

Warner Music Group Corp.
Form 10-Q
August 04, 2011
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2011

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 001-32502

Warner Music Group Corp.

(Exact name of Registrant as specified in its charter)

Edgar Filing: Warner Music Group Corp. - Form 10-Q

Delaware
(State or other jurisdiction of
incorporation or organization)

13-4271875
(I.R.S. Employer
Identification No.)

75 Rockefeller Plaza
New York, NY 10019

(Address of principal executive offices)

(212) 275-2000

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.) Yes No

As of August 3, 2011, the number of shares of the Registrant's common stock, par value \$0.001 per share, outstanding was 1,000. All of the Registrant's common stock is owned by Airplanes Music LLC, which is an affiliate of Access Industries, Inc.

Table of Contents

WARNER MUSIC GROUP CORP.

INDEX

	Page
Part I. Financial Information	
Item 1. <u>Financial Statements (Unaudited)</u>	3
<u>Consolidated Balance Sheets as of June 30, 2011 and September 30, 2010</u>	3
<u>Consolidated Statements of Operations for the Three and Nine Months Ended June 30, 2011 and 2010</u>	4
<u>Consolidated Statements of Cash Flows for the Nine Months Ended June 30, 2011 and 2010</u>	5
<u>Consolidated Statement of Deficit for the Nine Months Ended June 30, 2011</u>	6
<u>Notes to Consolidated Interim Financial Statements</u>	7
<u>Supplementary Information Consolidating Financial Statements</u>	17
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	24
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	57
Item 4. <u>Controls and Procedures</u>	57
Part II. Other Information	
Item 1. <u>Legal Proceedings</u>	58
Item 1A. <u>Risk Factors</u>	59
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	68
Item 3. <u>Defaults Upon Senior Securities</u>	68
Item 4. <u>(Removed and Reserved)</u>	68
Item 5. <u>Other Information</u>	68
Item 6. <u>Exhibits</u>	69
<u>Signatures</u>	71

Table of Contents**ITEM 1. FINANCIAL STATEMENTS****Warner Music Group Corp.****Consolidated Balance Sheets (Unaudited)**

	June 30, 2011	September 30, 2010
	(in millions)	
Assets		
Current assets:		
Cash and equivalents	\$ 290	\$ 439
Accounts receivable, less allowances of \$83 and \$111 million	357	434
Inventories	28	37
Royalty advances expected to be recouped within one year	160	143
Deferred tax assets	30	30
Other current assets	89	78
Total current assets	954	1,161
Royalty advances expected to be recouped after one year	196	189
Property, plant and equipment, net	124	121
Goodwill	1,087	1,057
Intangible assets subject to amortization, net	1,062	1,119
Intangible assets not subject to amortization	100	100
Other assets	60	64
Total assets	\$ 3,583	\$ 3,811
Liabilities and Deficit		
Current liabilities:		
Accounts payable	\$ 141	\$ 206
Accrued royalties	1,038	1,034
Accrued liabilities	226	314
Accrued interest	15	59
Deferred revenue	132	100
Other current liabilities	32	40
Total current liabilities	1,584	1,753
Long-term debt	1,952	1,945
Deferred tax liabilities	164	169
Other noncurrent liabilities	172	155
Total liabilities	3,872	4,022
Commitments and Contingencies (See Note 9)		
Deficit:		
Common stock (\$0.001 par value; 500,000,000 shares authorized; 156,670,273 and 154,950,776 shares issued and outstanding)		
Additional paid-in capital	627	611
Accumulated deficit	(1,031)	(929)
Accumulated other comprehensive income, net	66	53
Total Warner Music Group Corp. shareholders' deficit	(338)	(265)
Noncontrolling interest	49	54

Edgar Filing: Warner Music Group Corp. - Form 10-Q

Total deficit	(289)	(211)
Total liabilities and deficit	\$ 3,583	\$ 3,811

See accompanying notes.

Table of Contents**Warner Music Group Corp.****Consolidated Statements of Operations (Unaudited)**

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2011	2010	2011	2010
	(in millions, except per share data)			
Revenues	\$ 686	\$ 652	\$ 2,157	\$ 2,232
Costs and expenses:				
Cost of revenues	(378)	(353)	(1,177)	(1,193)
Selling, general and administrative expenses (a)	(242)	(245)	(762)	(804)
Amortization of intangible assets	(56)	(55)	(165)	(165)
Total costs and expenses	(676)	(653)	(2,104)	(2,162)
Operating income (loss)	10	(1)	53	70
Interest expense, net	(47)	(46)	(141)	(143)
Other income (expense), net	6	1	5	(2)
Loss before income taxes	(31)	(46)	(83)	(75)
Income tax expense	(15)	(9)	(20)	(24)
Net loss	(46)	(55)	(103)	(99)
Less: loss attributable to noncontrolling interest			1	2
Net loss attributable to Warner Music Group Corp.	\$ (46)	\$ (55)	\$ (102)	\$ (97)
Net loss per common share attributable to Warner Music Group Corp.:				
Basic	\$ (0.30)	\$ (0.37)	\$ (0.68)	\$ (0.65)
Diluted	\$ (0.30)	\$ (0.37)	\$ (0.68)	\$ (0.65)
Weighted average common shares:				
Basic	151.8	149.7	150.8	149.6
Diluted	151.8	149.7	150.8	149.6
(a) Includes depreciation expense of:	\$ (11)	\$ (10)	\$ (31)	\$ (28)

See accompanying notes.

Table of Contents**Warner Music Group Corp.****Consolidated Statements of Cash Flows (Unaudited)**

	Nine Months Ended June 30, 2011	Nine Months Ended June 30, 2010
	(in millions)	
Cash flows from operating activities		
Net loss	\$ (103)	\$ (99)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	196	193
Deferred income taxes	(11)	(9)
Impairment of cost-method investment		1
Non-cash interest expense	9	17
Non-cash stock-based compensation expense	10	7
Other non-cash items	(2)	(5)
Changes in operating assets and liabilities:		
Accounts receivable	93	173
Inventories	10	7
Royalty advances	(15)	2
Accounts payable and accrued liabilities	(169)	(135)
Accrued interest	(44)	(42)
Other balance sheet changes	8	(10)
Net cash (used in) provided by operating activities	(18)	100
Cash flows from investing activities		
Investments and acquisitions of businesses	(59)	(1)
Acquisition of publishing rights	(58)	(39)
Proceeds from the sale of investments		9
Capital expenditures	(34)	(30)
Net cash used in investing activities	(151)	(61)
Cash flows from financing activities		
Proceeds from exercise of stock options	6	
Distribution to noncontrolling interest holder	(1)	(2)
Net cash provided by (used in) financing activities	5	(2)
Effect of exchange rate changes on cash and equivalents	15	(21)
Net (decrease) increase in cash and equivalents	(149)	16
Cash and equivalents at beginning of period	439	384
Cash and equivalents at end of period	\$ 290	\$ 400

See accompanying notes.

Table of Contents**Warner Music Group Corp.****Consolidated Statement of Deficit (Unaudited)**

	Common Stock Shares	Value	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Warner Music Group Corp. Shareholders' Deficit	Noncontrolling Interests	Total Equity (Deficit)
(in millions, except number of common shares)								
Balance at September 30, 2010	154,950,776	\$ 0.001	\$ 611	\$ (929)	\$ 53	\$ (265)	\$ 54	\$ (211)
Comprehensive loss:								
Net loss				(102)		(102)	(1)	(103)
Foreign currency translation adjustment					11	11		11
Deferred gains on derivative financial instruments					2	2		2
Total comprehensive loss						(89)	(1)	(90)
Noncontrolling interests of acquired businesses							(4)	(4)
Stock based compensation	44,963		10			10		10
Exercises of stock options	1,674,534		6			6		6
Balance at June 30, 2011	156,670,273	\$ 0.001	\$ 627	\$ (1,031)	\$ 66	\$ (338)	\$ 49	\$ (289)

See accompanying notes.

Table of Contents

Warner Music Group Corp.

Notes to Consolidated Interim Financial Statements (Unaudited)

1. Description of Business

Warner Music Group Corp. (the Company) was formed on November 21, 2003. The Company is the direct parent of WMG Holdings Corp. (Holdings), which is the direct parent of WMG Acquisition Corp. (Acquisition Corp.). Acquisition Corp. is one of the world's major music-based content companies.

Pursuant to the Agreement and Plan of Merger, dated as of May 6, 2011 (the Merger Agreement), by and among the Company, Airplanes Music LLC, a Delaware limited liability company (Parent) and an affiliate of Access Industries, Inc. (Access) and Airplanes Merger Sub, Inc., a Delaware corporation and a wholly-owned subsidiary of Airplanes (Merger Sub), on July 20, 2011 (the Closing Date), Merger Sub merged with and into the Company with the Company surviving as a wholly-owned subsidiary of Parent (the Merger).

On July 20, 2011, in connection with the Merger, each outstanding share of common stock of the Company (other than any shares owned by the Company or its wholly-owned subsidiaries, or by Parent and its affiliates, or by any stockholders who were entitled to and who properly exercised appraisal rights under Delaware law, and shares of unvested restricted stock granted under the Company's equity plan) was cancelled and converted automatically into the right to receive \$8.25 in cash, without interest and less applicable withholding taxes (collectively, the Merger Consideration).

