69,945	NM \$99,409
Projected 12/31/03 Last Twelve Months Revenue	\$ 70,351	NM \$305,250

Consideration of the Discounted Cash Flow Analysis Although discounted cash flow is a commonly used valuation methodology, Broadview did not employ such an analysis for the purposes of valuing Liquid Audio on a standalone basis. Discounted cash flow analysis is most appropriate for companies that exhibit relatively steady or somewhat predictable streams of future cash flow. Given the uncertainty in estimating both the future cash flows and sustainable long-term growth rate for Liquid Audio, and given that Liquid Audio is currently generating negative free cash flow, Broadview considered a discounted cash flow analysis inappropriate for valuing Liquid Audio.

Combined Organization Public Company Comparables Analysis Alliance's ongoing operations are anticipated to be the core functioning business of the combined organization. As such, Broadview considered ratios of market capitalization, adjusted for cash and debt when necessary, to selected projected operating results in order to derive multiples placed on a company in Alliance's market segment. The Alliance Comparable Index is comprised of public companies that Broadview deemed comparable to Alliance. Broadview selected five public company comparables defined as Wholesale Distributors of Finished Goods with trailing twelve months revenue between \$250 million and \$4 billion and TTM gross margins between 0% and 25%. The Alliance Comparables Index consists of: ScanSource, Inc.; Allou Health & Beauty Care, Inc.; United Stationers, Inc.; Handleman Company; and Daisytex International Corp.

For this analysis, Broadview examined publicly available information, as well as a range of estimates based on securities research analyst reports. In order to perform this analysis, Broadview compared financial projections of the combined organization with publicly available information for the Alliance Comparables Index. The following table presents, as of July 14, 2002, the median multiples and the range of multiples for the Alliance Comparable Index of total market capitalization (defined as

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equity market capitalization plus total debt minus cash and cash equivalents) divided by selected operating metrics:

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	Median Multiple	Range of Multiples	
Total Market Capitalization to Last Twelve Months Revenue	0.32	0.30	0.52
Share Price to Last Twelve Months Earnings Per Share	9.02	6.46	20.40
Total Market Capitalization to Projected 12/31/02 Revenue	0.37	0.21	0.47
Share Price to Projected 12/31/02 Earnings Per Share	9.15	6.01	17.66

The following table presents, as of July 14, 2002, the median implied value and the range of implied values of Liquid Audio's common stock, calculated by multiplying the multiples shown above by the appropriate combined organization operating projection:

	Median Implied Value	Range of Implied Values	
Total Market Capitalization to Projected 12/31/02 Revenue	\$ 307,294	\$181,432	\$383,627
Share Price to Projected 12/31/02 Earnings Per Share	\$ 58,784	\$38,593	\$113,479

Combined Present Value Of Future Potential Share Price Analysis Based On Earnings Broadview calculated the present value of the future potential share price of shares of the combined organization's common stock on a standalone basis using earnings estimates from Liquid Audio and Alliance management for the twelve months ending December 31, 2002 and December 31, 2003. The implied share price calculated using the median Share Price to Last Twelve Months Earnings Per Share for the Alliance Comparables Index applied to management estimates and discounted based on the Capital Asset Pricing Model using the median capital-structure adjusted beta for the public company comparables is \$1.11 for the projected December 31, 2002 Last Twelve Months Earnings Per Share and \$1.96 for the projected December 31, 2003 Last Twelve Months Earnings Per Share.

The analysis implies the following medians and ranges for value:

	Implied Median Value	Range of Implied Values	
Projected 12/31/02 Last Twelve Months Earnings Per Share	\$ 54,641	\$22,730	\$150,104
Projected 12/31/03 Last Twelve Months Earnings Per Share	\$ 96,904	\$35,884	\$282,111

Combined Present Value Of Future Potential Share Price Analysis Based On Revenue Broadview calculated the present value of the future potential share price of shares of the combined organization's common stock on a standalone basis using revenue estimates from Liquid Audio and Alliance management for the twelve months ending December 31, 2002 and December 31, 2003. The implied share price calculated using the median Total Market Capitalization to Last Twelve Months Revenue for the Alliance Comparables Index applied to management estimates and discounted based on the CAPM using the median capital-structure adjusted beta for the public company comparables is \$4.89 for the projected December 31, 2002 Last Twelve Months Revenue and \$4.66 for the projected December 31, 2003 Last Twelve Months Revenue.

The analysis implies the following medians and ranges for value:

	Implied Median Value	Range of Implied Values	
Projected 12/31/02 Last Twelve Months Revenue	\$ 241,836	\$71,416	\$460,704
Projected 12/31/03 Last Twelve Months Revenue	\$ 230,218	\$60,456	\$464,888

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Combined Organization Discounted Cash Flow Analysis Broadview examined the value of the combined organization based on projected free cash flow estimates for the combined organization on a *pro forma* basis. The free cash flow estimates were generated from financial projections from the date of the valuation through December 31, 2006 provided by Alliance management and December 31, 2005 provided by Liquid Audio management and Broadview estimates through December 31, 2006 utilizing Liquid Audio management estimates. Estimates for the combined organization prepared by Broadview were approved by Liquid Audio's and Alliance's management. A range of terminal values at December 31, 2007 were determined by ascribing long-term growth rates, which ranged from 2% to 6%, to the annual free cash flow for the twelve months ending December 31, 2007. Broadview calculated a discount rate of 11.28% based on a weighted average of the individual discount rates calculated for Liquid Audio and Alliance.

Using the 11.28% discount rate implies the following range of implied values:

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	<u>Implied Median Value</u>	<u>Implied Range of Values Based On 2% 6% Growth Rate</u>	
DCF	\$ 370,831	\$312,539	\$473,320

Relative Contribution Analysis Broadview examined the relative contribution of Liquid Audio to Alliance for a number of historical and projected operating and financial metrics. In this analysis, projected figures for Liquid Audio and Alliance are based on management estimates.

The following reflect the relative contribution of Liquid Audio and Alliance for each operating and financial metric:

	<u>Liquid Audio</u>	<u>Alliance</u>
Last Twelve Months Revenue	0.5%	99.5%
Last Twelve Months Gross Profit	1.9%	98.1%
Projected 12/31/02 Revenue	0.3%	99.7%
Projected 12/31/02 Gross Profit	0.5%	99.5%
Projected 12/31/03 Revenue	2.4%	97.6%
Projected 12/31/03 Gross Profit	9.9%	90.1%
Cash	93.7%	6.3%
Debt	1.0%	99.0%

Pro Forma Combination Analysis Broadview calculated the *pro forma* impact of the merger on the combined organization's projected earnings per share for Liquid Audio's fiscal years ending December 31, 2002 and December 31, 2003, taking into consideration various financial effects which will result from consummation of the merger. This analysis relies upon certain financial and operating assumptions provided by the management of Liquid Audio and Alliance. Broadview examined a purchase scenario under the assumption that no opportunities for cost savings or revenue enhancements exist. Based on this scenario, the *pro forma* purchase model indicates EPS accretion, for the fiscal year ending December 31, 2003.

In connection with the review of the merger by the Liquid Audio board, Broadview performed a variety of financial and comparative analyses. The summary set forth above does not purport to be a complete description of the analyses performed by Broadview in connection with the merger.

The preparation of a fairness opinion is a complex process and is not necessarily susceptible to partial analysis or summary description. In arriving at its opinion, Broadview considered the results of all of its analyses as a whole and did not attribute any particular weight to any analysis or factor considered by it. Furthermore, Broadview believes that selecting any portion of its analyses, without considering all analyses, would create an incomplete view of the process underlying its opinion.

In performing its analyses, Broadview made numerous assumptions with respect to industry performance and general business and economic conditions and other matters, many of which are beyond the control of Liquid Audio or Alliance. The analyses performed by Broadview are not necessarily indicative of actual values or actual future results, which may be significantly more or less favorable than suggested by such analyses. The exchange ratio pursuant to the merger agreement and other terms of the merger agreement were determined through arm's length negotiations between Liquid Audio and Alliance, and were approved by the Liquid Audio board. Broadview provided advice to the Liquid Audio board during such negotiations; however, Broadview did not recommend any specific consideration to the Liquid Audio board or that any specific consideration constituted the only appropriate consideration for the merger. In addition, Broadview's opinion and presentation to the Liquid Audio board was one of many factors taken into consideration by the Liquid Audio board in making its decision to approve the merger. Consequently, the Broadview analyses as described above should not be viewed as determinative of the opinion of the Liquid Audio board with respect to the value of Liquid Audio or of whether the Liquid Audio board would have been willing to agree to a different consideration.

Upon completion of the merger, Liquid Audio will be obligated to pay Broadview a transaction fee of 1.5% of the total consideration received by Liquid Audio stockholders. Liquid Audio has already paid Broadview fairness opinion fees and an adequacy opinion fee totaling \$650,000. \$450,000 of the fairness opinion fees and adequacy opinion fee will be credited against the transaction fee payable by Liquid Audio upon completion of the merger. In addition, Liquid Audio has agreed to indemnify Broadview and its affiliates against certain liabilities and expenses related to their engagement, including liabilities under the federal securities laws. The terms of the fee arrangement with Broadview, which Liquid Audio and Broadview believe are customary in transactions of this nature, were negotiated at arm's length between Liquid Audio

and Broadview, and the Liquid Audio board of directors was aware of the nature of the fee arrangement, including the fact that a significant portion of the fees payable to Broadview is contingent upon completion of the merger.

Alliance's Reasons for the Merger

In determining the fairness of the merger and the merger agreement, the Alliance board of directors consulted with Alliance's management and legal counsel. Alliance's board of directors believed that it could make an informed decision in favor of the merger and the merger agreement based upon the information obtained during these consultations. The Alliance board of directors considered many factors in the course of making its evaluation, including, but not limited to:

the potential strategic benefits of combining the companies to become the leading provider of commerce solutions for both physical and digital entertainment;

historical information concerning Liquid Audio's business, financial condition, technology and competitive position;

presentations by the Liquid Audio management team to the senior management of Alliance;

the greater financial resources, competitive strength and business opportunities resulting from the merger;

the belief that the terms and conditions of the merger agreement, including the amount and form of consideration, the nature of the parties' representations, warranties and covenants, and the conditions to their respective obligations to consummate the merger, are reasonable;

the belief that the combined organization could benefit from the potential synergies created in combining the research and development and technological strengths of Liquid Audio with the Alliance business plan;

the increased liquidity that Alliance stockholders will enjoy through ownership of publicly traded stock; and

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the ability to leverage buyer and supplier relationships to cross-sell products.

The Alliance board of directors also identified and considered a number of potentially negative factors relating to the merger, including:

the risk that the potential benefits sought in the merger might not be fully realized, or realized at all under certain circumstances;

the possibility that the merger might not be completed in a timely manner, the negative effects of which would be compounded by the reorganization of the company's operations in anticipation of the integration of Liquid Audio and Alliance following the completion of the merger;

the continuous depletion of Liquid Audio's cash;

limited analyst coverage and institutional ownership;

the possibility that the merger might not be completed at all, in light of dissident Liquid Audio stockholders;

the historical lack of profitability of the Liquid Audio business;

the historical lack of profitability of the digital music market;

the risk that despite the efforts of management of the combined organization, key personnel might not remain employed by the combined organization;

the risks attendant to Alliance gaining access to public markets through a business combination, including, for example, the potential heightened public market scrutiny of the merger and the minimal institutional support following the merger;

the risks related to Liquid Audio's business and how they would affect the operations of the combined organization;
the public skepticism and scrutiny of "reverse IPO" transactions and the historical lack of success of such transactions; and
the other risks described in the section entitled "Risk Factors" of this proxy statement/prospectus.

Considering these potential negative factors, the Alliance board of directors concluded that, on balance, the potential benefits of the merger outweighed the potentially negative factors associated with the merger.

This discussion of the information and factors considered by the Alliance board of directors is not intended to be exhaustive, but is believed to include all of the material factors considered by the board of directors. In making its determination, the Alliance board of directors considered factors as a whole and did not assign specific or relative weights to the factors. Nor did the Alliance board of directors reach specific conclusions on any single factor (or any aspect thereof) considered, but rather, it conducted an overall analysis of these factors. In addition, individual members of the Alliance board of directors may have given different weight to different factors.

Interests of Liquid Audio Directors and Executive Officers

Upon completion of the merger and the issuance of Liquid Audio stock in the merger, the directors and officers of Liquid Audio, along with those individuals who were directors and officers of Liquid Audio since the beginning of fiscal year ended December 31, 2001, will collectively beneficially own approximately 4.3% of the outstanding stock of Liquid Audio, calculated on the basis set forth under "Liquid Audio Principal Stockholders" and assuming all stockholders, including each director and officer of Liquid Audio (other than Mr. Kearby and Mr. Flynn) tender their shares.