On July 20, 2011, the Company notified the New York Stock Exchange, Inc. (the NYSE) of its intent to remove the Company's common stock from listing on the NYSE and requested that the NYSE file with the SEC an application on Form 25 to report the delisting of the Company's common stock from the NYSE. On July 21, 2011, in accordance with the Company's request, the NYSE filed the Form 25 with the SEC in order to provide notification of such delisting and to effect the deregistration of the Company's common stock under Section 12(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act). On August 2, 2011 the Company filed a Form 15 with the SEC in order to provide notification of a suspension of its duty to file reports under Section 15(d) of the Exchange Act.

Parent funded the Merger Consideration through cash on hand at the Company at closing, equity financing obtained from Parent and debt financing obtained from third party lenders. See Note 14, Subsequent Events.

The Company classifies its business interests into two fundamental operations: Recorded Music and Music Publishing. A brief description of these operations is presented below.

Recorded Music Operations

The Company's Recorded Music business primarily consists of the discovery and development of artists and the related marketing, distribution and licensing of recorded music produced by such artists.

The Company is also diversifying its revenues beyond its traditional businesses by entering into expanded-rights deals with recording artists in order to partner with artists in other areas of their careers. Under these agreements, the Company provides services to and participates in artists activities outside the traditional recorded music business. The Company has built artist services capabilities and platforms for exploiting this broader set of music-related rights and participating more broadly in the monetization of the artist brands it helps create. In developing the Company's artist services business, the Company has both built and expanded in-house capabilities and expertise and has acquired a number of existing artist services companies involved in artist management, merchandising, strategic marketing and brand management, ticketing, concert promotion, fan clubs, original programming and video entertainment. The Company believes that entering into expanded-rights deals and enhancing its artist services capabilities associated with the Company's artists and other artists will permit it to diversify revenue streams to better capitalize on the growth areas of the music industry and permit it to build stronger, long-term relationships with artists and more effectively connect artists and fans.

In the U.S., Recorded Music operations are conducted principally through the Company's major record labels Warner Bros. Records and The Atlantic Records Group. The Company's Recorded Music operations also include Rhino, a division that specializes in marketing the Company's music catalog through compilations and reissues of previously released music and video titles, as well as in the licensing of recordings to and from third parties for various uses, including film and television soundtracks. Rhino has also become the Company's primary licensing division focused on acquiring broader licensing rights from certain catalog artists. For example, the Company has an exclusive license with The Grateful Dead to manage the band's intellectual property and a 50% interest in Frank Sinatra Enterprises, an entity that administers licenses for use of

Edgar Filing: Warner Music Group Corp. - Form 10-Q

Frank Sinatra's name and likeness and manages all aspects of his music, film and stage content. The Company also conducts its Recorded Music operations through a collection of additional record labels, including, among others, Asylum, Cordless, East West, Elektra, Nonesuch, Reprise, Roadrunner, Rykodisc, Sire and Word.

Table of Contents

Outside the U.S., Recorded Music activities are conducted in more than 50 countries primarily through Warner Music International (WMI) and its various subsidiaries, affiliates and non-affiliated licensees. WMI engages in the same activities as the Company's U.S. labels: discovering and signing artists and distributing, marketing and selling their recorded music. In most cases, WMI also markets and distributes the records of those artists for whom the Company's U.S. record labels have international rights. In certain smaller markets, WMI licenses to unaffiliated third-party record labels the right to distribute its records. The Company's international artist services operations also include a network of concert promoters through which WMI provides resources to coordinate tours for the Company's artists and other artists.

Recorded Music distribution operations include WEA Corp., which markets and sells music and DVD products to retailers and wholesale distributors in the U.S.; ADA, which distributes the products of independent labels to retail and wholesale distributors in the U.S.; various distribution centers and ventures operated internationally; an 80% interest in Word Entertainment, which specializes in the distribution of music products in the Christian retail marketplace and ADA Global, which provides distribution services outside of the U.S. through a network of affiliated and non-affiliated distributors.

The Company plays an integral role in virtually all aspects of the recorded music value chain from discovering and developing talent to producing albums and promoting artists and their products. After an artist has entered into a contract with one of the Company's record labels, a master recording of the artist's music is created. The recording is then replicated for sale to consumers primarily in the CD and digital formats. In the U.S., WEA Corp., ADA and Word market, sell and deliver product, either directly or through sub-distributors and wholesalers, to record stores, mass merchants and other retailers. The Company's recorded music products are also sold in physical form to online physical retailers such as Amazon.com, barnesandnoble.com and bestbuy.com and in digital form to online digital retailers like Apple's iTunes and mobile full-track download stores such as those operated by Verizon or Sprint. In the case of expanded-rights deals where the Company acquires broader rights in a recording artist's career, the Company may provide more comprehensive career support and actively develop new opportunities for an artist through touring, fan clubs, merchandising and sponsorships, among other areas. The Company believes expanded-rights deals create better partnerships with its artists, which allow the Company and its artists to work together more closely to create and sustain artistic and commercial success.

The Company has integrated the sale of digital content into all aspects of its Recorded Music and Music Publishing businesses including A&R, marketing, promotion and distribution. The Company's new media executives work closely with A&R departments to make sure that while a record is being made, digital assets are also created with all of its distribution channels in mind, including subscription services, social networking sites, online portals and music-centered destinations. The Company works side by side with its mobile and online partners to test new concepts. The Company believes existing and new digital businesses will be a significant source of growth for the next several years and will provide new opportunities to monetize its assets and create new revenue streams. As a music-based content company, the Company has assets that go beyond its recorded music and music publishing catalogs, such as its music video library, which it has begun to monetize through digital channels. The proportion of digital revenues attributed to each distribution channel varies by region and since digital music is in the relatively early stages of growth, proportions may change as the roll out of new technologies continues. As an owner of musical content, the Company believes it is well positioned to take advantage of growth in digital distribution and emerging technologies to maximize the value of its assets.

Music Publishing Operations

Where recorded music is focused on exploiting a particular recording of a composition, music publishing is an intellectual property business focused on the exploitation of the composition itself. In return for promoting, placing, marketing and administering the creative output of a songwriter, or engaging in those activities for other rights holders, the Company's Music Publishing business garners a share of the revenues generated from use of the composition.

The Company's Music Publishing operations include Warner/Chappell, its global Music Publishing company, headquartered in New York with operations in over 50 countries through various subsidiaries, affiliates and non-affiliated licensees. The Company owns or controls rights to more than one million musical compositions, including numerous pop hits, American standards, folk songs and motion picture and theatrical compositions. Assembled over decades, its award-winning catalog includes over 65,000 songwriters and composers and a diverse range of genres including pop, rock, jazz, country, R&B, hip-hop, rap, reggae, Latin, folk, blues, symphonic, soul, Broadway, techno, alternative, gospel and other Christian music. In January 2011, the Company acquired Southside Independent Music Publishing, a leading independent music publishing company, further adding to its catalog. Warner/Chappell also administers the music and soundtracks of several third-party television and film producers and studios, including Lucasfilm, Ltd., Hallmark Entertainment, Disney Music Publishing and Turner Music Publishing. In 2007, the Company entered the production music library business with the acquisition of Non-Stop Music. The Company has subsequently continued to expand its production music operations with the acquisitions of Groove Addicts Production Music Library and Carlin Recorded Music Library in fiscal 2010 and 615 Music in fiscal 2011.

Table of Contents

2. Basis of Presentation

Interim Financial Statements

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine month periods ended June 30, 2011 are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2011.

The consolidated balance sheet at September 30, 2010 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2010 (File No. 001-32502).

Basis of Consolidation

The accompanying financial statements present the consolidated accounts of all entities in which the Company has a controlling voting interest and/or variable interest entities required to be consolidated in accordance with U.S. GAAP. Significant inter-company balances and transactions have been eliminated. Certain reclassifications have been made to the prior fiscal years consolidated financial statements to conform with the current fiscal-year presentation.

The Company maintains a 52-53 week fiscal year ending on the Friday nearest to each reporting date. As such, all references to June 30, 2011 and 2010 relate to the three-month periods June 24, 2011 and June 26, 2010, respectively. For convenience purposes, the Company continues to date its financial statements as of June 30.

The Company has performed a review of all subsequent events through the date the financial statements were issued, and has determined that other than as described in Note 14, no additional disclosures are necessary.

New Accounting Pronouncements

In June 2009, the FASB issued FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R) (FAS 167) (codified under ASC Topic 810, *Consolidation*), which amends the consolidation guidance for variable interest entities. The amendments include: (1) the elimination of the exemption from consolidation for qualifying special purpose entities, (2) a new approach for determining the primary beneficiary of a VIE, which requires that the primary beneficiary have both (i) the power to control the most significant activities of the VIE and (ii) either the obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE and (3) the requirement to continually reassess who should consolidate a variable-interest entity. FAS 167 is effective for the beginning of an entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. The Company has adopted the new standard, effective October 1, 2010, on a prospective basis, which did not have a material impact on its financial statements.

3. Comprehensive (Loss) Income

Comprehensive (loss) income consists of net loss and other gains and losses affecting equity that, under U.S. GAAP, are excluded from net (loss) income. For the Company, the components of other comprehensive (loss) income primarily consist of foreign currency translation gains and losses and deferred gains and losses on financial instruments designated as hedges under FASB ASC Topic 815, *Derivatives and Hedging* (ASC 815), which include foreign exchange contracts. The following summary sets forth the components of accumulated other comprehensive income, net of related taxes (in millions):

Foreign Currency	Minimum Pension	Derivative Financial	Accumulated Other
---------------------	--------------------	-------------------------	----------------------

Edgar Filing: Warner Music Group Corp. - Form 10-Q

	Translation Gain (Losses)	Liability Adjustment	Instruments Gain (Losses) (in millions)	Comprehensive Income
Balance at September 30, 2010	\$ 58	\$ (3)	\$ (2)	\$ 53
Activity through June 30, 2011	11		2	13
Balance at June 30, 2011	\$ 69	\$ (3)	\$	\$ 66

4. Net (Loss) Income Per Common Share

The Company computes net (loss) income per common share in accordance with FASB ASC Topic 260, *Earnings per Share* (ASC 260). Under the provisions of ASC 260, basic net (loss) income per common share is computed by dividing the net (loss)

Table of Contents

income applicable to common shares after preferred dividend requirements, if any, by the weighted average of common shares outstanding during the period. Diluted net (loss) income per common share adjusts basic net (loss) income per common share for the effects of stock options, warrants and other potentially dilutive financial instruments, only in the periods in which such effect is dilutive.

The following table sets forth the computation of basic and diluted net (loss) income per common share (in millions, except per share amounts):

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Nine Months Ended June 30, 2011	Nine Months Ended June 30, 2010
Numerator:				
Basic and diluted net loss per common share:				
Net loss attributable to Warner Music Group Corp.	\$ (46)	\$ (55)	\$ (102)	\$ (97)
Denominator:				
Weighted average common shares outstanding for basic calculation (a)	151.8	149.7	150.8	149.6
Dilutive effect of options and restricted stock				
Weighted average common outstanding shares for diluted calculation	151.8	149.7	150.8	149.6
Net loss per common share attributable to Warner Music Group Corp. basic	\$ (0.30)	\$ (0.37)	\$ (0.68)	\$ (0.65)
Net loss per common share attributable to Warner Music Group Corp. diluted	\$ (0.30)	\$ (0.37)	\$ (0.68)	\$ (0.65)

(a) The denominator excludes the effect of unvested common shares subject to repurchase or cancellation.

The calculation of diluted net loss per share excludes the following weighted average number of stock options and restricted stock because to include them in the calculation would be anti-dilutive:

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Nine Months Ended June 30, 2011	Nine Months Ended June 30, 2010
Stock options	11.2	13.5	10.3	13.5
Restricted stock	0.3			

As a result of the Merger (as described in Note 14), all shares of the Company's common stock, stock options and restricted shares of common stock were cancelled.

5. Goodwill and Intangible Assets**Goodwill**

The following analysis details the changes in goodwill for each reportable segment during the three months ended June 30, 2011 (in millions):

Edgar Filing: Warner Music Group Corp. - Form 10-Q

	Recorded Music	Music Publishing	Total
Balance at September 30, 2010	\$ 463	\$ 594	\$ 1,057
Acquisitions	16	7	23
Dispositions			
Other (b)	7		7
Balance at June 30, 2011	\$ 486	\$ 601	\$ 1,087

Table of Contents**Intangible Assets**

Intangible assets consist of the following (in millions):

	September 30, 2010	Acquisitions (a)	Other (b)	June 30, 2011
Intangible assets subject to amortization:				
Recorded music catalog	\$ 1,376		4	\$ 1,380
Music publishing copyrights	976	82	21	1,079
Artist contracts	79		1	80
Trademarks	31			31
Other intangible assets	9			9
	2,471	82	26	2,579
Accumulated amortization	(1,352)			(1,517)
Total net intangible assets subject to amortization	1,119			1,062
Intangible assets not subject to amortization:				
Trademarks and brands	100			100
Total net other intangible assets	\$ 1,219			\$ 1,162

(a) The acquisition of music publishing copyrights for the nine months ended June 30, 2011 primarily includes Southside Independent Music Publishing and 615 Music.

(b) Other represents foreign currency translation adjustments.

As a result of the Merger (as described in Note 14), the Company will apply the provisions of ASC 805, Business Combinations and therefore the existing goodwill and intangible asset values are subject to change.

6. Restructuring Costs**Acquisition-Related Restructuring Costs**

In 2004, an investor group acquired Warner Music Group from Time Warner Inc. (the 2004 Acquisition). In connection with the 2004 Acquisition, the Company reviewed its operations and implemented several plans to restructure its operations. As part of these restructuring plans, the Company recorded a restructuring liability during 2004, which included costs to exit and consolidate certain activities of the Company, costs to exit certain leased facilities and operations such as international distribution operations, costs to terminate employees and costs to terminate certain artist, songwriter, co-publisher and other contracts. Such liabilities were recognized as part of the cost of the 2004 Acquisition. As of June 30, 2011, the Company had approximately \$20 million of liabilities outstanding primarily related to long-term lease obligations for vacated facilities, which are expected to be settled by 2019 and \$40 million of liabilities outstanding primarily related to revaluations of artist and other contracts.

As a result of the Merger (as described in Note 14), the Company will apply the provisions of ASC 805, Business Combinations and therefore the existing Acquisition-Related Restructuring Costs values are subject to change.

7. Debt

The Company's long-term debt consists of (in millions):

Edgar Filing: Warner Music Group Corp. - Form 10-Q

	June 30, 2011	September 30, 2010
9.5% Senior Secured Notes due 2016 Acquisition Corp (a)	\$ 1,069	\$ 1,065
7.375% U.S. dollar-denominated Senior Subordinated Notes due 2014 Acquisition Corp.	465	465
8.125% Sterling-denominated Senior Subordinated Notes due 2014 Acquisition Corp. (b)	160	157
9.5% Senior Discount Notes due 2014 Holdings	258	258
Total long term debt	\$ 1,952	\$ 1,945

- (a) 9.5% Senior Secured Notes due 2016; face amount of \$1.1 billion less unamortized discount of \$31 million at June 30, 2011 and \$35 million at September 30, 2010.
- (b) Change represents the impact of foreign currency exchange rates on the carrying value of the £100 million Sterling-denominated notes.

Table of Contents**Restricted Net Assets**

The Company is a holding company with no independent operations or assets other than through its interests in its subsidiaries, such as Holdings and Acquisition Corp. Accordingly, the ability of the Company to obtain funds from its subsidiaries is restricted by the agreements governing the debt obligations of its subsidiaries. In connection with the Merger, the Company repurchased or called for redemption all of the outstanding Acquisition Corp. Senior Subordinated Notes due 2014 and Holdings Senior Discount Notes due 2014 and have satisfied and discharged all of the Company's obligations under the indentures governing those notes. The Acquisition Corp. Senior Secured Notes due 2016 have continued to remain outstanding following the Merger. In connection with the Merger, in May 2011, the Company received the requisite consents from holders of the Acquisition Corp. Senior Secured Notes due 2016 to amend the indenture governing the Acquisition Corp. Senior Secured Notes due 2016 such that the Merger would not constitute a "Change of Control" as defined therein. See Note 14, Subsequent Events.

8. Stock-based Compensation

The following table represents the expense recorded by the Company with respect to its stock-based awards for the three and nine months ended June 30, 2011 and 2010 (in millions):

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Nine Months Ended June 30, 2011	Nine Months Ended June 30, 2010
Recorded Music	\$ 2	\$ 1	\$ 6	\$ 4
Music Publishing				
Corporate expenses	1	1	4	3
Total	\$ 3	\$ 2	\$ 10	\$ 7

During the nine months ended June 30, 2011, the Company awarded 44,963 shares of restricted stock and 2,160,000 stock options to its employees. During the nine months ended June 30, 2010, the Company awarded 35,309 shares of restricted stock and 185,000 stock options to its employees.

In connection with the consummation of the Merger (as described in Note 14), immediately prior to the effective time of the Merger, each stock option issued by the Company, whether or not then exercisable or vested, was cancelled. Also at the effective time of the Merger, each restricted share of common stock either vested (to the extent not already vested) or was forfeited, in each case in accordance with its terms.

9. Commitments and Contingencies*Pricing of Digital Music Downloads*

On December 20, 2005 and February 3, 2006, the Attorney General of the State of New York served the Company with requests for information in connection with an industry-wide investigation as to whether the practices of industry participants concerning the pricing of digital music downloads violate Section 1 of the Sherman Act, New York State General Business Law §§ 340 et seq., New York Executive Law §63(12), and related statutes. On February 28, 2006, the Antitrust Division of the U.S. Department of Justice served the Company with a request for information in the form of a Civil Investigative Demand as to whether its activities relating to the pricing of digitally downloaded music violate Section 1 of the Sherman Act. Both investigations have now been closed. Subsequent to the announcements of the above governmental investigations, more than thirty putative class action lawsuits concerning the pricing of digital music downloads were filed and were later consolidated for pre-trial proceedings in the Southern District of New York. The consolidated amended complaint, filed on April 13, 2007, alleges conspiracy among record companies to delay the release of their content for digital distribution, inflate their pricing of CDs and fix prices for digital downloads. The complaint seeks unspecified compensatory, statutory and treble damages. All defendants, including the Company, filed a motion to dismiss the consolidated amended complaint on July 30, 2007. On October 9, 2008, the District Court issued an order dismissing the case as to all defendants, including the Company. On November 20, 2008, plaintiffs filed a Notice of Appeal from the order of the District Court to the Circuit Court for the Second Circuit. Oral argument took place before the Second Circuit Court of Appeals on September 21, 2009.