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Gerald W. Kearby, president, chief executive officer and director of Liquid Audio, and Robert G. Flynn, senior vice president of business development, secretary and director of Liquid Audio, have interests in the merger that are different from your interests. In connection with the execution of the original merger agreement in June 2002, Messrs. Kearby and Flynn each entered into employment agreements with Alliance. These agreements will become effective upon the consummation of the merger. Pursuant to these agreements, each of Mr. Kearby and Mr. Flynn will have a three (3) year term of employment. Each will receive an annual base salary no less than (i) his Liquid Audio salary as of January 1, 2002 or (ii) an amount commensurate with other executives of Alliance with similar responsibilities and expertise. In addition, each of Mr. Kearby and Mr. Flynn will receive a retention payment of \$750,000, in the aggregate, to be paid over a three (3) year period. Each of Mr. Kearby and Mr. Flynn may also be eligible for discretionary bonuses granted by the combined organization's board of directors or by the Compensation Committee of the board of directors. Each is entitled to severance upon termination without cause equal to two times his then current annual base salary, as well as any unpaid portion of the aforementioned retention payment. Upon termination for cause or upon voluntary resignation, each is entitled to his base salary, and is not entitled to any unpaid retention payments. Neither Mr. Kearby, nor Mr. Flynn is permitted to compete or otherwise interfere with the combined organization's business for a period of five (5) years following the consummation of the merger. Each of Mr. Kearby and Mr. Flynn is entitled to \$750,000 payable over a three (3) year period as compensation for his agreement not to compete. Upon termination for cause or resignation by either Mr. Kearby or Mr. Flynn, the noncompete consideration payable to such executive will be reduced by the amount not yet paid to such executive as of the date of termination or resignation, unless the termination or resignation occurs within one year of the consummation of the merger, in which case \$125,000 of the retention payment paid to each of Mr. Kearby and Mr. Flynn will be allocated as consideration for the agreement not to compete. Upon termination without cause, each of Mr. Kearby and Mr. Flynn will continue to be entitled to the entire consideration for his agreement not to compete. Upon breach of the non-compete obligation, each of Mr. Kearby and Mr. Flynn forfeit his consideration for the agreement not to compete.

Mr. Bolcerek's employment agreement provides that 25% of the unvested options to purchase Liquid Audio stock held by Mr. Bolcerek will vest upon consummation of a change of control, as defined in the employment agreement, and an additional 12.5% of his unvested options to purchase Liquid Audio Stock will vest in the event he is terminated or constructively terminated due to a change of control. Pursuant to the terms of such employment agreement, the merger will constitute a change of control that would result in an acceleration of the vesting of options to purchase an aggregate of 50,000 shares of Liquid Audio common stock at an exercise price of \$1.84 per share.

Liquid Audio has agreed to pay severance to each of Messrs. Rishniw, Wingate, Blanco and Bolcerek in the event that his employment with Liquid Audio is terminated without cause or he is constructively terminated. Liquid Audio has agreed to pay six months' salary for each of Messrs. Wingate, Blanco and Bolcerek, which amounts to \$115,000, \$87,500 and \$87,500, respectively. In the case of Leon Rishniw, Liquid Audio has agreed to pay \$170,000, which is one year's salary.

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Liquid Audio has entered into agreements indemnifying its directors and executive officers which contain provisions that may require Liquid Audio to, among other things:

indemnify its directors and officers against liabilities that may arise by reason of their status or service as directors or officers, other than liabilities arising from willful misconduct of a culpable nature; and

advance their expenses incurred as a result of any proceeding against them as to which they could be indemnified.

In addition, the merger agreement provides that Liquid Audio will maintain directors' and officers' liability insurance in specified amounts and for specified periods following the effective time of the merger, covering the existing Liquid Audio directors for their acts and omissions occurring prior to the completion of the merger.

As a result of the foregoing, the directors and executive officers of Liquid Audio may be more likely to vote for the adoption of the merger agreement than Liquid Audio stockholders generally.

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CERTAIN TERMS OF THE MERGER AGREEMENT

The following description of the merger agreement describes certain material terms of the merger agreement. The full text of the merger agreement is attached as Annex A to this proxy statement/prospectus and is incorporated herein by reference. Liquid Audio stockholders are encouraged to read carefully the entire merger agreement.

Structure of the Merger

At the effective time of the merger, Liquid Audio's wholly-owned subsidiary, April Acquisition Corp., will be merged with and into Alliance. Upon completion of the merger, Alliance will continue as the surviving corporation and will be a wholly-owned subsidiary of Liquid Audio.

Effective Time of the Merger

The merger agreement provides that the merger will become effective when a certificate of merger is filed with the Secretary of State of the State of Delaware in accordance with the relevant provisions of the Delaware General Corporation Law. The completion of the merger will take place no later than the second business day after the conditions to the merger set forth in the merger agreement are satisfied or waived, or at such other time, date and location as the parties agree in writing.

Manner and Basis of Converting Shares of Alliance Preferred Stock and Alliance Common Stock

The merger agreement provides that, immediately prior to the effective time of the merger, each share of Alliance preferred stock issued and outstanding will convert into shares of Alliance common stock. Alliance is required to effect a conversion of all Alliance preferred stock into Alliance common stock immediately prior to the completion of the merger, and accordingly, no Alliance preferred stock will be outstanding at the effective time of the merger.

As of the effective time of the merger, each share of Alliance common stock issued and outstanding immediately prior to the completion of the merger (including the shares of Alliance common stock issuable upon conversion of the Alliance preferred stock), other than any dissenting shares and shares of Alliance capital stock held by Alliance or Alliance's wholly-owned subsidiaries, will be cancelled and extinguished and converted automatically into the right to receive such number (the "Exchange Ratio") of shares of Liquid Audio common stock as would result in (i) the holders of Alliance common stock immediately prior to the effective time of the merger (including shares of Alliance common stock issuable upon conversion of Alliance preferred stock) owning 74% of the voting power of Liquid Audio immediately after the effective time of the merger and (ii) the holders of Liquid Audio common stock immediately prior to the effective time of the merger owning 26% of the voting power of Liquid Audio common stock immediately after the effective time of the merger.

The number of shares to be received by each individual stockholder of Alliance depends upon the exact number of shares of Liquid Audio outstanding immediately before the Effective Time of the merger. Since the number of Liquid Audio shares outstanding prior to the merger will be impacted by the exercise of any options and the number of shares tendered in the related tender offer, an exchange ratio cannot be

conclusively determined at this time.

No fractional shares of Liquid Audio common stock will be issued in the merger. Instead, each Alliance stockholder otherwise entitled to a fractional share will receive a cash amount, rounded to the nearest whole cent, without interest, determined by multiplying that fraction by the closing price of Liquid Audio common stock on The Nasdaq National Market on the last trading day before the effective time of the merger.

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Directors and Officers of Liquid Audio Upon Completion of the Merger

As a condition to the merger, the Liquid Audio board of directors immediately prior to the Effective Time shall consist of members designated by Liquid Audio who shall comprise one-third of the board of directors and members designated by Alliance who shall comprise two-thirds of the board of directors. See "Management Executive Officers and Directors Post-Merger." Liquid Audio and Alliance will each designate individuals so that the directors satisfy the Qualitative Listing Requirements of The Nasdaq National Market.

The existing officers of Liquid Audio who are not designated as officers after completion of the merger, will also resign upon completion of the merger and new officers will be appointed by the newly-constituted Liquid Audio board of directors. The individuals currently contemplated to become the directors and officers of Liquid Audio immediately following the completion of the merger are identified under the heading entitled "Management."

Increasing Authorized Liquid Audio Common Stock After the Merger

The merger agreement provides that:

following the effective time of the merger, Liquid Audio will take all action necessary in accordance with the Delaware General Corporation Law and the Liquid Audio charter documents to call, give notice of, hold and convene a meeting of the Liquid Audio stockholders to consider approval of an amendment to Liquid Audio's certificate of incorporation to increase the total number of shares of Liquid Audio common stock that Liquid Audio is authorized to issue to at least 100,000,000; and

the Liquid Audio board of directors will recommend that Liquid Audio stockholders vote in favor of the approval and adoption of such amendment at the Liquid Audio stockholders meeting.

Exchange of Alliance Stock Certificates

Following the effective time of the merger, an exchange agent, selected by Liquid Audio and subject to Alliance's reasonable satisfaction, will mail to each record holder of Alliance common stock a letter of transmittal and instructions specifying other details of the exchange. The record holders will use the letter of transmittal to exchange Alliance stock certificates for the shares of Liquid Audio common stock and cash in lieu of fractional shares of Liquid Audio common stock to which the record holders of Alliance common stock are entitled to receive in connection with the merger.

After the effective time of the merger, transfers of Alliance capital stock will not be registered on the stock transfer records of Alliance, and each certificate that previously evidenced Alliance capital stock (including certificates evidencing Alliance preferred stock that has been converted into Alliance common stock) will be deemed to evidence the right to receive the shares of Liquid Audio common stock and cash in lieu of fractional shares of Liquid Audio common stock to which the record holders of Alliance capital stock are entitled to receive in connection with the merger. Liquid Audio will not pay dividends or other distributions on any shares of Liquid Audio common stock to be issued to the holder of any Alliance stock certificate that is not surrendered until the Alliance capital stock certificate is surrendered as provided in the merger agreement. No interest will be payable on the cash to be paid to Alliance stockholders in lieu of the issuance of fractional shares of Liquid Audio common stock.

Assumption of Alliance Stock Options and Warrants

At the effective time of the merger, Liquid Audio will assume each outstanding option to purchase Alliance common stock, whether or not exercisable at the effective time of the merger. Each Alliance

option will continue to be subject to the same terms and conditions set forth in the Alliance stock option plans (and any applicable stock option agreement for such Alliance option) that it was subject to immediately prior to the completion of the merger, including any repurchase rights or vesting provisions, except for the following two adjustments. First, each assumed Alliance option will be exercisable, or will become exercisable in accordance with its terms, for that number of whole shares of Liquid Audio common stock equal to the product of the number of shares of Alliance common stock that were issuable upon exercise of that option immediately prior to the completion of the merger multiplied by the Exchange Ratio, rounded to the nearest whole number of shares of Liquid Audio common stock. Second, the per share exercise price for the shares of Liquid Audio common stock issuable upon exercise of each assumed Alliance option will be equal to the quotient determined by dividing the exercise price per share of Alliance common stock at which that option was exercisable immediately prior to the completion of the merger by the Exchange Ratio, rounded to the nearest whole cent. After the completion of the merger, Liquid Audio will issue to each person who holds an assumed Alliance option a document evidencing the assumption of that option by Liquid Audio. In addition, within 120 days after the effective time of the merger, Liquid Audio will register the shares of Liquid Audio common stock issuable upon exercise of the assumed Alliance options by filing a Form S-8 with the SEC.

At the effective time of the merger, Liquid Audio will assume each issued and outstanding warrant to purchase Alliance preferred stock and Alliance common stock, whether or not exercisable at the effective time of the merger, in accordance with the terms of such warrants.

The Tender Offer

In conjunction with the merger, Liquid Audio will offer to purchase up to 10 million shares of its common stock, representing a total purchase of up to 44% of its outstanding common stock on August 12, 2002 at a purchase price of \$3.00 per share. If more than 10 million shares of Liquid Audio common stock are tendered, Liquid Audio will accept the tendered shares on a pro rata basis up to that amount. The offer to purchase Liquid Audio shares of common stock and the ability to withdraw a self tender will expire twenty business days following the date of commencement of the tender offer, unless extended by Liquid Audio, and payments for the tendered shares will be made after the expiration of the tender offer. The tender offer is also subject to Liquid Audio obtaining exemptive relief from the SEC from the requirements of Regulation M for the conduct of the tender offer or being advised in writing by its counsel that it may proceed without such exemption.

The obligation of Liquid Audio to consummate the tender offer and to accept for payment and to pay for shares of Liquid Audio common stock tendered pursuant to the tender offer is subject to the following conditions:

the issuance of shares of Liquid Audio stock in the merger will have been approved by the requisite vote of stockholders of Liquid Audio; and

none of the following events will have occurred at any time following the date of the merger agreement and before the time of payment for any shares of Liquid Audio common stock: (1) the promulgation of any law or order or the institution of any pending action by a governmental entity which prohibits the purchase of shares of Liquid Audio common stock pursuant to the tender offer or consummation of the merger, or seeks to restrain the making or consummation of the tender offer or the merger; (2) the termination of the merger agreement in accordance with its terms, or (3) the agreement between Liquid Audio and Alliance that Liquid Audio amend the tender offer to terminate the tender offer or postpone the payment for shares of Liquid Audio common stock under the tender offer.

Liquid Audio expressly reserves the right to waive any condition other than those described in the first bullet point above and to make any other changes in the terms and conditions of the tender offer. No change to the terms and conditions of the tender offer may be made which:

changes the amount of consideration to be paid to holders of Liquid Audio common stock for shares of Liquid Audio common stock in the tender offer;

changes the form of consideration to be paid in the tender offer;

changes the number of shares of Liquid Audio common stock sought to be purchased in the tender offer; or

imposes conditions to the tender offer in addition to those described above, provided that the tender offer may be extended to the extent required by law and after the initially scheduled expiration date if upon any expiration of the tender offer any condition to the tender offer will not be satisfied and there is a reasonable basis to believe that such condition could be satisfied.

Following the termination of the tender offer, which we expect will occur immediately prior to the merger, Liquid Audio shall pay for shares of Liquid Audio stock tendered pursuant to the tender offer, provided that, if the number of shares of Liquid Audio stock that has been validly tendered and not withdrawn at the expiration of the tender offer exceeds 10,000,000 shares, the number of shares of Liquid Audio stock to be purchased by Liquid Audio pursuant to the tender offer will be prorated so that the number of shares of Liquid Audio stock purchased by Liquid Audio will equal 10,000,000 shares. Liquid Audio will accept the tendered shares in exchange for cash.

Holders of such shares that have been tendered will cease to have any rights with respect to such tendered shares, other than the right to receive \$3.00 per share.

NO PERSON HAS BEEN AUTHORIZED TO MAKE ANY RECOMMENDATION ON BEHALF OF LIQUID AUDIO AS TO WHETHER STOCKHOLDERS SHOULD TENDER OR REFRAIN FROM TENDERING SHARES PURSUANT TO THE TENDER OFFER. NO PERSON HAS BEEN AUTHORIZED TO GIVE ANY INFORMATION OR TO MAKE ANY REPRESENTATION IN CONNECTION WITH THE TENDER OFFER OTHER THAN THOSE CONTAINED HEREIN OR IN THE LETTER OF TRANSMITTAL. IF GIVEN OR MADE, SUCH RECOMMENDATION AND SUCH INFORMATION AND REPRESENTATION MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED BY LIQUID AUDIO.