Edgar Filing: Warner Music Group Corp. - Form 10-Q

On January 12, 2010, the Second Circuit vacated the judgment of the District Court and remanded the case for further proceedings. On January 27, 2010, all defendants, including the Company, filed a petition for rehearing en banc with the Second Circuit. On March 26, 2010, the Second Circuit denied the petition for rehearing en banc. On August 20, 2010 all defendants including the Company, filed a petition for Certiorari before the Supreme Court. The petition was rejected on January 10, 2011. Upon remand to the District Court, all defendants, including the Company, filed a renewed motion to dismiss challenging, among other things, plaintiffs' state law claims and standing to bring certain claims based mainly on arguments made but not addressed by the District Court in defendants' original motion to dismiss. On July 18, 2011, the District Court issued an order granting defendants' motion to dismiss in part and denying it in part. The case will proceed into discovery, including a determination as to whether class treatment is appropriate, based on a schedule to be determined by the District Court. The Company intends to defend against these lawsuits.

Table of Contents

vigorously, but is unable to predict the outcome of these suits. Any litigation the Company may become involved in as a result of the inquiries of the Attorney General and Department of Justice, regardless of the merits of the claim, could be costly and divert the time and resources of management.

In addition to the matter discussed above, the Company is involved in other litigation arising in the normal course of business. Management does not believe that any legal proceedings pending against the Company will have, individually, or in the aggregate, a material adverse effect on its business. However, the Company cannot predict with certainty the outcome of any litigation or the potential for future litigation. Regardless of the outcome, litigation can have an adverse impact on the Company, including its brand value, because of defense costs, diversion of management resources and other factors.

Income Taxes

The Company is currently under examination by various taxing authorities. The accrual for uncertain tax positions has increased by \$21 million from \$10 million as of September 30, 2010 to \$31 million as of June 30, 2011. The Company expects that \$21 million of this total will be paid during the next twelve months, and \$17 million of the payment will be reimbursed by Time Warner under the terms of the 2004 Acquisition.

10. Derivative Financial Instruments

The Company uses derivative financial instruments primarily foreign currency forward exchange contracts (FX Contracts) for the purpose of managing foreign currency exchange risk by reducing the effects of fluctuations in foreign currency exchange rates.

The Company enters into FX Contracts primarily to hedge its royalty payments and balance sheet items denominated in foreign currency. The Company applies hedge accounting to FX Contracts for cash flows related to royalty payments. The Company records these FX Contracts in the consolidated balance sheet at fair value and changes in fair value are recognized in Other Comprehensive Income (OCI) for unrealized items and recognized in earnings for realized items. The Company elects to not apply hedge accounting to foreign currency exposures related to balance sheet items. The Company records these FX Contracts in the consolidated balance sheet at fair value and changes in fair value are immediately recognized in earnings. Fair value is determined by using observable market transactions of spot and forward rates (i.e., Level 2 inputs). Refer to Note 13.

Netting provisions are provided for in existing International Swap and Derivative Association Inc. (ISDA) agreements in situations where the Company executes multiple contracts with the same counterparty. As a result, net assets or liabilities resulting from foreign exchange derivatives subject to these netting agreements are classified within other current assets or other current liabilities in the Company s balance sheet. The Company monitors its positions with, and the credit quality of, the financial institutions that are party to any of its financial transactions.

11. Segment Information

As discussed more fully in Note 1, based on the nature of its products and services, the Company classifies its business interests into two fundamental operations: Recorded Music and Music Publishing. Information as to each of these operations is set forth below. The Company evaluates performance based on several factors, of which the primary financial measure is operating income (loss) before non-cash depreciation of tangible assets, non-cash amortization of intangible assets and non-cash impairment charges to reduce the carrying value of goodwill and intangible assets (OIBDA). The Company has supplemented its analysis of OIBDA results by segment with an analysis of operating income (loss) by segment.

The accounting policies of the Company s business segments are the same as those described in the summary of significant accounting policies included in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2010. The Company accounts for intersegment sales at fair value as if the sales were to third parties. While inter-company transactions are treated like third-party transactions to determine segment performance, the revenues (and corresponding expenses recognized by the segment that is counterparty to the transaction) are eliminated in consolidation, therefore, do not themselves impact the consolidated results. Segment information consists of the following (in millions):

Table of Contents

Three Months Ended	Recorded	Music	Corporate	Total
June 30, 2011	music	publishing	expenses and	
			eliminations	
Revenues	\$ 545	\$ 146	\$ (5)	\$ 686
OIBDA	84	22	(29)	77
Depreciation of property, plant and equipment	(7)	(1)	(3)	(11)
Amortization of intangible assets	(37)	(19)		(56)
Operating income (loss)	\$ 40	\$ 2	\$ (32)	\$ 10
June 30, 2010				
Revenues	\$ 519	\$ 139	\$ (6)	\$ 652
OIBDA	65	18	(19)	64
Depreciation of property, plant and equipment	(5)	(1)	(4)	(10)
Amortization of intangible assets	(39)	(16)		(55)
Operating income (loss)	\$ 21	\$ 1	\$ (23)	\$ (1)
Nine Months Ended				
June 30, 2011				
	Recorded	Music	Corporate	Total
	music	publishing	expenses and	
			eliminations	
Revenues	\$ 1,768	\$ 403	\$ (14)	\$ 2,157
OIBDA	228	90	(69)	249
Depreciation of property, plant and equipment	(20)	(3)	(8)	(31)
Amortization of intangible assets	(111)	(54)		(165)
Operating income (loss)	\$ 97	\$ 33	\$ (77)	\$ 53
June 30, 2010				
Revenues	\$ 1,836	\$ 414	\$ (18)	\$ 2,232
OIBDA	227	101	(65)	263
Depreciation of property, plant and equipment	(17)	(3)	(8)	(28)
Amortization of intangible assets	(115)	(50)		(165)
Operating income (loss)	\$ 95	\$ 48	\$ (73)	\$ 70

Table of Contents**12. Additional Financial Information****Cash Interest and Taxes**

The Company made interest payments of approximately \$176 million and \$169 million during the nine months ended June 30, 2011 and 2010, respectively. The Company paid approximately \$27 million and \$31 million of income and withholding taxes during the nine months ended June 30, 2011 and 2010, respectively. The Company received \$10 million and \$11 million of income tax refunds during the nine months ended June 30, 2011 and 2010, respectively.

13. Fair Value Measurements

ASC 820 defines fair value as the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that asset or liability. The fair value should be calculated based on assumptions that market participants would use in pricing the asset or liability, not on assumptions specific to the entity.

In addition to defining fair value, ASC 820 expands the disclosure requirements around fair value and establishes a fair value hierarchy for valuation inputs. The hierarchy prioritizes the inputs into three levels based on the extent to which inputs used in measuring fair value are observable in the market. Each fair value measurement is reported in one of the three levels which is determined by the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

Level 1 inputs are based upon unadjusted quoted prices for identical instruments traded in active markets.

Level 2 inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques that include option pricing models, discounted cash flow models and similar techniques.

In accordance with the fair value hierarchy, described above, the following table shows the fair value of the Company's financial instruments that are required to be measured at fair value as of June 30, 2011. Derivatives not designated as hedging instruments primarily represent the balances below and the gains and losses on these financial instruments are included as other expense in the statement of operations. Derivatives designated as hedging instruments as of June 30, 2011 are not material to the Company's financial statements.

	Fair Value Measurements as of June 30, 2011			
	(Level 1)	(Level 2)	(Level 3)	Total
	(in millions)			
<i>Other Current Assets:</i>				
Foreign Currency Forward Exchange Contracts (a)	\$	\$ 2	\$	\$ 2
<i>Other Current Liabilities:</i>				
Foreign Currency Forward Exchange Contracts (a)	\$	\$ (3)	\$	\$ (3)
<i>Other Non-Current Liabilities:</i>				
Contractual Obligations (b)	\$	\$	\$ (12)	\$ (12)

(a) The fair value of foreign currency forward exchange contracts is based on dealer quotes of market forward rates and reflects the amount that the Company would receive or pay at their maturity dates for contracts involving the same currencies and maturity dates.

(b)

Edgar Filing: Warner Music Group Corp. - Form 10-Q

This represents purchase obligations and contingent consideration related to our various acquisitions. This is based on a discounted cash flow (DCF) approach and it is adjusted to fair value on a recurring basis.

The majority of the Company's non-financial instruments, which include goodwill, intangible assets, inventories and property, plant, and equipment, are not required to be remeasured at fair value on a recurring basis. These assets are evaluated for impairment if certain triggering events occur. If such evaluation indicates that an impairment exists, the asset is written down to its fair value. In addition, an impairment analysis is performed at least annually for goodwill and indefinite-lived intangible assets.

Fair Value of Debt

Based on the level of interest rates prevailing at June 30, 2011, the fair value of the Company's fixed-rate debt exceeded the carrying value by approximately \$110 million. Unrealized gains or losses on debt do not result in the realization or expenditure of cash and generally are not recognized for financial reporting purposes unless the debt is retired prior to its maturity.

Table of Contents

14. Subsequent Events

Pursuant to the Merger Agreement, on the Closing Date, Merger Sub merged with and into the Company with the Company surviving as a wholly-owned subsidiary of Parent.

On the Closing Date, in connection with the Merger, each outstanding share of common stock of the Company (other than any shares owned by the Company or its wholly-owned subsidiaries, or by Parent and its affiliates, or by any stockholders who were entitled to and who properly exercised appraisal rights under Delaware law, and shares of unvested restricted stock granted under the Company's equity plan) was cancelled and converted automatically into the right to receive the Merger Consideration.

Equity contributions totaling \$1.1 billion from Parent, together with (i) the proceeds from the sale of (a) \$150 million aggregate principal amount of 9.50% Senior Secured Notes due 2016 (the Secured WMG Notes) initially issued by WM Finance Corp., (the Initial OpCo Issuer), (b) \$765 million aggregate principal amount of 11.50% Senior Notes due 2018 initially issued by the Initial OpCo Issuer, (the Unsecured WMG Notes) and (c) \$150 million aggregate principal amount of 13.75% Senior Notes due 2019 (the Holdings Notes and together with the Secured WMG Notes and the Unsecured WMG Notes, the Notes) initially issued by WM Holdings Finance Corp., (the Initial Holdings Issuer) and (ii) cash on hand at the Company, were used, among other things, to finance the aggregate Merger Consideration, to make payments in satisfaction of other equity-based interests in the Company under the Merger Agreement, to repay certain of the Company's existing indebtedness and to pay related transaction fees and expenses. On the Closing Date, (i) Acquisition Corp. became the obligor under the Secured WMG Notes and the Unsecured WMG Notes as a result of the merger of Initial OpCo Issuer with and into Acquisition Corp. (the OpCo Merger) and (ii) Holdings became the obligor under the Holdings Notes as a result of the merger of Initial Holdings Issuer with and into Holdings (the Holdings Merger). On the Closing Date, the Company also entered into, but did not draw under, a new \$60 million revolving credit facility.

In connection with the Merger, the Company also refinanced certain of its existing consolidated indebtedness, including (i) the repurchase and redemption by Holdings of its approximately \$258 million in fully accreted principal amount outstanding 9.5% Senior Discount Notes due 2014 (the Existing Holdings Notes), and the satisfaction and discharge of the related indenture and (ii) the repurchase and redemption by Acquisition Corp. of its \$465 million in aggregate principal amount outstanding 7 3/8% Dollar-denominated Senior Subordinated Notes due 2014 and £100 million in aggregate principal amount of its outstanding 8 1/8% Sterling-denominated Senior Subordinated Notes due 2014 (the Existing Acquisition Corp. Notes and together with the Existing Holdings Notes, the Existing Notes), and the satisfaction and discharge of the related indenture, and payment of related tender offer or call premiums and accrued interest on the Existing Notes.

Table of Contents

WARNER MUSIC GROUP CORP.

Supplementary Information

Consolidating Financial Statements

The Company is the direct parent of Holdings, which is the direct parent of Acquisition Corp. As of June 30, 2011, Holdings had issued and outstanding the Existing Holdings Notes. The Existing Holdings Notes were, and the Holdings Notes are, guaranteed by the Company on a full, unconditional, joint and several basis. The following consolidating financial statements are presented for the information of the holders of the Existing Holdings Notes and the Holdings Notes and present the results of operations, financial position and cash flows of (i) the Company, which was the guarantor of the Existing Holdings Notes, (ii) Holdings, which was the issuer of the Existing Holdings Notes, (iii) the subsidiaries of Holdings (Acquisition Corp. is the only direct subsidiary of Holdings) and (iv) the eliminations necessary to arrive at the information for the Company on a consolidated basis. Investments in consolidated subsidiaries are presented under the equity method of accounting.

The Company and Holdings are holding companies that conduct substantially all their business operations through Acquisition Corp. Accordingly, the ability of the Company and Holdings to obtain funds from its subsidiaries is restricted by the agreements governing the debt obligations of its subsidiaries.

In connection with the Merger, the Company repurchased or called for redemption all of the outstanding Existing Holdings Notes and have satisfied and discharged all of the Company's obligations under the indentures governing those notes. See Note 14, Subsequent Events.

Table of Contents**WARNER MUSIC GROUP CORP.****Supplementary Information****Consolidating Balance Sheet (Unaudited)****June 30, 2011**

	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	Warner Music Group Corp. Consolidated
Assets:					
Current assets:					
Cash and equivalents	\$ 155	\$	\$ 135	\$	\$ 290
Accounts receivable, net			357		357
Inventories			28		28
Royalty advances expected to be recouped within one year			160		160
Deferred tax assets			30		30
Other current assets			89		89
Total current assets	155		799		954
Royalty advances expected to be recouped after one year			196		196
Investments in and advances to (from) consolidated subsidiaries	(525)	(227)		752	
Property, plant and equipment, net			124		124
Goodwill			1,087		1,087
Intangible assets subject to amortization, net			1,062		1,062
Intangible assets not subject to amortization			100		100
Other assets	32	(39)	67		60
Total assets	\$ (338)	\$ (266)	\$ 3,435	\$ 752	\$ 3,583
Liabilities and Deficit:					
Current liabilities:					
Accounts payable	\$	\$	\$ 141	\$	\$ 141
Accrued royalties			1,038		1,038
Accrued liabilities			226		226
Accrued interest		1	14		15
Deferred revenue			132		132
Other current liabilities			32		32
Total current liabilities		1	1,583		1,584
Long-term debt		258	1,694		1,952
Deferred tax liabilities, net			164		164
Other noncurrent liabilities			172		172
Total liabilities		259	3,613		3,872
Total Warner Music Group Corp. shareholders deficit	(338)	(525)	(227)	752	(338)

Edgar Filing: Warner Music Group Corp. - Form 10-Q

Noncontrolling interest			49		49
Total deficit	(338)	(525)	(178)	752	(289)
Total liabilities and deficit	\$ (338)	\$ (266)	\$ 3,435	\$ 752	\$ 3,583

Table of Contents**WARNER MUSIC GROUP CORP.****Supplementary Information****Consolidating Balance Sheet (Unaudited)****September 30, 2010**

	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	Warner Music Group Corp. Consolidated
Assets:					
Current assets:					
Cash and equivalents	\$ 176	\$	\$ 263	\$	\$ 439
Accounts receivable, net			434		434
Inventories			37		37
Royalty advances expected to be recouped within one year			143		143
Deferred tax assets			30		30
Other current assets			78		78
Total current assets	176		985		1,161
Royalty advances expected to be recouped after one year			189		189
Investments in and advances to (from) consolidated subsidiaries	(454)	(174)		628	
Property, plant and equipment, net			121		121
Goodwill			1,057		1,057
Intangible assets subject to amortization, net			1,119		1,119
Intangible assets not subject to amortization			100		100
Other assets	14	(15)	65		64
Total assets	\$ (264)	\$ (189)	\$ 3,636	\$ 628	\$ 3,811
Liabilities and Deficit:					
Current liabilities:					
Accounts payable	\$	\$	\$ 206	\$	\$ 206
Accrued royalties			1,034		1,034
Accrued liabilities			314		314
Accrued interest		7	52		59
Deferred revenue			100		100
Other current liabilities			40		40
Total current liabilities		7	1,746		1,753
Long-term debt		258	1,687		1,945
Deferred tax liabilities, net			169		169
Other noncurrent liabilities	1		154		155
Total liabilities	1	265	3,756		4,022
Total Warner Music Group Corp. shareholders deficit	(265)	(454)	(174)	628	(265)

Edgar Filing: Warner Music Group Corp. - Form 10-Q

Noncontrolling interest			54		54
Total deficit	(265)	(454)	(120)	628	(211)
Total liabilities and deficit	\$ (264)	\$ (189)	\$ 3,636	\$ 628	\$ 3,811

Table of Contents**WARNER MUSIC GROUP CORP.****Supplementary Information****Consolidating Statements of Operations (Unaudited)****For The Three Months Ended June 30, 2011 and 2010**

	Three months ended June 30, 2011				Warner Music Group Corp. Consolidated
	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	
Revenues	\$	\$	\$ 686	\$	\$ 686
Costs and expenses:					
Cost of revenues			(378)		(378)
Selling, general and administrative expenses			(242)		(242)
Amortization of intangible assets			(56)		(56)
Total costs and expenses			(676)		(676)
Operating income			10		10
Interest expense, net		(7)	(40)		(47)
Equity (losses) gains from consolidated subsidiaries	(46)	(39)		85	
Other income, net			6		6
Loss before income taxes	(46)	(46)	(24)	85	(31)
Income tax expense			(15)		(15)
Net loss	(46)	(46)	(39)	85	(46)
Less: loss attributable to noncontrolling interest					
Net loss attributable to Warner Music Group Corp.	\$ (46)	\$ (46)	\$ (39)	\$ 85	\$ (46)

	Three months ended June 30, 2010				Warner Music Group Corp. Consolidated
	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	
Revenues	\$	\$	\$ 652	\$	\$ 652
Costs and expenses:					
Cost of revenues			(353)		(353)
Selling, general and administrative expenses			(245)		(245)
Amortization of intangible assets			(55)		(55)
Total costs and expenses			(653)		(653)
Operating loss			(1)		(1)

Edgar Filing: Warner Music Group Corp. - Form 10-Q

Interest expense, net		(7)	(39)		(46)
Equity (losses) gains from consolidated subsidiaries	(55)	(47)		102	
Other (expense) income, net		(1)	2		1
Loss before income taxes	(55)	(55)	(38)	102	(46)
Income tax expense			(9)		(9)
Net loss	(55)	(55)	(47)	102	(55)
Less: loss attributable to noncontrolling interest					
Net loss attributable to Warner Music Group Corp.	\$ (55)	\$ (55)	\$ (47)	\$ 102	\$ (55)