Representations and Warranties

The merger agreement contains various representations and warranties of the parties, which will expire at the effective time of the merger. These representations and warranties are not easily summarized and Liquid Audio stockholders are referred to Articles II and III of the merger agreement attached as Annex A to this proxy statement/prospectus for the complete text of these provisions.

Representations and Warranties of Alliance

The representations and warranties made by Alliance to Liquid Audio include representations and warranties related to:

the corporate organization, good standing and qualification to do business of Alliance and its subsidiaries;

the certificate of incorporation and bylaws of Alliance and the organizational documents for its subsidiaries;

Alliance's capitalization;

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Alliance's authority to enter into the merger agreement and the absence of any conflicts between the merger agreement and Alliance's and its subsidiaries' charter documents;

regulatory and third party consents required by Alliance to complete the merger and tender offer;

Alliance's financial statements;

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the absence of any undisclosed liabilities of Alliance;

the absence of certain changes or events related to Alliance since March 31, 2002;

Alliance's taxes, tax returns and audits;

intellectual property matters pertaining to Alliance;

compliance by Alliance and its subsidiaries with applicable legal requirements;

permits required to conduct the respective businesses of Alliance and its subsidiaries and their compliance with those permits;

litigation involving Alliance and its subsidiaries;

payments required to be made by Alliance to brokers and agents in connection with the merger;

certain material contracts of Alliance;

Alliance's employee benefit plans, other employment matters and labor relations;

Alliance's real property;

Alliance's sale of its All Media Guide and Digital On-Demand businesses;

transactions with certain parties related to Alliance;

title to Alliance's properties;

environmental matters pertaining to Alliance;

the accuracy of the information supplied by Alliance for inclusion in this proxy statement/prospectus, the related registration statement filed by Liquid Audio and the tender offer documents;

the approval of the merger and related matters by the Alliance board of directors; and

the fact that Alliance's principal stockholder holds a sufficient amount of Alliance common stock and preferred stock to cause the conversion of all outstanding Alliance preferred stock into Alliance common stock and to approve the merger, all in accordance with the Delaware General Corporation Law and Alliance's charter documents.

Representations and Warranties of Liquid Audio

The representations and warranties made by Liquid Audio to Alliance include representations and warranties related to:

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the corporate organization, good standing and qualification to do business of Liquid Audio and its subsidiaries;

the certificate of incorporation and bylaws of Liquid Audio and the organizational documents for its subsidiaries;

Liquid Audio's capitalization;

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Liquid Audio's authority to issue Liquid Audio stock pursuant to the merger agreement, and the absence of any conflicts between the merger agreement and Liquid Audio's and its subsidiaries' charter documents;

regulatory and third party consents required by Liquid Audio to complete the merger and the tender offer;

Liquid Audio's filings and reports with the Securities and Exchange Commission;

Liquid Audio's financial statements;

the absence of any undisclosed liabilities of Liquid Audio and its subsidiaries;

the absence of certain changes or events relating to Liquid Audio and its subsidiaries since March 31, 2002;

Liquid Audio's taxes, tax returns and audits;

intellectual property matters pertaining to Liquid Audio;

compliance by Liquid Audio and its subsidiaries with applicable legal requirements;

permits required to conduct the respective businesses of Liquid Audio and its subsidiaries and their compliance with those permits;

litigation involving Liquid Audio and its subsidiaries;

payments required to be made by Liquid Audio to brokers and agents in connection with the merger;

certain material contracts of Liquid Audio;

Liquid Audio's employee benefit plans, other employment matters and labor relations;

Liquid Audio's real property;

transactions with certain parties related to Liquid Audio;

title to Liquid Audio's properties;

environmental matters pertaining to Liquid Audio;

the accuracy of the information supplied by Liquid Audio in this proxy statement/prospectus, the related registration statement filed by Liquid Audio and the tender offer documents;

the approval of the merger, the tender offer and related matters by the Liquid Audio board of directors;

the operations of April Acquisition Corp.;

the fairness opinion delivered by Broadview International LLC to the Liquid Audio board of directors regarding the transaction; and

actions taken by Liquid Audio so that Alliance will not be an "Acquiring Person" under Liquid Audio's Preferred Stock Rights Agreement, dated August 7, 2001, and so that the merger will not cause any rights under the Rights Agreement to be exercised, distributed or triggered.

Liquid Audio's Conduct of Business Prior to the Completion of the Merger

Under the terms of the merger agreement, Liquid Audio has agreed that during the period from June 12, 2002 until the earlier of the termination of the merger agreement in accordance with its terms or the effective time of the merger, Liquid Audio and its subsidiaries did and will carry on its business

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in the usual, regular and ordinary course, and will use all reasonable efforts to preserve intact its present business organization and keep available the services of present executive officers and key employees, unless Alliance consents in writing. In addition, during such period Liquid Audio has not and will not, without the prior written consent of Alliance, do any of the following or permit any of its subsidiaries to do any of the following:

enter into any new line of business;

declare, set aside or pay any dividends on or make any other distributions (whether in cash, stock, equity securities or property) in respect of any capital stock or split, combine or reclassify any capital stock or issue or authorize the issuance of any other securities in respect of, in lieu of or in substitution for any capital stock;

purchase, redeem or otherwise acquire, directly or indirectly, any shares of capital stock of Liquid Audio or its subsidiaries, except pursuant to the tender offer or repurchases of unvested shares at cost in connection with the termination of the employment relationship with any employee pursuant to stock option or purchase agreements in effect on June 12, 2002;

issue, deliver or sell or authorize or propose the issuance, delivery or sale of, any shares of capital stock or securities convertible into, or subscriptions, rights, warrants or options to acquire, or other agreements or commitments of any character obligating it to issue any such shares or other convertible securities, other than the issuance of shares of Liquid Audio stock pursuant to the exercise of options or warrants outstanding as of June 12, 2002;

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make any changes (by split-up, combination, reorganization or otherwise) in the capital structure of Liquid Audio;

cause, permit or propose any amendments to the Liquid Audio charter documents or any of the organizational documents of its subsidiaries, except to the extent necessary to comply with the obligations under the provisions of the merger agreement relating to the composition of the Liquid Audio board of directors after the effective time of the merger;

acquire or enter into an agreement to acquire by merger, consolidation, or purchase of the stock or assets of, any business or entity or any person or division thereof, or otherwise acquire or agree to acquire any assets;

enter into any joint ventures, strategic partnerships or alliances, other than licensing agreements in the ordinary course of business consistent with past practice;

except as previously disclosed in Liquid Audio's reports filed with the SEC, sell, lease or otherwise dispose of any property or asset, or permit any lien or other encumbrance to be imposed on any property or asset of Liquid Audio, in each case other than in the ordinary course of business consistent with past practice;

make any loans, advances or capital contributions to, or investments in, any other person, other than advances for business related travel expenses made in the ordinary course of business;

engage in any transaction with any officer, director or stockholder of Liquid Audio, or any person with whom, to the knowledge of Liquid Audio any such stockholder, officer or director has any direct or indirect relation by blood, marriage or adoption, or any entity in which any of such persons owns any beneficial interest (other than a publicly-held corporation whose stock is traded on a national securities exchange or in the over-the-counter market and less than 1% of the stock of which is beneficially owned by such persons) except for compensation and benefits received in the ordinary course of business as an employee or director of Liquid Audio;

enter into, modify or extend in any manner the terms of any employment, severance, consulting, or similar agreements with officers, directors or employees (except for employees terminated by

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Liquid Audio in accordance with the severance policies set forth on Exhibit A of the merger agreement) nor grant any increase in the compensation of officers, directors or employees, whether now or hereafter payable (except, with respect to employees other than officers and directors, for compensation increases in the ordinary course of business and consistent with past practice), including any such increase pursuant to any option, bonus, stock purchase, pension, profit-sharing, deferred compensation, retirement or other plan, arrangement, contract or commitment;

terminate an employee of Liquid Audio, other than terminations for cause and terminations meeting the criteria set forth in Exhibit A of the merger agreement;

incur any indebtedness for borrowed money or guarantee any such indebtedness of another person, issue or sell any debt securities or options, warrants, calls or other rights to acquire any debt securities of it, guarantee any debt securities of another person, enter into any "keep well" or other agreement to maintain any financial statement condition of any other person (other than any wholly-owned subsidiary of Liquid Audio) or enter into any arrangement having the economic effect of any of the foregoing;

permit a change in its methods of maintaining its books, accounts or business records except as required by United States generally accepted accounting principles or the SEC, change its fiscal year, any of its accounting principles or methods by which such principles are applied for tax or financial reporting purposes;

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enter into, terminate, fail to renew, or accelerate any license, distributorship, dealer, sales representative, joint venture, credit or other agreement if such action could reasonably be expected to have, individually or in the aggregate, a material adverse effect;

license any of its intellectual property or technology, other than in the ordinary course of business;

make or change any material tax election, settle any audit relating to taxes pending as of June 12, 2002 or arising on or after June 12, 2002, or amend any tax return in any material respect;

enter into, modify or amend in a manner adverse in any material respect to Liquid Audio, or terminate any of its material contracts or waive, release or assign any material rights or claims under such material contracts, other than the expiration of any Liquid Audio material contract in accordance with the terms and conditions thereof;

pay, discharge, settle or satisfy any material claims, liabilities or obligations (absolute, accrued, asserted or unasserted, contingent or otherwise), other than the payment, discharge, settlement or satisfaction of such claims, liabilities or obligations (i) in the ordinary course of business consistent with past practice or (ii) in accordance with the terms of liabilities reflected or reserved against in the Liquid Audio balance sheet dated March 31, 2002; *provided* that the foregoing shall not prohibit Liquid Audio from paying any legal, accounting, financial advisor or financial printer fees and expenses or SEC and other regulatory filing fees incurred in connection with the merger;

pay or make any accrual or arrangement for payment of any pension, retirement allowance or other employee benefit pursuant to any Liquid Audio employee plan, to any officer, director, employee, consultant or any affiliate of Liquid Audio or any amount relating to unused vacation days, other than as required under applicable law; adopt or pay, grant, issue, accelerate or accrue salary or other payments or benefits pursuant to any Liquid Audio employee plan with or for the benefit of any director, officer, employee, agent or consultant, whether past or present, other than as required under applicable law or the current terms of any Liquid Audio employee

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benefit plan; or amend in any respect any Liquid Audio employee plan in a manner inconsistent with the foregoing;

except as required by law, enter into any collective bargaining agreement;

terminate, amend or waive any of the confidentiality and noncompetition agreements entered into by its employees and consultants with Liquid Audio or any of its subsidiaries prior to the effective time of the merger. Such agreements shall continue to be in full force and effect immediately after the effective time of the merger, except for those agreements that, pursuant to their terms, terminate at or prior to the effective time of the merger;

change or modify its policies, procedures and practices as relating to Liquid Audio's payment of accounts payables and other liabilities incurred in the ordinary course of business; or

agree in writing or otherwise to take any of the foregoing actions.

Alliance's Conduct of Business Prior to the Completion of the Merger

Under the terms of the merger agreement, Alliance has agreed that during the period from June 12, 2002 until the earlier of the termination of the merger agreement in accordance with its terms or the effective time of the merger, Alliance did and will carry on its business in the usual, regular and ordinary course, in substantially the same manner as it is currently conducted and use all reasonable efforts consistent with past practices and policies to preserve intact its present business organization and keep available the services of its present executive officers and key

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employees, unless Liquid Audio consents in writing. In addition, during such period Alliance has not and will not, without the prior written consent of Liquid Audio, do any of the following or permit any of its subsidiaries to do any of the following:

enter into any new line of business material to Alliance and its subsidiaries taken as a whole;

declare, set aside or pay any dividends on or make any other distributions (whether in cash, stock, equity securities or property) in respect of any capital stock or split, combine or reclassify any capital stock or issue or authorize the issuance of any other securities in respect of, in lieu of or in substitution for any capital stock, except (a) as required by the existing agreements in connection with Alliance's sale of its All Media Guide and Digital On-Demand businesses or (b) in connection with a spin-off, sale or other disposition by Alliance of its All Media Guide and Digital On-Demand businesses;

purchase, redeem or otherwise acquire, directly or indirectly, any shares of capital stock of it or its subsidiaries, except repurchases of unvested shares at cost in connection with the termination of the employment relationship with any employee pursuant to stock option or purchase agreements in effect on June 12, 2002 or entered into the ordinary course of business consistent with past practice after June 12, 2002;

issue, deliver or sell or authorize or propose the issuance, delivery or sale of, any shares of capital stock or securities convertible into, or subscriptions, rights, warrants or options to acquire, or other agreements or commitments of any character obligating it to issue any such shares or other convertible securities, other than the issuance of shares of its common stock pursuant to the conversion of outstanding shares of Alliance preferred stock and the exercise of options or warrants outstanding as of June 12, 2002;

cause, permit or propose any amendments to its charter documents or any of the organizational documents of its subsidiaries;

acquire or agree to acquire by merging or consolidating with, or by purchasing any equity interest in or a portion of the assets of, or by any other manner, any business or any person or

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division thereof which are material, individually or in the aggregate, to the business of Alliance and its subsidiaries taken as a whole, or otherwise acquire or agree to acquire any assets which are material, individually or in the aggregate, to the business of Alliance and its subsidiaries taken as a whole;

sell, lease, license, encumber or otherwise dispose of any properties or assets which are material, individually or in the aggregate, to its business, except (a) in the ordinary course of business consistent with past practice, (b) the sale by Alliance of its All Media Guide and Digital On-Demand businesses pursuant to the existing agreements to sell such businesses, or (c) any spin-off, sale or other disposition by Alliance of the All Media Guide or Digital On-Demand businesses; *provided, that*, in the event of any such spin-off, sale or other disposition, Alliance shall not enter into any agreement that (A) significantly limits the ability of Liquid Audio, Alliance or their respective subsidiaries to compete, including restrictions on any such company's ability to offer competitive products or services or (B) includes exclusivity provisions preventing Liquid Audio, Alliance or their respective subsidiaries, the combined organization or any subsidiary of such companies from engaging in any transaction with any third party;

make any loans, advances or capital contributions to, or investments in, any other person, other than (i) loans or investments by it or a subsidiary of it or in it or any subsidiary of it, (ii) employee loans or advances made in the ordinary course of business or loans in the ordinary course of business consistent with past practice which are not, individually or in the aggregate, material to it and its subsidiaries taken as a whole, and (iii) as permitted pursuant to the Alliance's existing credit agreement with its third party lender;

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enter into, modify or extend in any manner the terms of any employment, severance, consulting, or similar agreements with directors and holders of more than 5% of the outstanding shares of any class of Alliance capital stock nor grant any increase in the compensation of directors or holders of more than 5% of the outstanding share of any class of Alliance capital stock, whether now or hereafter payable;

incur any indebtedness for borrowed money or guarantee any such indebtedness of another person, issue or sell any debt securities or options, warrants, calls or other rights to acquire any debt securities of it, guarantee any debt securities of another person, enter into any "keep well" or other agreement to maintain any financial statement condition of any other person (other than any wholly-owned subsidiary of it) or enter into any arrangement having the economic effect of any of the foregoing, except (i) for borrowings pursuant to Alliance's credit agreement in the ordinary course of business and (ii) as permitted pursuant to Alliance's credit agreement;

permit a change in its methods of maintaining its books, accounts or business records except as required by United States generally accepted accounting principles, change its fiscal year, any of its accounting principles or methods by which such principles are applied for tax or financial reporting purposes; or

agree in writing or otherwise to take any of the foregoing actions.