Table of Contents**WARNER MUSIC GROUP CORP.****Supplementary Information****Consolidating Statements of Operations (Unaudited)****For The Nine Months Ended June 30, 2011 and 2010**

	Nine months ended June 30, 2011				Warner Music Group Corp. Consolidated
	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	
Revenues	\$	\$	\$ 2,157	\$	\$ 2,157
Costs and expenses:					
Cost of revenues			(1,177)		(1,177)
Selling, general and administrative expenses			(762)		(762)
Amortization of intangible assets			(165)		(165)
Total costs and expenses			(2,104)		(2,104)
Operating income			53		53
Interest expense, net		(19)	(122)		(141)
Equity (losses) gains from consolidated subsidiaries	(101)	(82)		183	
Other expense, net			5		5
Loss before income taxes	(101)	(101)	(64)	183	(83)
Income tax expense	(1)		(19)		(20)
Net loss	(102)	(101)	(83)	183	(103)
Less: loss attributable to noncontrolling interest			1		1
Net loss attributable to Warner Music Group Corp.	\$ (102)	\$ (101)	\$ (82)	\$ 183	\$ (102)

	Nine months ended June 30, 2010				Warner Music Group Corp. Consolidated
	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	
Revenues	\$	\$	\$ 2,232	\$	\$ 2,232
Costs and expenses:					
Cost of revenues			(1,193)		(1,193)
Selling, general and administrative expenses			(804)		(804)
Amortization of intangible assets			(165)		(165)
Total costs and expenses			(2,162)		(2,162)
Operating income			70		70
Interest expense, net		(19)	(124)		(143)

Edgar Filing: Warner Music Group Corp. - Form 10-Q

Equity (losses) gains from consolidated subsidiaries	(97)	(77)		174	
Other expense, net		(1)	(1)		(2)
Loss before income taxes	(97)	(97)	(55)	174	(75)
Income tax expense			(24)		(24)
Net loss	(97)	(97)	(79)	174	(99)
Less: loss attributable to noncontrolling interest			2		2
Net loss attributable to Warner Music Group Corp.	\$ (97)	\$ (97)	\$ (77)	\$ 174	\$ (97)

Table of Contents**WARNER MUSIC GROUP CORP.****Supplementary Information****Consolidating Statement of Cash Flows (Unaudited)****For The Nine Months Ended June 30, 2011**

	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	Warner Music Group Corp. Consolidated
Cash flows from operating activities					
Net (loss) income	\$ (102)	\$ (101)	\$ (83)	\$ 183	\$ (103)
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:					
Depreciation and amortization			196		196
Deferred income taxes			(11)		(11)
Non-cash interest expense			9		9
Non-cash, stock-based compensation expense			10		10
Equity losses (gains) from consolidated subsidiaries	101	82		(183)	
Other non-cash items			(2)		(2)
Changes in operating assets and liabilities:					
Accounts receivable			93		93
Inventories			10		10
Royalty advances			(15)		(15)
Accounts payable and accrued liabilities	(3)		(166)		(169)
Accrued interest		(6)	(38)		(44)
Other balance sheet changes	(20)	25	3		8
Net cash (used in) provided by operating activities	(24)		6		(18)
Cash flows from investing activities					
Investments and acquisitions of businesses			(59)		(59)
Acquisition of publishing rights			(58)		(58)
Capital expenditures			(34)		(34)
Net cash used in investing activities			(151)		(151)
Cash flows from financing activities					
Proceeds from exercise of stock options	3		3		6
Distribution to noncontrolling interest holder			(1)		(1)
Net cash provided by financing activities	3		2		5
Effect of exchange rate changes on cash and equivalents			15		15
Net decrease in cash and equivalents	(21)		(128)		(149)
Cash and equivalents at beginning of period	176		263		439

Edgar Filing: Warner Music Group Corp. - Form 10-Q

Cash and equivalents at end of period	\$ 155	\$	\$ 135	\$	\$ 290
---------------------------------------	--------	----	--------	----	--------

Table of Contents**WARNER MUSIC GROUP CORP.****Supplementary Information****Consolidating Statement of Cash Flows (Unaudited)****For The Nine Months Ended June 30, 2010**

	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	Consolidated
Cash flows from operating activities					
Net (loss) income	\$ (99)	\$ (99)	\$ (79)	\$ 178	\$ (99)
Adjustments to reconcile net (loss) income to net cash provided by operating activities:					
Depreciation and amortization			193		193
Deferred income taxes			(9)		(9)
Impairment of cost-method investment			1		1
Non-cash interest expense		5	12		17
Non-cash stock-based compensation expense			7		7
Equity losses (gains) from consolidated subsidiaries	99	79		(178)	
Other non-cash items			(5)		(5)
Changes in operating assets and liabilities:					
Accounts receivable			173		173
Inventories			7		7
Royalty advances			2		2
Accounts payable and accrued liabilities			(135)		(135)
Accrued interest		1	(43)		(42)
Other balance sheet changes	(12)	14	(12)		(10)
Net cash (used in) provided by operating activities	(12)		112		100
Cash flows from investing activities					
Investments and acquisitions of businesses			(1)		(1)
Acquisition of publishing rights			(39)		(39)
Proceeds from the sale of investments			9		9
Capital expenditures			(30)		(30)
Net cash used in investing activities			(61)		(61)
Cash flows from financing activities					
Distribution to noncontrolling interest holder			(2)		(2)
Net cash used in financing activities			(2)		(2)
Effect of foreign currency exchange rate changes on cash			(21)		(21)
Net decrease in cash and equivalents	(12)		28		16
Cash and equivalents at beginning of period	188		196		384
Cash and equivalents at end of period	\$ 176	\$	\$ 224	\$	\$ 400

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion of our results of operations and financial condition with the unaudited interim financial statements included elsewhere in this Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2011 (the "Quarterly Report").

We maintain an Internet site at www.wmg.com. We use our website as a channel of distribution for material company information. Financial and other material information regarding the Company is routinely posted on and accessible at <http://investors.wmg.com>. In addition, you may automatically receive email alerts and other information about the Company by enrolling your email by visiting the "email alerts" section at <http://investors.wmg.com>. We make available on our website free of charge our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K as soon as practicable after we electronically file such reports with the Securities and Exchange Commission (the "SEC"). Our website and the information posted on it or connected to it shall not be deemed to be incorporated by reference into this Quarterly Report.

SAFE HARBOR STATEMENT UNDER PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Quarterly Report includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements other than statements of historical facts included in this Quarterly Report, including, without limitation, statements regarding our future financial position, business strategy, budgets, projected costs, cost savings, industry trends and plans and objectives of management for future operations, are forward-looking statements. In addition, forward-looking statements generally can be identified by the use of forward-looking terminology such as may, will, expect, intend, estimate, anticipate, believe or continue or the negative thereof or variations thereon or similar terms. Such statements include, among others, statements set forth under "Factors Affecting Results of Operations and Financial Condition - Additional Targeted Savings" below, statements regarding our ability to develop talent and attract future talent, our ability to reduce future capital expenditures, our ability to monetize our music content, including through new distribution channels and formats to capitalize on the growth areas of the music industry, our ability to effectively deploy our capital, the development of digital music and the effect of digital distribution channels on our business, including whether we will be able to achieve higher margins from digital sales, the success of strategic actions we are taking to accelerate our transformation as we redefine our role in the music industry, the effectiveness of our ongoing efforts to reduce overhead expenditures and manage our variable and fixed cost structure and our ability to generate expected cost savings from such efforts, our success in limiting piracy, our ability to compete in the highly competitive markets in which we operate, the growth of the music industry and the effect of our and the music industry's efforts to combat piracy on the industry, our intention to pay dividends or repurchase our outstanding notes in open market purchases, privately or otherwise, the impact on us of potential strategic transactions, our ability to fund our future capital needs and the effect of litigation on us. Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to have been correct.

There are a number of risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements contained in this Quarterly Report. Additionally, important factors could cause our actual results to differ materially from the forward-looking statements we make in this Quarterly Report. As stated elsewhere in this Quarterly Report, such risks, uncertainties and other important factors include, among others:

litigation in respect of the Merger Agreement;

disruption from the Merger and the transactions related to the Merger making it more difficult to maintain certain strategic relationships;

risks relating to recent or future ratings agency actions or downgrades as a result of the Merger and the transactions related to the Merger or for any other reason;

reduced access to capital markets as the result of the delisting of the Company's common stock on the New York Stock Exchange following consummation of the Merger;

Edgar Filing: Warner Music Group Corp. - Form 10-Q

the impact of our substantial leverage, including the increase associated with additional indebtedness incurred in connection with the Merger and the transactions related to the Merger, on our ability to raise additional capital to fund our operations, on our ability to react to changes in the economy or our industry and on our ability to meet our obligations under our indebtedness;

our ability to achieve expected or targeted cost savings following consummation of the Merger;

the continued decline in the global recorded music industry and the rate of overall decline in the music industry;

our ability to continue to identify, sign and retain desirable talent at manageable costs;

the threat posed to our business by piracy of music by means of home CD-R activity, Internet peer-to-peer file-sharing and sideloading of unauthorized content;

the significant threat posed to our business and the music industry by organized industrial piracy;

Table of Contents

the popular demand for particular recording artists and/or songwriters and albums and the timely completion of albums by major recording artists and/or songwriters;

the diversity and quality of our portfolio of songwriters;

the diversity and quality of our album releases;

significant fluctuations in our results of operations and cash flows due to the nature of our business;

our involvement in intellectual property litigation;

the possible downward pressure on our pricing and profit margins;

our ability to continue to enforce our intellectual property rights in digital environments;

the ability to develop a successful business model applicable to a digital environment and to enter into expanded-rights deals with recording artists in order to broaden our revenue streams in growing segments of the music business;

the impact of heightened and intensive competition in the recorded music and music publishing businesses and our inability to execute our business strategy;

risks associated with our non-U.S. operations, including limited legal protections of our intellectual property rights and restrictions on the repatriation of capital;

the impact of legitimate music distribution on the Internet or the introduction of other new music distribution formats;

the reliance on a limited number of online music stores and their ability to significantly influence the pricing structure for online music stores;

the impact of rate regulations on our Recorded Music and Music Publishing businesses;

the impact of rates on other income streams that may be set by arbitration proceedings on our business;

the impact an impairment in the carrying value of goodwill or other intangible and long-lived assets could have on our operating results and shareholders' deficit;

risks associated with the fluctuations in foreign currency exchange rates;

Edgar Filing: Warner Music Group Corp. - Form 10-Q

our ability and the ability of our joint venture partners to operate our existing joint ventures satisfactorily;

the enactment of legislation limiting the terms by which an individual can be bound under a personal services contract;

potential loss of catalog if it is determined that recording artists have a right to recapture recordings under the U.S. Copyright Act;

changes in law and government regulations;

trends that affect the end uses of our musical compositions (which include uses in broadcast radio and television, film and advertising businesses);

the growth of other products that compete for the disposable income of consumers;

risks inherent in relying on one supplier for manufacturing, packaging and distribution services in North America and Europe;

risks inherent in our acquiring or investing in other businesses including our ability to successfully manage new businesses that we may acquire as we diversify revenue streams within the music industry;

the fact that we have engaged in substantial restructuring activities in the past, and may need to implement further restructurings in the future and our restructuring efforts may not be successful or generate expected cost savings;

the fact that we are outsourcing certain back-office functions, such as IT infrastructure and development and certain finance and accounting functions, which will make us more dependent upon third parties;

that changes to our information technology infrastructure to harmonize our systems and processes may fail to operate as designed and intended;

the possibility that our owners' interests will conflict with ours or yours; and

failure to attract and retain key personnel.

There may be other factors not presently known to us or which we currently consider to be immaterial that may cause our actual results to differ materially from the forward-looking statements.

All forward-looking statements attributable to us or persons acting on our behalf apply only as of the date of this Quarterly Report and are expressly qualified in their entirety by the cautionary statements included in this Quarterly Report. We disclaim any duty to publicly update or revise forward-looking statements to reflect events or circumstances after the date made or to reflect the occurrence of unanticipated events.

Table of Contents

INTRODUCTION

Warner Music Group Corp. (the **Company**) was formed on November 21, 2003. The Company is the direct parent of Holdings, which is the direct parent of Acquisition Corp. Acquisition Corp. is one of the world's major music-based content companies.

Pursuant to the Agreement and Plan of Merger, dated as of May 6, 2011 (the **Merger Agreement**), by and among the Company, Airplanes Music LLC, a Delaware limited liability company (**Parent**) and an affiliate of Access Industries, Inc. (**Access**) and Airplanes Merger Sub, Inc., a Delaware corporation and a wholly-owned subsidiary of Airplanes (**Merger Sub**), on July 20, 2011 (the **Closing Date**), Merger Sub merged with and into the Company with the Company surviving as a wholly-owned subsidiary of Parent (the **Merger**).

On July 20, 2011, in connection with the Merger, each outstanding share of common stock of the Company (other than any shares owned by the Company or its wholly-owned subsidiaries, or by Parent and its affiliates, or by any stockholders who were entitled to and who properly exercised appraisal rights under Delaware law, and shares of unvested restricted stock granted under the Company's equity plan) was cancelled and converted automatically into the right to receive \$8.25 in cash, without interest and less applicable withholding taxes (collectively, the **Merger Consideration**).

On July 20, 2011, the Company notified the New York Stock Exchange, Inc. (the **NYSE**) of its intent to remove the Company's common stock from listing on the NYSE and requested that the NYSE file with the SEC an application on Form 25 to report the delisting of the Company's common stock from the NYSE. On July 21, 2011, in accordance with the Company's request, the NYSE filed the Form 25 with the SEC in order to provide notification of such delisting and to effect the deregistration of the Company's common stock under Section 12(b) of the Securities Exchange Act of 1934, as amended (the **Exchange Act**). On August 2, 2011, the Company filed a Form 15 with the SEC in order to provide notification of a suspension of its duty to file reports under Section 15(d) of the Exchange Act.

Parent funded the Merger Consideration through cash on hand at the Company at closing, equity financing obtained from Parent and debt financing obtained from third party lenders. See **Overview - The Merger**.

The Company and Holdings are holding companies that conduct substantially all of their business operations through their subsidiaries. The terms **we**, **us**, **our**, **ours**, and the **Company** refer collectively to Warner Music Group Corp. and its consolidated subsidiaries, except where otherwise indicated.

Management's discussion and analysis of results of operations and financial condition (**MD&A**) is provided as a supplement to the unaudited financial statements and footnotes included elsewhere herein to help provide an understanding of our financial condition, changes in financial condition and results of our operations. MD&A is organized as follows:

Overview. This section provides a general description of our business, as well as recent developments that we believe are important in understanding our results of operations and financial condition and in anticipating future trends.

Results of operations. This section provides an analysis of our results of operations for the three and nine months ended June 30, 2011 and 2010. This analysis is presented on both a consolidated and segment basis.

Financial condition and liquidity. This section provides an analysis of our cash flows for the nine months ended June 30, 2011 and 2010, as well as a discussion of our financial condition and liquidity as of June 30, 2011. The discussion of our financial condition and liquidity includes (i) a summary of our debt agreements and (ii) a summary of our key debt compliance measures under our debt agreements.

Use of OIBDA

We evaluate our operating performance based on several factors, including our primary financial measure of operating income (loss) before non-cash depreciation of tangible assets, non-cash amortization of intangible assets and non-cash impairment charges to reduce the carrying value of goodwill and intangible assets (which we refer to as **OIBDA**). We consider OIBDA to be an important indicator of the operational strengths and performance of our businesses, including the ability to provide cash flows to service debt. However, a limitation of the use of OIBDA as a performance measure is that it does not reflect the periodic costs of certain capitalized tangible and intangible assets used in

Edgar Filing: Warner Music Group Corp. - Form 10-Q

generating revenues in our businesses. Accordingly, OIBDA should be considered in addition to, not as a substitute for, operating income, net income (loss) attributable to Warner Music Group Corp. and other measures of financial performance reported in accordance with U.S. GAAP. In addition, our definition of OIBDA may differ from similarly titled measures used by other companies. A reconciliation of consolidated historical OIBDA to operating income and net income (loss) attributable to Warner Music Group Corp. is provided in our Results of Operations.

Use of Constant Currency

As exchange rates are an important factor in understanding period to period comparisons, we believe the presentation of results on a constant-currency basis in addition to reported results helps improve the ability to understand our operating results and evaluate

Table of Contents

our performance in comparison to prior periods. Constant-currency information compares results between periods as if exchange rates had remained constant period over period. We use results on a constant-currency basis as one measure to evaluate our performance. We calculate constant currency by calculating prior-year results using current-year foreign currency exchange rates. We generally refer to such amounts calculated on a constant-currency basis as excluding the impact of foreign currency exchange rates. These results should be considered in addition to, not as a substitute for, results reported in accordance with U.S. GAAP. Results on a constant-currency basis, as we present them, may not be comparable to similarly titled measures used by other companies and are not a measure of performance presented in accordance with U.S. GAAP.

OVERVIEW

We are one of the world's major music-based content companies. We classify our business interests into two fundamental operations: Recorded Music and Music Publishing. A brief description of each of those operations is presented below.

Recorded Music Operations

Our Recorded Music business primarily consists of the discovery and development of artists and the related marketing, distribution and licensing of recorded music produced by such artists.

We are also diversifying our revenues beyond our traditional businesses by entering into expanded-rights deals with recording artists in order to partner with artists in other areas of their careers. Under these agreements, we provide services to and participate in artists' activities outside the traditional recorded music business. We have built artist services capabilities and platforms for exploiting this broader set of music-related rights and participating more broadly in the monetization of the artist brands we help create. In developing our artist services business, we have both built and expanded in-house capabilities and expertise and have acquired a number of existing artist services companies involved in artist management, merchandising, strategic marketing and brand management, ticketing, concert promotion, fan club, original programming and video entertainment. We believe that entering into expanded-rights deals and enhancing our artist services capabilities with respect to our artists and other artists will permit us to diversify revenue streams to better capitalize on the growth areas of the music industry and permit us to build stronger, long-term relationships with artists and more effectively connect artists and fans.