Certain Covenants

Under the terms of the merger agreement, Alliance and Liquid Audio have each agreed that until the earlier of the termination of the merger agreement in accordance with its terms or the effective time of the merger, each of them will, among other things and subject to certain exceptions specified in the merger agreement:

use all reasonable efforts to take, or cause to be taken, all actions, and to do, or cause to be done, and to assist and cooperate with one another in doing, all things necessary, proper or

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advisable to complete and make effective the tender offer and the merger and the other transactions contemplated by the merger agreement;

give the other party prompt notice after obtaining actual knowledge of any representation or warranty made by the notifying party contained in the merger agreement becoming inaccurate, or any failure of the notifying party to comply with or satisfy in any material respect any covenant or agreement to be complied with or satisfied by it under the merger agreement, in each case, to the extent that such inaccuracy or failure would result in the conditions relating to the accuracy of the notifying party's representations and warranties or the performance of the notifying party's covenants set forth in Article VI of the merger agreement not being satisfied;

coordinate and cooperate with one another and use all reasonable efforts to comply with all legal requirements and make all filings required by any governmental entity in connection with the merger and the transactions contemplated by the tender offer and the merger agreement;

respond as promptly as practicable to any inquiries or requests received from any governmental entity with respect to the tender offer and the merger or any other transaction contemplated by the merger agreement;

cooperate to fulfill the requirements of maintaining Liquid Audio's listing on The Nasdaq National Market after the effective time of the merger; and

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in the event that the requisite stockholder approvals for the issuance of Liquid Audio stock in the merger are obtained but less than 10,000,000 shares of Liquid Audio stock are tendered and not properly withdrawn pursuant to the tender offer, negotiate in good faith to effect alternative arrangements that would preserve for the parties and their stockholders the economic, voting and other material benefits of the transactions contemplated by the merger agreement.

In addition, Liquid Audio and AEC Associates, LLC, the principal stockholder of Alliance, will negotiate in good faith acceptable terms concerning registration rights applicable to the shares of Liquid Audio stock to be issued to AEC Associates, the principal stockholder of Alliance, in connection with the merger and such terms will include:

three demand registration rights, with the first right exercisable no earlier than three months after the closing date;

unlimited piggyback registration rights;

a five-year term for the registration rights agreement; and

such other customary terms and conditions to be negotiated in good faith by the parties.

Restrictions on Solicitation of Alternative Acquisition Proposals by Liquid Audio

Under the terms of the merger agreement, Liquid Audio has agreed that it will not, and it will not authorize or instruct any representative of Liquid Audio to, and Liquid Audio will use its reasonable efforts to cause each of the employees and agents of Liquid Audio not to:

solicit, initiate, encourage or knowingly facilitate or induce the making, submission or announcement of, any Acquisition Proposal (defined below);

participate in any discussions or negotiations regarding, or furnish to any person any nonpublic information in connection with or in response to any inquiries or the making of any proposal that constitutes or would reasonably be expected to lead to, any Acquisition Proposal;

engage in discussions with any person with respect to any Acquisition Proposal, except as to the existence of the merger agreement and as otherwise permitted by the merger agreement;

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approve, endorse or recommend any Acquisition Proposal, except as otherwise permitted by the merger agreement; or

enter into any letter of intent or similar document contemplating or otherwise relating to any Acquisition Proposal.

Under the terms of the merger agreement, if Liquid Audio receives an Acquisition Proposal or any request for information or inquiry that Liquid Audio reasonably believes would lead to an Acquisition Proposal, Liquid Audio must provide Alliance with written notice of the material terms and conditions of the Acquisition Proposal, request or inquiry, the identity of the person or group making the Acquisition Proposal, request or inquiry, and a copy of all written materials provided in connection with the Acquisition Proposal, request or inquiry. Liquid Audio must also provide Alliance with 24 hours' prior notice of any meeting of the Liquid Audio board of directors at which the board of directors is reasonably expected to consider any Acquisition Proposal.

Notwithstanding the foregoing, in the event that Liquid Audio receives an Acquisition Proposal that is a Superior Offer (defined below) before the date of the Liquid Audio stockholders meeting, Liquid Audio may take any of the following actions (but only if and to the extent that Liquid Audio's board of directors concludes in good faith, after consultation with its outside legal counsel, that failure to do so would be inconsistent with the proper discharge of its fiduciary duties): (i) furnish nonpublic information regarding Liquid Audio to the third party making such Acquisition Proposal, (ii) withhold, withdraw, amend or modify its recommendation in favor of the tender offer and the merger, and in the

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case of a Superior Offer that is a tender or exchange offer made directly to the stockholders of Liquid Audio, recommend that its stockholders accept the tender or exchange offer or (iii) terminate the merger agreement to accept the Superior Offer if all of the following are met:

the Superior Offer has not been withdrawn;

the Liquid Audio stockholders' meeting to vote on the issuance of Liquid Audio stock in the merger has not occurred;

Liquid Audio has provided to Alliance (i) written notice which shall state expressly that Liquid Audio has received a Superior Offer, the material terms and conditions of the Superior Offer and the identity of the person or group making the Superior Offer and that Liquid Audio intends to effect a change of recommendation or termination of the merger agreement to accept a Superior Offer and (ii) a copy of all written materials provided in connection with the Superior Offer (such notice and materials to be delivered to Alliance at least 5 business days prior to taking such action which constitutes a change of recommendation or termination of the merger agreement to accept the Superior Offer); and

Liquid Audio has not breached any of the provisions set forth in Sections 5.2 and 5.3 of the merger agreement which relate to obtaining approval of the Liquid Audio stockholders and treatment of other Acquisition Proposals.

Except in the context of termination fees, the merger agreement defines an Acquisition Proposal as any bona fide written offer or proposal made after the date of the merger agreement relating to any transaction or series of related transactions involving:

any purchase from Liquid Audio or acquisition by any person or group of persons of more than a 10% interest of any class of equity securities of Liquid Audio or any of its subsidiaries;

any tender offer or exchange offer that if consummated would result in any person or group beneficially owning 10% or more of any class of equity securities of Liquid Audio or any of its subsidiaries;

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any merger, consolidation, conversion, share exchange, recapitalization, business combination or similar transaction involving Liquid Audio or any of its subsidiaries (it being understood that the acceptance of payment and payment for shares of Liquid Audio common stock pursuant to the offer will not be deemed to cause an Acquisition Proposal);

any sale, lease (other than in the ordinary course of business), exchange, transfer, license (other than in the ordinary course of business), acquisition or disposition of more than 10% of the assets of Liquid Audio; or

any liquidation or dissolution of Liquid Audio.

In the context of termination fees, references to "10%" in the definition of "Acquisition Proposal" shall be deemed to be references to "50%" and a liquidation or dissolution of Liquid Audio shall not be deemed to be an Acquisition Proposal.

The merger agreement defines a Superior Offer as an unsolicited, bona fide written offer made by a third party after the date of the merger agreement to acquire, directly or indirectly, pursuant to a tender offer, exchange offer, merger, consolidation or other business combination, a majority of the total outstanding assets or voting securities of Liquid Audio on terms that the Liquid Audio board of directors by a majority vote has in good faith determined, if consummated in accordance with its terms and after consultation with outside legal counsel and its financial adviser, (i) is superior to the tender offer and the merger from a financial point of view, (ii) is reasonably capable of being consummated and (iii) is not subject to any financing contingency.

Obligation of Alliance's Board of Directors to Recommend Approval and Adoption of the Merger Agreement and Approval of the Merger

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The merger agreement provides that Alliance will take all action reasonably necessary in accordance with the Delaware General Corporation Law to obtain the adoption and approval of the merger agreement and approval of the merger by its stockholders. The Alliance board of directors will recommend by vote that the Alliance stockholders vote in favor of the approval and adoption of the merger agreement and the approval of the merger.

Obligation of Liquid Audio's Board of Directors to Recommend the Issuance of Liquid Audio Stock in the Merger

The merger agreement provides that:

Liquid Audio will take all action necessary in accordance with Delaware law and the Liquid Audio charter documents to call, give notice of, hold and convene a meeting of the Liquid Audio stockholders to vote on the issuance of Liquid Audio stock in the merger, the meeting to be held as promptly as practicable, and in any event (to the extent permissible under applicable law) within 30 days after the declaration of the effectiveness of the registration statement of which this proxy statement/prospectus is a part; and

the Liquid Audio board of directors will recommend by vote that Liquid Audio stockholders vote in favor of the approval of the issuance of Liquid Audio stock in the merger at the Liquid Audio stockholders meeting.

Conditions to the Completion of the Merger

Conditions to the Obligations of Each Party

The merger agreement provides that the obligations of Liquid Audio and Alliance to effect the merger and otherwise complete the transactions contemplated by the merger agreement are subject to

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the satisfaction, at or prior to the completion of the merger, of the following conditions, in addition to the additional conditions applicable to the respective parties set forth below:

the respective stockholders of Alliance and April Acquisition Corp. will have voted in favor of the approval and adoption of the merger agreement and the approval of the merger;

the Liquid Audio stockholders will have voted in favor of the issuance of Liquid Audio stock in the merger;

no governmental entity will have enacted, issued, promulgated, enforced or entered any statute, rule, regulation, executive order, decree, injunction or other order that is in effect on the closing date of the merger and that has the effect of making the tender offer or the merger illegal or otherwise prohibiting consummation of the merger;

the SEC will have declared effective the registration statement which includes this proxy statement/prospectus, and the registration statement will not be subject to any issued or pending stop order suspending the effectiveness of the registration statement or any pending or threatened stop order proceedings;

all waiting periods (and any extension of such waiting period) under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 relating to the merger will have expired or terminated early and all other material foreign antitrust approvals required to be obtained in connection with the merger will have been obtained;

Alliance and Liquid Audio will have received written opinions from their respective tax counsels that the merger will constitute a tax-free reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 1986; and

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all conditions precedent as set forth in the consent of General Electric Capital Corporation, Alliance's senior lender, shall have been satisfied.

Additional Conditions to the Obligations of Alliance

The merger agreement provides that the obligation of Alliance to effect the merger and otherwise complete the transactions contemplated by the merger agreement is subject to the satisfaction, at or prior to the completion of the merger, of the following conditions, in addition to the conditions set forth above under "Conditions to the Obligations of Each Party":

the representations and warranties of Liquid Audio set forth in the merger agreement will have been accurate on the date of the merger agreement and will be accurate at and as of the effective time of the merger as if made as of the effective time, except for those representations and warranties that address matters only as of a particular date, which will be accurate as of that date, and where the failure of the representations and warranties to be accurate would not reasonably be expected to have a material adverse effect on Liquid Audio, taken as a whole, provided that for purposes of this condition, all "material adverse effect" and materiality terms in the representations and warranties in Article III of the merger agreement will be inapplicable;

Liquid Audio will have performed or complied in all material respects with all agreements and covenants required by the merger agreement to be performed or complied with by Liquid Audio on or prior to the closing date of the merger;

the Liquid Audio common stock issued in connection with the merger will be listed on The Nasdaq National Market;

Liquid Audio shall furnish Alliance with a certificate of its appropriate offers as to compliance;

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the individuals designated by Alliance to serve as directors of Liquid Audio after the effective time of the merger shall have been appointed;

Liquid Audio shall furnish Alliance with a certificate from its appropriate officers setting forth the capitalization of Liquid Audio immediately prior to the effective time of the merger setting forth (i) the number of shares of Liquid Audio common stock issued and outstanding as of such time and (ii) the number of issued and outstanding options to acquire Liquid Audio common stock under Liquid Audio's option plans as of such time;

at the effective time of the merger, Liquid Audio shall have a cash balance equal to or greater than \$82,300,000 *minus* (x) the product of (i) \$1,750,000 multiplied by (ii) the number of whole calendar months and in the case of any partial calendar month, the applicable fractional portion of such calendar month, for the period between June 12, 2002 and the effective time of the merger *plus*(y) any costs, expenses or fees incurred by Liquid Audio in connection with (i) reductions in Liquid's workforce after the date hereof to the extent such reductions meet the criteria set forth in Exhibit A of the merger agreement, (ii) legal and accounting fees in connection with the merger agreement, the tender offer and the merger in an amount not to exceed \$3,000,000, (iii) financial advisor fees payable to Broadview International LLC in connection with the merger agreement, the tender offer and the merger, (iv) financial printer fees in connection with the merger agreement, the tender offer and the merger, (v) SEC and other regulatory filing fees in connection with the merger agreement, the tender offer and the merger, and (vi) maintaining Liquid's existing policy for directors' and officers' liability insurance in effect as of the date of the merger agreement, plus (z) \$30,000,000 to be used to pay for the purchase of Liquid Audio common stock in the tender offer;

no "material adverse effect" to Liquid Audio and its subsidiaries taken as a whole shall have occurred; and

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other than liabilities (i) disclosed by Liquid Audio in Section 3.9 of its disclosure schedules to the merger agreement, (ii) disclosed or provided for in the Liquid Audio balance sheet dated March 31, 2002, (iii) incurred since the date of the Liquid Audio balance sheet dated March 31, 2002, in the ordinary course of business consistent with past practices, and (iv) liabilities incurred pursuant to the merger agreement; Liquid Audio shall not have incurred any liabilities of any kind whatsoever (whether absolute, accrued, contingent or otherwise) in an aggregate amount greater than \$1,500,000.

Additional Conditions to the Obligations of Liquid Audio

The merger agreement provides that the obligation of Liquid Audio to effect the merger and otherwise complete the transactions contemplated by the merger agreement is subject to the satisfaction, at or prior to the completion of the merger, of the following conditions, in addition to the conditions set forth above under "Conditions to the Obligations of Each Party":

The representations and warranties of Alliance set forth in the merger agreement will have been accurate on the date of the merger agreement and will be accurate at and as of the effective time of the merger as if made as of the effective time, except for those representations and warranties that address matters only as of a particular date, which will be accurate as of that date, and where the failure of the representations and warranties to be accurate would not reasonably be expected to have a material adverse effect on Liquid Audio and Alliance, taken as a whole, provided that for purposes of this condition, all "material adverse effect" and materiality terms in the representations and warranties in Article II of the merger agreement will be inapplicable;

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Alliance will have performed or complied in all material respects with all agreements and covenants required by the merger agreement to be performed or complied with by Alliance on or prior to the closing date of the merger;

Alliance shall furnish Liquid Audio with a certificate from its appropriate officers setting forth the capitalization of Alliance immediately prior to the effective time of the merger, after giving effect to the conversions of Alliance preferred stock, setting forth (i) the number of shares of Alliance common stock issued and outstanding as of such time and (ii) the number of issued and outstanding options and warrants to acquire Alliance common stock pursuant to outstanding Alliance options and Alliance warrants as of such time;

No "material adverse effect" to Alliance and its subsidiaries taken as a whole shall have occurred; and

All shares of Alliance preferred stock will have converted into Alliance common stock immediately prior to the effective time of the merger.

Termination of the Merger Agreement

The merger agreement provides that Liquid Audio and Alliance can agree by mutual written consent to terminate the merger agreement at any time before the completion of the merger. In addition, either Liquid Audio or Alliance may terminate the merger agreement at any time before the completion of the merger if:

the merger has not been completed by December 31, 2002, provided that the right to terminate the merger agreement for this reason will not be available to either Liquid Audio or Alliance if the action or failure to act by that party has been a principal cause of the failure of the merger to occur before that date and such action or failure to act constitutes a material breach of the merger agreement;

a governmental entity has issued a final and nonappealable order, decree or ruling or taken any other final and nonappealable action having the effect of permanently restraining, enjoining or otherwise prohibiting the tender offer and the merger;

the Liquid Audio stockholders fail to vote in favor of the issuance of Liquid Audio stock in the merger;

the Alliance stockholders shall fail to vote in favor of the approval of the merger; or

the SEC shall have declined to grant an exemption from the requirements of Rule 102 of Regulation M in connection with the tender offer and the merger, unless counsel advises Liquid Audio that it may proceed in the absence of such exemption.

The merger agreement further provides that Liquid Audio may terminate the merger agreement at any time before the completion of the merger if any of the following occurs:

Liquid Audio enters into a definitive agreement related to a Superior Offer; or

there is a breach of any representation, warranty, covenant or agreement on the part of Alliance set forth in the merger agreement, or any representation or warranty of Alliance shall be or have become untrue, in either case such that the closing conditions set forth in Section 6.3(a) or Section 6.3(b) of the merger agreement would not be satisfied and such breach is not cured within 20 days after delivery of written notice to Alliance of such breach (except in the case of a breach that is not curable or efforts to cure such breach have ceased).

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The merger agreement also provides that Alliance may terminate the merger agreement at any time before the completion of the merger if any of the following occurs:

there is a breach of any representation, warranty, covenant or agreement on the part of Liquid Audio set forth in the merger agreement, or any representation or warranty of Liquid Audio shall be or have become untrue, in either case such that the closing conditions set forth in Section 6.2(a) or Section 6.2(b) of the merger agreement would not be satisfied and such breach is not cured within 20 days after delivery of written notice to Liquid Audio of such breach (except in the case of a breach that is not curable or efforts to cure such breach have ceased); or

at any time prior to the approval of the issuance of Liquid Audio stock in the merger, a "triggering event" with respect to Liquid Audio has occurred, which is deemed to have occurred if: (i) Liquid Audio's board of directors or any board committee by a majority vote shall for any reason have withdrawn or shall have amended or modified, in a manner adverse to Alliance, its recommendation in favor of, the approval of the issuance of Liquid Audio stock in the merger or that the Liquid Audio stockholders tender their shares pursuant to the tender offer, (ii) Liquid Audio shall have failed to include in the prospectus/proxy statement the recommendation of its board of directors in favor of the approval of the issuance of Liquid Audio stock in the merger or in the tender offer documents the recommendation of the Liquid Audio board of directors that the Liquid Audio stockholders tender their shares pursuant to the tender offer, (iii) Liquid Audio's board of directors or any board committee by a majority vote shall have approved or recommended any Acquisition Proposal, (iv) a tender or exchange offer relating to its securities shall have been commenced by a person unaffiliated with Alliance and Liquid Audio shall not have sent to its stockholders pursuant to Rule 14e-2 promulgated under the Securities and Exchange Act, within ten (10) business days after such tender or exchange offer is first published, sent or given, a statement disclosing that the Liquid Audio board of directors recommends rejection of such tender or exchange offer or (v) Liquid Audio enters into agreements related to a Superior Offer.

Expenses and Termination Fees

Shared Fees and Expenses

The merger agreement provides that regardless of whether the merger is completed, Liquid Audio and Alliance will each pay their own expenses incurred in connection with the merger, except that Liquid Audio and Alliance will share equally all fees and expenses (i) of the financial printer incurred in connection with the preparation and mailing of the registration statement of which this proxy statement/prospectus is a part, this proxy statement/prospectus and any amendments or supplements to either of them and (ii) relating to compliance with the Hart-Scott-Rodino Antitrust Improvements Act of 1976.

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Fees to be Paid by Liquid Audio in the Event the Merger Agreement is Terminated

Under the terms of the merger agreement, Liquid Audio will pay a \$3,000,000 termination fee to Alliance if:

Liquid Audio or Alliance terminates the merger agreement because the merger was not consummated by December 31, 2002, and within 12 months after such termination, Liquid Audio enters into a definitive agreement with respect to, or consummates, any Acquisition Proposal;

Alliance terminates the merger agreement because a "triggering event" occurred prior to the approval of the issuance of Liquid Audio stock in the merger by the required vote of Liquid Audio stockholders; or

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Liquid Audio terminates the merger agreement because it enters into a definitive agreement related to a Superior Offer.

Under the terms of the merger agreement, Liquid Audio will pay to Alliance a \$1,000,000 termination fee in the event either Alliance or Liquid Audio terminates the merger agreement because the required vote of the Liquid Audio stockholders for the issuance of Liquid Audio's stock in the merger shall have not been obtained at a meeting of the Liquid Audio stockholders or if Alliance or Liquid Audio terminates the merger agreement because the SEC shall have declined to grant an exemption from the requirements of Rule 102 of Regulation M in connection with the tender offer and the merger and counsel has not advised Liquid Audio that it may proceed in the absence of such exemption. If within 12 months after such termination, Liquid Audio enters into a definitive agreement with respect to, or consummates, any Acquisition Proposal, Liquid Audio will pay to Alliance an additional fee of \$750,000. If within 6 months after such termination, Liquid Audio completes a liquidation or dissolution, Liquid Audio will pay to Alliance an additional fee of \$750,000.

Extension, Waiver and Amendment

Either Liquid Audio or Alliance may extend the time for the performance of any of the other's obligations or other acts under the merger agreement, waive any inaccuracies in the other's representations and warranties and waive compliance by the other with any of the agreements or conditions contained in the merger agreement.

The merger agreement may be amended at any time by the parties by action taken or authorized by their respective boards of directors, whether before or after approval of the matters presented in connection with the merger by the stockholders of Liquid Audio and the stockholders of Alliance. No amendment may be made, however, without the approval of the stockholders of Liquid Audio or the stockholders of Alliance after the approval by such respective stockholders of the matters presented in connection with the merger if applicable law or the rules of any relevant stock exchange requires further approval by such respective stockholders.

Definition of Material Adverse Effect

For purposes of the merger agreement the term "material adverse effect" when used in connection with an entity, means any change, event, violation, inaccuracy, circumstance or effect, individually or when taken together with all other effects that have occurred prior to the date of determination of the occurrence of the material adverse effect, that is or is reasonably likely to (i) be materially adverse to the business, assets (including intangible assets), capitalization, financial condition or results of operations of such entity taken as a whole with its subsidiaries or (ii) materially impede the ability or authority of such entity to consummate the transactions contemplated by the merger agreement in accordance with its terms and applicable legal requirements. For purposes of clause (i) above, in no event shall any of the following, alone or in combination, be deemed to constitute, nor shall any of the following be taken into account in determining whether there has been or will be, a material adverse effect on any entity:

any effect resulting from compliance with the terms and conditions of the merger agreement;

in the case of Liquid Audio, any change in such entity's stock price or trading volume, in and of itself;

any effect that results from changes affecting any of the industries in which such entity operates generally or the United States economy generally (which changes in each case do not disproportionately affect such entity in any material respect);

any effect that results from changes affecting general worldwide economic or capital market conditions (which changes in each case do not disproportionately affect such entity in any material respect); or

in the case of Liquid Audio, (i) the failure to meet published or internal earnings, revenue estimates or projections or (ii) the continuing loss of money resulting from the business operations of Liquid Audio.

AGREEMENTS RELATED TO THE MERGER

The following is a summary of the material terms of certain agreements related to the merger agreement. This summary may not contain all of the information that is important to investors. This summary is qualified in its entirety by reference to the agreements discussed below which are attached as Annexes to this proxy statement/prospectus. Investors are urged to read the agreements in their entirety.

Voting and Conversion Agreement with the Principal Stockholder of Alliance

The following description of the voting and conversion agreement entered into by AEC Associates, LLC, the principal stockholder of Alliance, describes certain material terms of such agreement. Investors are encouraged to read carefully the entire form of voting and conversion agreement. AEC Associates, LLC has the right to vote approximately 66.1% of the outstanding Alliance common stock.

Pursuant to the terms of the voting and conversion agreement, during the period from June 12, 2002, through the termination of the voting and conversion agreement, the principal stockholder has agreed to vote all shares of Alliance capital stock owned by that stockholder: (a) in favor of the approval and adoption of the merger agreement and the approval of the merger, each of the other actions contemplated by the merger agreement and any action in furtherance of any of the foregoing, and (b) against any action or agreement that would result in a breach in any material respect of any covenant, representation or warranty or any other obligation of Alliance under the merger agreement.

In addition, the voting and conversion agreement prohibits the principal stockholder from transferring any shares of Alliance capital stock, or any option to purchase shares of Alliance capital stock, owned by the principal stockholder before the termination of the voting and conversion agreement.

The voting and conversion agreement also provides that the principal stockholder has (a) agreed that immediately prior to the completion of the merger, and only in the event that the merger is completed, all shares of Alliance preferred stock will automatically convert into Alliance common stock at the respective conversion prices determined in accordance with the Alliance third amended and restated articles of incorporation, (b) agreed to execute and deliver any and all documents necessary to confirm the principal stockholder's agreement to that conversion, and (c) acknowledged that that the principal stockholder will be deemed to have irrevocably delivered a written consent authorizing and approving and to have otherwise voted in favor of that conversion.

The voting and conversion agreement will terminate upon the earlier to occur of the completion of the merger and the date of the termination of the merger agreement pursuant to Article VII of the merger agreement.

Employment Agreements

Gerald W. Kearby, president, chief executive officer and director of Liquid Audio, and Robert G. Flynn, senior vice president of business development, secretary and director of Liquid Audio, have interests in the merger that are different from your interests. In connection with the execution of the original merger agreement in June 2002, Messrs. Kearby and Flynn each entered into employment agreements with Alliance. These agreements will become effective upon the consummation of the merger. Pursuant to these agreements, each of Mr. Kearby and Mr. Flynn will have a three (3) year term of employment. Each will receive an annual base salary no less than (i) his Liquid Audio salary as of January 1, 2002 or (ii) an amount commensurate with other executives of Alliance with similar responsibilities and expertise. In addition, each of Mr. Kearby and Mr. Flynn will receive a retention payment of \$750,000, in the aggregate, to be paid over a three (3) year period. Each of Mr. Kearby and Mr. Flynn may also be eligible for discretionary bonuses granted by the combined organization's Board of Directors or by the Compensation Committee of the Board of Directors. Each is entitled to

severance upon termination without cause equal to two times his then current annual base salary, as well as any unpaid portion of the aforementioned retention payment. Upon termination for cause or upon voluntary resignation, each is entitled to his base salary, and is not entitled to any unpaid retention payments. Neither Mr. Kearby, nor Mr. Flynn is permitted to compete or otherwise interfere with the combined organization's business for a period of five (5) years following the consummation of the merger. Each of Mr. Kearby and Mr. Flynn are entitled to \$750,000 payable over a three (3) year period as compensation for his agreement not to compete. Upon termination for cause or resignation by either Mr. Kearby or Mr. Flynn, the noncompete consideration payable to such executive will be reduced by the amount not yet paid to such executive as of the date of termination or resignation, unless the termination or resignation occurs within one year of the consummation of the merger, in which case \$125,000 of the retention payment paid to each of Mr. Kearby and Mr. Flynn will be allocated as consideration for the agreement not to compete. Upon termination without cause, each of Mr. Kearby and Mr. Flynn will continue to be entitled to the entire consideration for his agreement not to compete. Upon breach of the non-compete obligation, each of Mr. Kearby and Mr. Flynn forfeit his consideration for the agreement not to compete.

Other Agreements by Messrs. Kearby and Flynn

In connection with the execution of the amended and restated merger agreement in July 2002, each of Messrs. Kearby and Flynn agreed not to tender shares of Liquid Audio common stock in the tender offer unless the tender offer is undersubscribed or to exercise any of their stock options prior to either the termination of the merger agreement or the consummation of the merger.

UNAUDITED PRO FORMA COMBINED CONDENSED FINANCIAL INFORMATION

As a result of the definitive merger agreement, Liquid Audio will acquire Alliance and all of the outstanding common and preferred stock of Alliance will be converted into Liquid Audio stock. The following unaudited pro forma combined condensed financial information sets forth certain historical financial information of Liquid Audio and Alliance on an unaudited pro forma basis after giving effect to the merger as a "reverse acquisition" with Alliance as the acquirer of Liquid Audio for accounting purposes (see Note b to the Unaudited Pro Forma Combined Condensed Financial Information). The acquisition will be accounted for using the purchase method of accounting, and accordingly, the purchase price will be allocated to the tangible and intangible assets of Liquid Audio acquired, and the liabilities of Liquid Audio assumed, on the basis of their fair values as of the acquisition date. The unaudited pro forma combined condensed financial information also reflects the issuance and conversion to stock of additional Alliance preferred stock upon completion of the merger.

The fiscal years of Alliance and Liquid Audio end on December 31. The Alliance and the Liquid Audio unaudited balance sheets as of June 30, 2002 have been combined as if the merger had occurred on June 30, 2002. For purposes of the pro forma information, the Alliance and the Liquid Audio statements of operations for the year ended December 31, 2001 and six months ended June 30, 2002 have been combined. The unaudited pro forma combined condensed statements of operations give effect to the merger as if it had occurred on January 1, 2001.

The unaudited pro forma combined condensed financial information is presented for illustrative purposes only and is not necessarily indicative of the financial position or operating results that would have actually occurred had the merger been completed at the beginning of the periods indicated, nor is it necessarily indicative of future financial position or operating results.

The allocation of the purchase price reflected in the unaudited pro forma combined condensed financial information is preliminary. The actual purchase price allocation to reflect the fair values of assets acquired and liabilities assumed will be based upon management's evaluation of such assets and liabilities upon completion of the merger. Accordingly, the adjustments included here will change based upon the final allocation of the total purchase price, as adjusted to reflect the actual assets and liabilities in existence at the date upon which the merger is completed, stock values, the value of the stock options assumed and transaction costs incurred. That allocation may differ significantly from the preliminary allocation included in this statement.

The unaudited pro forma combined condensed financial information should be read in conjunction with the audited consolidated financial statements and related notes of Liquid Audio and Liquid Audio Management's Discussion and Analysis of Financial Condition and Results of Operations and the audited financial statements and related notes of Alliance and Alliance Management's Discussion and Analysis of Financial Condition and Results of Operations included in this proxy statement/prospectus.

**Unaudited Pro Forma Combined Condensed Balance Sheet
June 30, 2002**

	<u>Alliance</u>	<u>Liquid Audio</u>	<u>Pro Forma Adjustments</u>	<u>Pro Forma Combined</u>
Assets				
Current assets:				
Cash and cash equivalents	\$ 13,560	\$ 81,018	\$ (30,000) (a)	\$ 57,941
			(6,637) (d)	
Accounts receivable, net of allowance	98,379	115		98,494
Inventory	94,532			94,532
Prepaid expenses and other current assets	4,205	718		4,923
Advances to Digital Media Infrastructure Services Group	4,528			4,528
	<u>215,204</u>	<u>81,851</u>	<u>(36,637)</u>	<u>260,418</u>
Total current assets	215,204	81,851	(36,637)	260,418
Property and equipment, net	32,431	2,391	(2,391) (c)	32,431
Goodwill	3,876			3,876
Intangible assets	13,588		2,622 (i)	16,210
Advances to affiliates	13,600		(13,600) (f)	
Other assets	1,810	899	(899) (c)	1,810
	<u>280,509</u>	<u>85,141</u>	<u>(50,905)</u>	<u>314,745</u>
Total Assets	\$ 280,509	\$ 85,141	\$ (50,905)	\$ 314,745
Liabilities and Stockholders' (Deficit) Equity				
Current liabilities:				
Accounts payable	\$ 183,078	\$ 1,110		\$ 184,188
Accrued liabilities	8,147	2,140		10,287
Deferred revenue		109		109
Current portion of long-term debt	348			348
Current portion of obligations under capital leases	435	11		446
Note payable to related party		376		376
Revolving credit facility	24,559			24,559
	<u>216,567</u>	<u>3,746</u>		<u>220,313</u>
Total current liabilities	216,567	3,746		220,313
Long-term debt	8,152			8,152
Obligations under capital leases	150			150
Commitments and contingencies				
Preferred stock, Series A1	28,359		(28,359) (b)	
Preferred stock, Series A2	55,022		(55,022) (b)	
Preferred stock, Series B	13,379		(13,379) (b)	
Stockholders' (deficit) equity				
Common stock 49,037,000 shares authorized issued and outstanding at June 30, 2002	7	23	(10) (a)	49
			29 (b)	
Additional paid-in-capital		203,065	(29,990) (a)	127,208

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	<u>Alliance</u>	<u>Liquid Audio</u>	<u>Pro Forma Adjustments</u>	<u>Pro Forma Combined</u>
			96,760	(b)
			(123,820)	(c)
			(6,637)	(d)
			(12,170)	(f)
Accumulated deficit	(41,127)	(121,693)	121,693	(c)
Total stockholders' (deficit) equity	(41,120)	81,395	45,855	86,130
	\$ 280,509	\$ 85,141	\$ (50,905)	\$ 314,745

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**Unaudited Pro Forma Combined Condensed Statement of Operations
Year Ended December 31, 2001**

	<u>Alliance</u>	<u>Liquid</u>	<u>Pro Forma Adj</u>	<u>Combined Pro Forma</u>
Net sales	\$ 588,604	\$ 4,728	\$	\$ 593,332
Cost of goods sold	512,264	2,343		514,607
Gross profit	76,340	2,385		78,725
Research and development		16,957		16,957
Selling, general and administrative expenses	64,294	21,031	(3,797)	(e)
			1,000	(j)
Amortization of intangible assets	2,622		(2,622)	(i)
Restructuring		4,497		4,497
Costs of unrealized acquisitions	600			600
Operating income (loss)	8,824	(40,100)	6,419	(25,857)
Interest, net	(4,978)	4,170	(1,594)	(g)
Loss on equity investment		1,254		1,254
Other expense	600			600
Income (loss) before provision for income taxes	3,246	(37,184)	4,825	(30,113)
Provision for income taxes	2,113		(2,113)	(h)
Net income (loss)	\$ 1,133	\$ (37,184)	\$ 6,938	\$ (30,113)
Loss applicable to common stockholders	\$ (8,343)	\$ (37,184)	\$	\$ (30,113)
Net loss per common share	\$ (0.12)	\$ (1.64)	\$	\$ (0.61)
Weighted average common shares outstanding	71,739	22,614		49,037

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Unaudited Pro Forma Combined Condensed Statement of Operations
For the Six Months Ended June 30, 2002

	Alliance	Liquid	Pro Forma Adj	Combined Pro Forma
Net sales	\$ 353,178	\$ 286	\$	\$ 353,464
Cost of goods sold	311,573	552		312,125
Gross profit (loss)	41,605	(266)		41,339
Research and development		5,937		5,937
Selling, general and administrative expenses	39,970	5,183	(1,279) (e)	44,374
Amortization of intangible assets			500 (j)	
Restructuring				
Costs of unrealized acquisitions				
Operating income (loss)	1,635	(11,386)	779	(8,972)
Other income	20	120		140
Interest, net	(1,465)	731	(798) (g)	(1,532)
Income (loss) before provision for income taxes	190	(10,535)	(19)	(10,364)
Benefits from income taxes	68		68 (h)	
Net income (loss)	\$ 122	\$ (10,535)	\$ 49	\$ (10,364)
Loss applicable to common stockholders	\$ (5,091)	\$ (10,535)	\$	\$ (10,364)
Net loss per common share	\$ (0.07)	\$ (0.46)		\$ (0.21)
Weighted average common shares outstanding	71,739	22,723		49,037
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Notes to Unaudited Pro Forma Combined Condensed Financial Information
(in thousands, except per share data)

- (a) Represents an assumed full subscription to the tender offer in which Liquid Audio has offered to repurchase and retire 10 million shares of common stock at a price of \$3.00 per share. If the tender offer is oversubscribed, Liquid Audio will purchase 10 million shares on a pro rata basis. If the tender offer is undersubscribed, provisions will be made to preserve the economic position of both the parties and the stockholders.
- (b) Represents the recapitalization of Alliance for the equivalent number of Liquid Audio shares received in the merger. Alliance stockholders will exchange outstanding preferred and common stock for shares of Liquid Audio, representing a 74% interest in the combined entity. Alliance's preferred stock will convert into common shares based upon the original conversion provisions of the respective issuance agreements. Alliance's outstanding options will also be converted to options in the combined organization based on the original conversion price of the respective issuance agreement resulting in no economic benefit to the Alliance option holders.
- For accounting purposes, Alliance is considered the acquirer, and as such Liquid Audio will contribute to Alliance its net assets and will retain approximately 13 million shares of common stock in the combined entity. This entry reflects the issuance of shares as discussed above and the elimination of the outstanding common and converted preferred stock of Alliance, assuming the tender offer is fully subscribed.

- (c) Represents the adjustment of Liquid Audio's net assets to reflect purchase consideration, based upon the estimated fair value of assets received and liabilities assumed by Alliance, the accounting acquirer. Purchase consideration has been estimated based upon Liquid Audio's working capital. While Liquid Audio (the issuer) is a public entity, the fair value of its outstanding shares, including warrants and options, is less than its working capital, composed primarily of cash. Accordingly, management believes that the purchase consideration is more appropriately determined as indicated above.
- For purposes of this pro forma information, no value has been ascribed to any intangible assets based upon management's initial estimates of fair value. Upon consummation of the transaction this estimate will be finalized.
- This entry adjusts Liquid Audio's net assets to their fair value, eliminates Liquid Audio's accumulated deficit and reflects Liquid Audio's stockholders controlling approximately 26% of the voting power or approximately 13 million shares in the combined entity (assuming full subscription to the tender offer).
- (d) Represents estimated transaction costs, consisting of fees for accountants, lawyers, bankers and consultants assisting in the transaction.
- (e) Represents the adjustment to depreciation, based upon the fair value adjustment of Liquid Audio's property, plant and equipment.
- (f) Represents a dividend to the shareholders of Alliance for a portion of the intercompany balance receivable from Digital Media Infrastructure Services Group ("DMISG") as of March 31, 2002. As part of the proposed spin-off of DMISG to the stockholders of Alliance, this amount will not be repaid, but will constitute part of the basis of DMISG.
- (g) Represents a decrease in interest income attributable to the decrease in cash assuming the tender offer is fully subscribed.
- (h) Represents a decrease in taxes. Liquid Audio's operating loss exceeds Alliances' operating income resulting in a net loss.
- (i) This amount represents amortization of intangible assets relating to Alliance's 1998 reorganization. Upon the adoption of SFAS 142 "Goodwill and Other Intangible Assets" Alliance will no longer amortize these amounts.
- (j) Represents incremental salary costs associated with employment agreements between Alliance and Messrs. Kearby and Flynn.

U.S. FEDERAL TAX CONSEQUENCES OF THE MERGER

The following summary describes the material U.S. Federal income tax consequences of the merger to Liquid Audio and its stockholders. In the opinion of Milbank, Tweed, Hadley & McCloy LLP counsel to Liquid Audio, the summary is accurate in all material respects with respect to the matters discussed therein. This summary does not describe any tax consequences arising under the laws of any state, locality or taxing jurisdiction other than the United States.

The summary is based upon the tax laws and practice of the United States as in effect on the date of this statement, as well as judicial and administrative interpretations thereof (in final or proposed form) available on or before such date. All of the foregoing are subject to change, which change could apply retroactively. Liquid Audio stockholders should note that no rulings have been or will be sought from the U.S. Internal Revenue Service (the "IRS") with respect to the tax consequences described below, and no assurance can be given that the IRS or a court will not take contrary positions. **Stockholders should consult their own tax advisors with respect to the federal, state, local and foreign tax consequences of the merger to them.**

The merger is intended to constitute a tax-free reorganization for U.S. federal income tax purposes. Whether or not the merger constitutes a tax-free reorganization, neither Liquid Audio nor its stockholders will recognize gain or loss as a result of the merger. (Liquid Audio stockholders may, however, recognize either income, gain or loss as a result of selling shares of Liquid Audio common stock in the tender offer.

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See the tender offer solicitation for a discussion of the U.S. federal income tax consequences to Liquid Audio stockholders that sell shares of common stock in the tender offer.)

Following the merger, net operating loss carryforwards and certain other tax attributes of Liquid Audio allocable to periods ending on or prior to the effective time of the merger will be subject to the limitations imposed by section 382 of the Internal Revenue Code of 1986, as amended (the "Code"). Under Code section 382, if a corporation undergoes an "ownership change," the amount of its pre-change losses (including certain "built-in" losses) that may be utilized to offset future taxable income is, in general, subject to an annual limitation. The issuance of Liquid Audio common stock to Alliance stockholders pursuant to the merger will cause an ownership change with respect to Liquid Audio. The amount of the annual limitation to which Liquid Audio would be subject is equal to the product of (i) the value of Liquid Audio's stock immediately before the merger and (ii) the "long-term tax exempt rate" in effect for the month in which the merger occurs. Any portion of the annual Code section 382 limitation that is unutilized in a particular taxable year would be available for use in subsequent taxable years.

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MANAGEMENT

Executive Officers and Directors Pre-Merger

The directors and executive officers of Liquid Audio, their ages and positions at Liquid Audio prior to the completion of the merger and certain biographical information is set forth below:

Name	Age	Position
Gerald W. Kearby	54	President, Chief Executive Officer and Director
Robert G. Flynn	48	Senior Vice President of Business Development, Director and Secretary
Michael R. Bolcerek	40	Senior Vice President and Chief Financial Officer
Richard W. Wingate	49	Senior Vice President of Content Development and Label Relations
Leon Rishniw	36	Vice President of Engineering
H. Thomas Blanco	52	Vice President, Human Resources
Raymond A. Doig	64	Director
Judith N. Frank	61	Director
Stephen Imbler	50	Director
James D. Somes	50	Director
Ann Winblad	51	Director

Mr. Kearby co-founded Liquid Audio in January 1996. Since January 1996, Mr. Kearby has served as our President and Chief Executive Officer and one of our directors. From June 1995 to December 1995, Mr. Kearby was co-founder and Chief Executive Officer of Integrated Media Systems, a manufacturer of computer-based professional audio equipment. From January 1989 until June 1995, Mr. Kearby served as Vice President of Sales and Marketing at Studer Editech Corporation, a professional audio recording equipment company. Mr. Kearby holds a B.A. in broadcast management and audio engineering from San Francisco State University.

Mr. Flynn co-founded Liquid Audio in January 1996. Since July 1999, Mr. Flynn has served as our Senior Vice President of Business Development and Secretary. From January 1996 to July 1999, Mr. Flynn served as our Vice President of Business Development and Secretary. Mr. Flynn also served as our Chief Financial Officer from January 1996 to August 1997 and as one of our directors from January 1996 to June 1996. From March 1987 until November 1995, Mr. Flynn served as a general partner of Entertainment Media Venture Partners I, L.P., an institutional venture capital fund investing in the entertainment, media and communications technology industries. During this time, Mr. Flynn also served on the board of directors of Integrated Media Systems. Mr. Flynn holds a B.A. in English from Stanford University and an M.B.A. from University of California at Los Angeles.

Mr. Bolcerek has served as Liquid Audio's Senior Vice President and Chief Financial Officer since April 2001. From June to September 2000, Mr. Bolcerek was Chief Operating Officer and Vice President of Finance for Mongomusic.com, an online music service provider. From January 1999 to June 2000, Mr. Bolcerek was a finance consultant to several high technology and Internet companies. From June 1997 to September 1998, Mr. Bolcerek was President, Chief Financial Officer and Vice President of Finance for Spatializer Audio Laboratories Inc., an audio technology licensing company. From January 1997 to May 1997, Mr. Bolcerek was acting Corporate Controller for Novadigm, Inc., a software company. From June 1995 to July 1996, Mr. Bolcerek was Controller for Nokia Display Products, Inc., a computer monitor manufacturer and division of Nokia Group. From January 1994 to March 1995, Mr. Bolcerek was Acting Chief Financial Officer and Treasurer for Axil Computer, Inc., a computer hardware manufacturer. Prior to January 1994, Mr. Bolcerek held finance positions at NeXT Computer, Inc. and Oracle Corporation. Mr. Bolcerek holds a B.A. in economics from Brown University.

Mr. Wingate has served as Liquid Audio's Senior Vice President of Content Development and Label Relations since November 1999 and as Liquid Audio's Vice President of Content Development and Label Relations since August 1998. Mr. Wingate operated his own new media marketing consulting company, Wingate Marketing, from July 1996 until June 1998. From August 1997 to June 1998, Mr. Wingate was also a private music industry consultant. From June 1994 to July 1996, Mr. Wingate was Senior Vice President, Marketing for Arista Records Incorporated, a music recording company. Prior to June 1994, Mr. Wingate held several senior management positions with major music industry record labels, including Polygram, Inc. and Columbia Records. Mr. Wingate holds a B.A. in communications from Brown University.

Mr. Rishniw has served as Liquid Audio's Vice President of Engineering since October 1999. He was originally employed by Liquid Audio as a software engineer in August 1996, became one of its Development Managers in January 1997 and Director of Engineering in November 1998. From May 1995 until August 1996, Mr. Rishniw served as a senior software engineer for Studer Editech, a professional audio recording equipment company. From August 1994 until May 1995, Mr. Rishniw served as a software engineer for Signal Stream Technology, a medical imaging technology provider. Mr. Rishniw holds a B.S. in engineering from Melbourne Institute of Technology.

Mr. Blanco has served as Liquid Audio's Vice President of Human Resources since May 2000. From May 1999 to May 2000, Mr. Blanco was at Aspect Communications, where he was Senior Director of Human Resources for Sales Operations & International. Prior to Aspect, Mr. Blanco was at Bank of America from June 1984 to November 1998 where he held various positions, including Manager of Staffing and Planning, Vice President of Corporate Staffing and Planning, Director of Human Resources for Latin America & Canada and Senior Vice President of Business Engineering Services. Mr. Blanco holds a B.A. in Spanish/English literature, and has completed coursework for his M.A., both from Queens College of City University of New York.

Mr. Doig has served as one of our directors since November 2001. Mr. Doig has served as President of EMV Partners Corp., a company engaged in business consulting and as the general partner of a venture capital limited partnership, from 1986 to 1998. From 1983 to 1986, Mr. Doig was co-founder and Chief Operating Officer of Stanfill, Doig & Co., a consulting firm. From March 1977 to August 1983, Mr. Doig served as President and CEO of 20th Century Fox International and as Vice President of Corporate Development for 20th Century Fox Film Corp. During 1998 and 1999, Mr. Doig served as a fulltime operations consultant to Entertainment Properties, Inc., a wholly-owned privately held company. Mr. Doig continues to act as a consultant to Entertainment Properties, Inc. on an as needed basis. Mr. Doig holds an M.B.A., an M.S. in Public Administration and a B.S. in Physical Sciences from the University of Southern California.

Ms. Frank has served as a director since August 22, 2002. Ms. Frank is a Principal of Asset Strategies for the past seven years. Asset Strategies focuses on strategic, transactional, and implementation matters for corporate, governmental and institutional clients. Since 1994, Ms. Frank has also been a part-time employee of the Department of General Services of the State of California working in the asset planning and enhancement group. Ms. Frank has an A.B. from the University of California, Berkeley, a M.S. from the University of Southern California and a M.B.A. from the Anderson School of Management, UCLA.

Mr. Imbler has served as one of Liquid Audio's directors since November 2001. Mr. Imbler has held a variety of positions at Hyperion Solutions Corporation, a business intelligence software company, since July 1995, including Advisor from October 2001 to present, President and Chief Operating Officer from April 1999 to October 2001 and Senior Vice President and Chief Financial Officer from July 1995 to April 1999. Mr. Imbler served as Senior Vice President and Chief Financial Officer for Gupta Corporation, an enterprise database software company, from November 1994 to July 1995, Vice President and Chief Financial Officer for QuickResponse Services Inc., a developer of supply chain software applications, from May 1993 to October 1994, and Vice President of Finance for Oracle

Corporation, an enterprise database and software developer, from July 1987 to May 1993. Mr. Imbler also serves on the board of directors for Wavecom, Inc., a French telecommunications company. Mr. Imbler holds an M.B.A. from University of Texas at Austin and a B.M. in piano performance from Wichita State University.

Mr. Somes has served as a director since August 22, 2002. Mr. Somes is a founder and Managing Director of Alexander Dunham Capital Group, Inc. since 1994. Alexander Dunham Capital is a boutique merchant bank advising high-growth technology and healthcare companies on capital formation (public and private companies), acquisitions, mergers, and general corporate finance issues. He has a B.A. from Tufts University and an M.B.A. from Columbia University.

Ms. Winblad has served as one of Liquid Audio's directors since May 1996. Ms. Winblad has been a general partner of Hummer Winblad Venture Partners, a venture capital investment firm, since 1989. She is a member of the board of trustees of the University of St. Thomas and is an advisor to numerous entrepreneurial groups such as the Software Development Forum and Software Industry Business Practices.

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Ms. Winblad also serves on the boards of directors of Net Perceptions Inc., a developer and supplier of real-time recommendation technology for the Internet, The Knot, Inc., an Internet-based wedding services company, and several private companies, and on the board of trustees of the University of St. Thomas. Ms. Winblad holds a B.S. in mathematics and business administration from the College of Saint Catherine and an M.A. in education with an economics focus from the University of St. Thomas.

There are no family relationships among any of Liquid Audio's directors or executive officers.

Executive Officers and Directors Post-Merger

Upon completion of the merger, the board of directors of Liquid Audio is expected to be comprised of nine individuals, $\frac{1}{3}$ of whom will be designated by Liquid Audio and $\frac{2}{3}$ of whom will be designated by Alliance. The following table lists the names, ages and positions of individuals expected to be designated by Liquid Audio and Alliance as directors and executive officers of Liquid Audio upon completion of the merger. The ages of the individuals are provided as of January 1, 2002.

Name	Age	Position(s)
Eric S. Weisman	40	President, Chief Executive Officer and Director
Jerry Bassin	70	Executive Vice President
Pinchas Blei	53	Chief Operating Officer, Distribution and Fulfillment Services Group
George W. Campagna	53	Chief Financial Officer
Lonnie M. Chenkin	45	Senior Vice President
Robert G. Flynn (1)	48	Executive Vice President, Digital Media Services Group and Director
Gerald W. Kearby (1)	54	President, Digital Media Services Group and Director
David H. Schlang	57	Executive Vice President
Alan Tuchman	43	President, Distribution and Fulfillment Services Group
Ronald W. Burkle	49	Director
Raymond A. Doig (1)	64	Director
Michael S. McQuary	42	Director
Steven L. Mortensen	41	Director
Erika Paulson	28	Director
Bruce Raben	48	Director

- (1) Liquid Audio's board of directors has designated these three individuals to serve on the post-merger board of directors as the designees of Liquid Audio as provided for in the merger agreement. All other current directors have agreed to resign from the board of directors. We

cannot be certain that the nominees recommended for election by the Liquid Audio board of directors, Gerald W. Kearby and Raymond A. Doig, will be elected at the stockholder meeting. If nominees other than Gerald W. Kearby and Raymond A. Doig are elected, then Liquid Audio's board of directors has determined that such directors, unless they resign from the board of directors, would replace Raymond A. Doig and Gerald W. Kearby as the designees of Liquid Audio on the board of directors of the combined organization. If the proposals made by musicmaker.com to expand the board of directors is approved, then the expanded board of directors would decide on how to comply with the obligations set forth in the merger agreement.

Eric S. Weisman, *President, Chief Executive Officer and Director*. Mr. Weisman is President, Chief Executive Officer and a director of Alliance. Since joining Alliance in 1994, Mr. Weisman has served in a number of executive positions. In 1997, Mr. Weisman was appointed Chief Operating Officer and held this position until his appointment as Chief Executive Officer and President in January 1998. Mr. Weisman has also served on the Board of Directors of Alliance since June 1997. Mr. Weisman's career began in 1985 at Premier Artists Services, a full service entertainment management and marketing company, where he was engaged in the development of leisure and lifestyle marketing initiatives on behalf of numerous Fortune 500 companies, including AT&T, The Coca-Cola Co. and Johnson & Johnson. Mr. Weisman has also worked closely with entertainment personalities such as Frank Sinatra, Liza Minnelli, Sammy Davis Jr. and Julio Iglesias. Mr. Weisman has over 16 years of entertainment, marketing and distribution experience. Mr. Weisman is the brother-in-law of Mr. Chenkin, Senior Vice President.

Jerry Bassin, *Executive Vice President*. Mr. Bassin is an Executive Vice President of Alliance, where he oversees various aspects of purchasing, inventory management and sales. Mr. Bassin is the founder of Bassin Distributors, which was sold to Alliance in 1989, at which

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time Mr. Bassin was appointed President of AEC Corp. Due to health reasons, Mr. Bassin took a medical leave of absence at the end of 1995, returning as a consultant in March of 1996. In February 1998, Mr. Bassin returned full-time as Executive Vice President working directly for the President and Chief Executive Officer of Alliance. Mr. Bassin has over 35 years of retail and distribution experience in the home entertainment marketplace.

Pinchas (Peter) Blei, *Chief Operating Officer, Distribution and Fulfillment Services Group*. Mr. Blei has been Chief Operating Officer of the Distribution and Fulfillment Services Group of Alliance since January 2000. Since joining Alliance in August 1995, Mr. Blei has held several executive positions including Vice President of Business Planning for Alliance through May 1996, Chief Financial Officer of AEC One Stop Group, Inc., a subsidiary of Alliance, from June 1996 to April 1997, and Chief Operating Officer from June 1997 to December 1999. Prior to joining Alliance, Mr. Blei served as Chief Financial Officer for Spec's Music Inc., a publicly-held music retailer based in South Florida, and as Executive Vice President, Chief Financial Officer and Director of MJS Entertainment and Margo Nursery Farms. Mr. Blei has 30 years of business experience of which 23 are in the distribution and retailing of home entertainment products. Mr. Blei holds a B.S. in Accounting from Florida State University and an M.B.A. from Barry University.

George W. Campagna, *Chief Financial Officer*. Mr. Campagna began his career with Alliance in 1997 and served as Chief Financial Officer of the AEC One Stop Group, Inc., a subsidiary of Alliance, until 1999. Mr. Campagna served as Senior Vice President between 1999 and 2000 and thereafter as Executive Vice President until June 2002, when he became Chief Financial Officer of Alliance. Mr. Campagna received his degree in Accounting from Fairleigh Dickinson University.

Lonnie M. Chenkin, *Senior Vice President*. Mr. Chenkin has been Senior Vice President of Corporate Development for Alliance since June 2001. His responsibilities include strategic planning, corporate development and business affairs. Mr. Chenkin joined Alliance in August 1999 as Vice President and Treasurer, a position he held through July 2000, when he was appointed Vice President of Corporate Development. From 1997 until he joined Alliance in 1999, Mr. Chenkin was President of

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PSI, a licensing and merchandising company. Mr. Chenkin has also held executive positions at Premier Artist Services, Burson Marsteller and Paramount Pictures. Mr. Chenkin has over 18 years of entertainment, marketing and distribution experience. Mr. Chenkin is the brother-in-law of Mr. Weisman, President, Chief Executive Officer and Director.

Robert G. Flynn, *Executive Vice President, Digital Media Services Group and Director*. See "Executive Officers and Directors Pre-Merger" for biographical information.

Gerald W. Kearby, *President, Digital Media Services Group and Director*. See "Executive Officers and Directors Pre-Merger" for biographical information.

David H. Schlang, *Executive Vice President*. Mr. Schlang is an Executive Vice President of Alliance. Mr. Schlang is the founder of One Way Records in Albany, New York, which was acquired by Alliance in September 1995. From 1995 to 1998, Mr. Schlang served as the President of One Way Records, after which he was appointed Executive Vice President of Alliance. Mr. Schlang has over 32 years of entertainment industry experience and knowledge, and he is currently Chairman of the Board of the music industry's trade association, National Association of Recording Merchandisers (NARM).

Alan Tuchman, *President, Distribution and Fulfillment Services Group*. Mr. Tuchman has been President of the Distribution and Fulfillment Services Group of Alliance since January 2000. Mr. Tuchman joined Alliance in 1991 and was Vice President from that time until 1996, when he became Senior Vice President of Strategic Planning. Mr. Tuchman held this position until 1997 when he became President of AEC One Stop Group, Inc., a subsidiary of Alliance. In January 2000, Mr. Tuchman was appointed to his current position. Mr. Tuchman has over 22 years of retail and distribution experience in the home entertainment marketplace. Mr. Tuchman majored in Business Administration at Hofstra University.

Ronald W. Burkle, *Director*. Mr. Burkle is the managing partner and majority owner of The Yucaipa Companies, a private investment firm based out of Los Angeles, California, which he co-founded in 1986. Mr. Burkle is the controlling shareholder of Golden State Foods Corp., the largest supplier of food products to McDonald's. Mr. Burkle serves as Trustee of The John F. Kennedy Center for the Performing Arts, The J. Paul Getty Trust, the National Urban League and the Los Angeles County Museum of Art. Mr. Burkle has also been a director of Occidental Petroleum Corporation since 1999, KB Home since 1995 and Yahoo! since 2001.

Raymond A. Doig, *Director*. See "Executive Officers and Directors Pre-Merger" for biographical information.

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Michael S. McQuary, *Director*. Mr. McQuary has been a director of EarthLink Network ("EarthLink") since February 2000, when EarthLink merged with MindSpring. Mr. McQuary was the President of EarthLink between February 2000 and May 2002. Prior to the merger of EarthLink and MindSpring, Mr. McQuary served as the President of MindSpring from March 1996, as Chief Operating Officer of MindSpring from September 1995, and as a director of MindSpring from December 1995 until MindSpring's merger with EarthLink. Mr. McQuary also served as MindSpring's Executive Vice President from October 1995 to March 1996 and MindSpring's Executive Vice President of Sales and Marketing from July 1995 to September 1995. Prior to joining MindSpring, Mr. McQuary served in a variety of management positions with Mobil Chemical Co. from August 1984 to June 1995, including Regional Sales Manager from April 1991 to February 1994 and Manager of Operations (Reengineering) from February 1994 to June 1995. Mr. McQuary also serves on the Board of Directors of the University of Virginia Alumni Association.

Steven L. Mortensen, *Director*. Mr. Mortensen has been the Chief Financial Officer for The Yucaipa Companies, a private investment firm based out of Los Angeles, California, since January 2002. Prior to The Yucaipa Companies, Mr. Mortensen served as a director and as President and Chief Operating Officer of Furr's Supermarkets, Inc. the largest privately held employer in the state of New Mexico, between 1999 and 2002. Mr. Mortensen has held senior financial positions at Kroger Co.

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between 1991 and 1999, including Vice President Finance/Controller from 1998 to 1999 and Vice President Finance/Assistant Controller. In the past, Mr. Mortensen has also been a member of the board of trustees for several multi-employer benefit funds, including the Southern California UFCW Pension Fund.

Erika Paulson, *Director*. Ms. Paulson is currently a partner with The Yucaipa Companies, a private investment firm based out of Los Angeles, California, which she joined in 1997. Ms. Paulson has been a director of Alliance since December 2001. Ms. Paulson has also been a director of Golden State Foods Corp. since December 2000, Golden State Enterprises since December 2000 and Kole Imports since February 2000. Prior to her time at The Yucaipa Companies, Ms. Paulson worked in the investment banking department at Bear Stearns.

Bruce Raben, *Director*. Mr. Raben has been a Managing Director at CIBC World Markets Corp. since 1996. From 1990 to 1996, Mr. Raben was a founder, Managing Director and Co-head of the Corporate Finance Department at Jeffries and Company, Inc. Prior to 1990, Mr. Raben was a Senior Managing Director at Drexel Burnham Lambert, Inc. Mr. Raben has served on the boards of numerous public and private companies and currently serves on the boards of Equity Marketing, Inc. and White Wing Environmental Corp. Mr. Raben received his MBA from Columbia Business School and his B.A. from Vassar College.

Employment Contracts and Change-In-Control Arrangements Pre-Merger

The compensation committee of Liquid Audio's board of directors has approved a plan that provides that in the event that (1) Liquid Audio enters into an agreement to dispose of all or substantially all of its assets, or (2) its stockholders dispose of 50% or more of its outstanding common stock, then the greater of one year or 25% of all of the outstanding/unvested stock options held by each of its executive officers and certain members of the Liquid Audio board of directors will immediately vest. Executive officers qualifying under this plan include Gerald W. Kearby and Robert G. Flynn; the executive officers listed under "Executive Officers and Directors Pre-Merger," and H. Thomas Blanco (Vice President of Human Resources), Matthew Smith (Vice President of Product Marketing) and Kay Marsh (Vice President of Information Technology). Under a separate employment agreement, 25% of the unvested stock options held by Michael R. Bolcerek will vest upon consummation of a change of control and an additional 12.5% of his unvested stock options will vest in the event of his termination or constructive termination as a result of a change of control of Liquid Audio. For purposes of Mr. Bolcerek's employment agreement, a change of control is defined as the occurrence of any of the following events: (i) any "person" (as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended) becoming the "beneficial owner" (as defined in Rule 13d-3 under said act), directly or indirectly, of securities of Liquid Audio representing 50% or more of the total voting power represented by Liquid Audio's then outstanding voting securities, other than in a private financing transaction approved by the board of directors of Liquid Audio; (ii) the direct or indirect sale or exchange by the stockholders of Liquid Audio of all or substantially all of the stock of Liquid Audio; (iii) a merger or consolidation in which Liquid Audio is a party and in which the stockholders of Liquid Audio before such merger or consolidation do not retain, directly or indirectly, at least a majority of the beneficial interest in the voting stock of Liquid Audio after the transaction; or (iv) the sale or disposition by Liquid Audio of all or substantially all Liquid Audio's assets. Pursuant to the terms of such employment agreement, the merger will constitute a change of control that would result in an acceleration of the vesting of options to purchase an aggregate of 50,000 shares of Liquid Audio common stock at an exercise price of \$1.84 a share.

Liquid Audio has agreed to pay severance to each of Messrs. Rishniw, Wingate, Blanco and Bolcerek in the event that his employment with Liquid Audio is terminated without cause or he is constructively terminated. Liquid Audio has agreed to pay six months' salary for each of Messrs. Wingate, Blanco and Bolcerek, which amounts \$115,000, \$87,500 and \$87,500, respectively. In the case of Leon Rishniw, Liquid Audio has agreed to pay \$170,000, which is one year's salary.

Employment Contracts and Change-in-Control Arrangements Post-Merger

Mr. Weisman has an employment agreement with Alliance to serve as its President and Chief Executive Officer. Pursuant to the agreement, Mr. Weisman's term of employment is for a rolling three year term which may be terminated on three years notice. Mr. Weisman received an annual base salary of \$500,000 for the 1999 calendar year, which salary is subject to a minimum adjustment of no more than 5% each year based upon the annual increase in the Consumer Price Index. Mr. Weisman's current salary is \$562,025. Mr. Weisman is also eligible for discretionary performance bonuses based upon Alliance's performance levels which are not to be less than those recommended in a report delivered to the Compensation Committee of the Board of Directors of Alliance in 1998. Mr. Weisman is entitled to a payment upon termination without cause equal to three times the aggregate of his then current annual base salary and fifty percent of the bonus paid for the last completed fiscal year. Two-thirds of such payment constitutes severance, and one-third of such payment is in consideration for Mr. Weisman's agreement not to compete with Alliance for a one-year period after his termination. The payment related to the noncompete is subject to repayment if Mr. Weisman breaches such agreement. Alliance has also agreed to provide additional payments to Mr. Weisman to pay for certain taxes and assessments in the event that an initial public offering triggers such payments. Mr. Weisman has an outstanding loan balance of \$65,888 as of July 18, 2002. Mr. Weisman also has available a \$100,000 line of credit under which there are no amounts outstanding. The maturity date of the loan and the termination of the line of credit facility is May 2004. The loan and any amounts outstanding under the line of credit bear interest at 7%. Twenty percent of the principal of the loan is to be repaid each year. Bonus payments made to Mr. Weisman are applied to reduce any amounts outstanding under the line of credit.

In connection with the execution of the original merger agreement in June 2002, Messrs. Kearby and Flynn have each entered into employment agreements with Alliance. These agreements will become effective upon the consummation of the merger. Pursuant to these agreements, each of Mr. Kearby and Mr. Flynn will have a three (3) year term of employment. Each will receive an annual base salary no less than (i) his Liquid Audio salary as of January 1, 2002 or (ii) an amount commensurate with other executives of Alliance with similar responsibilities and expertise. In addition, each of Mr. Kearby and Mr. Flynn will receive a retention payment of \$750,000, in the aggregate, to be paid over a two (2) year period. Each of Mr. Kearby and Mr. Flynn may also be eligible for discretionary bonuses granted by the combined organization's Board of Directors or by the Compensation Committee of the Board of Directors. Each is entitled to severance upon termination without cause equal to two times his then current annual base salary, as well as any unpaid portion of the aforementioned retention payment. Upon termination for cause or upon voluntary resignation, each is entitled to his base salary, and is not entitled to any unpaid retention payments. Neither Mr. Kearby, nor Mr. Flynn is permitted to compete or otherwise interfere with the combined organization's business for a period of five (5) years following the consummation of the merger. Each of Mr. Kearby and Mr. Flynn are entitled to \$750,000 payable over a three (3) year period as compensation for his agreement not to compete. Upon termination for cause or resignation by either Mr. Kearby or Mr. Flynn, the noncompete consideration payable to such executive will be reduced by the amount not yet paid to such executive as of the date of termination or resignation, unless the termination or resignation occurs within one year of the consummation of the merger, in which case \$125,000 of the retention payment paid to each of Mr. Kearby and Mr. Flynn will be allocated as consideration for the agreement not to compete. Upon termination without cause, each of Mr. Kearby and Mr. Flynn will continue to be entitled to the entire consideration for his agreement not to compete. Upon breach of the non-compete obligation, each of Mr. Kearby and Mr. Flynn forfeits his consideration for the agreement not to compete.

Board Committees Pre-Merger***Audit Committee***

The audit committee of Liquid Audio's board of directors currently is composed of Stephen V. Imbler, Ann Winblad and Raymond A. Doig. All three directors qualify as independent. Liquid Audio's audit committee held a total of five (5) meetings during fiscal 2001.

The audit committee makes recommendations to the Liquid Audio board of directors regarding the selection of independent accountants, reviews the results and scope of audit and other services provided by its independent accountants and reviews the accounting principles and auditing practices and procedures to be used for its financial statements. The rules of the National Association of Securities Dealers ("NASD") require audit committees to have at least three members who are "independent," as that term