In the U.S., our Recorded Music operations are conducted principally through our major record labels Warner Bros. Records and The Atlantic Records Group. Our Recorded Music operations also include Rhino, a division that specializes in marketing our music catalog through compilations and reissues of previously released music and video titles, as well as in the licensing of recordings to and from third parties for various uses, including film and television soundtracks. Rhino has also become our primary licensing division focused on acquiring broader licensing rights from certain recording artists. For example, we have an exclusive license with The Grateful Dead to manage the band's intellectual property and a 50% interest in Frank Sinatra Enterprises, an entity that administers licenses for use of Frank Sinatra's name and likeness and manages all aspects of his music, film and stage content. We also conduct our Recorded Music operations through a collection of additional record labels, including, among others, Asylum, Cordless, East West, Elektra, Nonesuch, Reprise, Roadrunner, Rykodisc, Sire and Word.

Outside the U.S., our Recorded Music activities are conducted in more than 50 countries primarily through WMI and its various subsidiaries, affiliates and non-affiliated licensees. WMI engages in the same activities as our U.S. labels: discovering and signing artists and distributing, marketing and selling their recorded music. In most cases, WMI also markets and distributes the records of those artists for whom our U.S. record labels have international rights. In certain smaller markets, WMI licenses to unaffiliated third-party record labels the right to distribute its records. Our international artist services operations also include a network of concert promoters through which WMI provides resources to coordinate tours for our artists and other artists.

Our Recorded Music distribution operations include WEA Corp., which markets and sells music and DVD products to retailers and wholesale distributors in the U.S.; ADA, which distributes the products of independent labels to retail and wholesale distributors in the U.S.; various distribution centers and ventures operated internationally; an 80% interest in Word Entertainment, which specializes in the distribution of music products in the Christian retail marketplace; and ADA Global, which provides distribution services outside of the U.S. through a network of affiliated and non-affiliated distributors.

We play an integral role in virtually all aspects of the recorded music value chain from discovering and developing talent to producing albums and promoting artists and their products. After an artist has entered into a contract with one of our record labels, a master recording of the artist's music is created. The recording is then replicated for sale to consumers primarily in the CD and digital formats. In the U.S., WEA Corp., ADA and Word market, sell and deliver product, either directly or through sub-distributors and wholesalers, to record stores, mass merchants and other retailers. Our recorded music products are also sold in physical form to online physical retailers such as Amazon.com, barnesandnoble.com

Edgar Filing: Warner Music Group Corp. - Form 10-Q

and bestbuy.com and in digital form to online digital retailers like Apple's iTunes and mobile full-track download stores such as those operated by Verizon or Sprint. In the case of expanded-rights deals where we acquire broader rights in a recording artist's career, we may provide more comprehensive career support and actively develop new opportunities for an artist through touring, fan clubs, merchandising and sponsorships, among other areas. We believe expanded-rights deals create better partnerships with our artists, which allow us and our artists to work together more closely to create and sustain artistic and commercial success.

Table of Contents

We have integrated the sale of digital content into all aspects of our Recorded Music and Music Publishing businesses including A&R, marketing, promotion and distribution. Our new media executives work closely with A&R departments to make sure that while a record is being made, digital assets are also created with all of our distribution channels in mind, including subscription services, social networking sites, online portals and music-centered destinations. We work side by side with our mobile and online partners to test new concepts. We believe existing and new digital businesses will be a significant source of growth for the next several years and will provide new opportunities to monetize our assets and create new revenue streams. As a music-based content company, we have assets that go beyond our recorded music and music publishing catalogs, such as our music video library, which we have begun to monetize through digital channels. The proportion of digital revenues attributed to each distribution channel varies by region and since digital music is still in the relatively early stages of growth, proportions may change as the roll out of new technologies continues. As an owner of musical content, we believe we are well positioned to take advantage of growth in digital distribution and emerging technologies to maximize the value of our assets.

Recorded Music revenues are derived from three main sources:

Physical and other: the rightsholder receives revenues with respect to sales of physical products such as CDs and DVDs. We are also diversifying our revenues beyond sales of physical products and receive other revenues from our artist services business and our participation in expanded rights associated with our artists and other artists, including sponsorship, fan club, artist websites, merchandising, touring, ticketing and artist and brand management;

Digital: the rightsholder receives revenues with respect to online and mobile downloads, mobile ringtones or ringback tones and online and mobile streaming; and

Licensing: the rightsholder receives royalties or fees for the right to use the sound recording in combination with visual images such as in films or television programs, television commercials and videogames.

The principal costs associated with our Recorded Music operations are as follows:

Royalty costs and artist and repertoire costs the costs associated with (i) paying royalties to artists, producers, songwriters, other copyright holders and trade unions, (ii) signing and developing artists, (iii) creating master recordings in the studio and (iv) creating artwork for album covers and liner notes;

Product costs the costs to manufacture, package and distribute product to wholesale and retail distribution outlets as well as those principal costs related to expanded rights;

Selling and marketing costs the costs associated with the promotion and marketing of artists and recorded music products, including costs to produce music videos for promotional purposes and artist tour support; and

General and administrative costs the costs associated with general overhead and other administrative costs.

Music Publishing Operations

Where recorded music is focused on exploiting a particular recording of a composition, music publishing is an intellectual property business focused on the exploitation of the composition itself. In return for promoting, placing, marketing and administering the creative output of a songwriter, or engaging in those activities for other rights holders, the Company's Music Publishing business garners a share of the revenues generated from use of the composition.

The Company's Music Publishing operations include Warner/Chappell, its global Music Publishing company, headquartered in New York with operations in over 50 countries through various subsidiaries, affiliates and non-affiliated licensees. The Company owns or controls rights to

Edgar Filing: Warner Music Group Corp. - Form 10-Q

more than one million musical compositions, including numerous pop hits, American standards, folk songs and motion picture and theatrical compositions. Assembled over decades, its award-winning catalog includes over 65,000 songwriters and composers and a diverse range of genres including pop, rock, jazz, country, R&B, hip-hop, rap, reggae, Latin, folk, blues, symphonic, soul, Broadway, techno, alternative, gospel and other Christian music. In January 2011, the Company acquired Southside Independent Music Publishing, a leading independent music publishing company, further adding to its catalog. Warner/Chappell also administers the music and soundtracks of several third-party television and film producers and studios, including Lucasfilm, Ltd., Hallmark Entertainment, Disney Music Publishing and Turner Music Publishing. In 2007, the Company entered the production music library business with the acquisition of Non-Stop Music. The Company has subsequently continued to expand its production music operations with the acquisitions of Groove Addicts Production Music Library and Carlin Recorded Music Library in fiscal 2010 and 615 Music in fiscal 2011.

Publishing revenues are derived from five main sources:

Mechanical: the licensor receives royalties with respect to compositions embodied in recordings sold in any physical format or configuration (e.g., CDs and DVDs);

Performance: the licensor receives royalties if the composition is performed publicly through broadcast of music on television, radio, cable and satellite, live performance at a concert or other venue (e.g., arena concerts, nightclubs), online and mobile streaming and performance of music in staged theatrical productions;

Table of Contents

Synchronization: the licensor receives royalties or fees for the right to use the composition in combination with visual images such as in films or television programs, television commercials and videogames as well as from other uses such as in toys or novelty items and merchandise;

Digital: the licensor receives royalties or fees with respect to online and mobile downloads, mobile ringtones and online and mobile streaming; and

Other: the licensor receives royalties for use in sheet music.

The principal costs associated with our Music Publishing operations are as follows:

Artist and repertoire costs the costs associated with (i) signing and developing songwriters and (ii) paying royalties to songwriters, co-publishers and other copyright holders in connection with income generated from the exploitation of their copyrighted works; and

General and administration costs the costs associated with general overhead and other administrative costs.

Table of Contents

Factors Affecting Results of Operations and Financial Condition

Market Factors

Since 1999, the recorded music industry has been unstable and the worldwide market has contracted considerably, which has adversely affected our operating results. The industry-wide decline can be attributed primarily to digital piracy. Other drivers of this decline are the bankruptcies of record retailers and wholesalers, growing competition for consumer discretionary spending and retail shelf space, and the maturation of the CD format, which has slowed the historical growth pattern of recorded music sales. While CD sales still generate most of the recorded music revenues, CD sales continue to decline industry-wide and we expect that trend to continue. While new formats for selling recorded music product have been created, including the legal downloading of digital music using the Internet and the distribution of music on mobile devices, revenue streams from these new formats have not yet reached a level where they fully offset the declines in CD sales. The recorded music industry performance may continue to negatively impact our operating results. In addition, a declining recorded music industry could continue to have an adverse impact on portions of the music publishing business. This is because the music publishing business generates a significant portion of its revenues from mechanical royalties from the sale of music in CD and other physical recorded music formats.

Severance Charges

During the nine months ended June 30, 2011 we took additional actions to further align our cost structure with industry trends. This resulted in severance charges of \$28 million for the nine months ended June 30, 2011, compared to \$20 million for the nine months ended June 30, 2010.

Additional Targeted Savings

We have targeted cost-savings over the next nine fiscal quarters of \$50 million to \$65 million based on identified cost-saving initiatives and opportunities, including targeted savings expected to be realized as a result of shifting from a public to a private company, reduced expenses related to finance, legal and information technology and reduced expenses related to certain planned corporate restructuring initiatives. There can be no assurances that these cost-savings will be achieved in full or at all.

LimeWire Settlement

In May 2011, the major record companies reached a global out-of-court settlement of copyright litigation against LimeWire. Under the terms of the settlement, the LimeWire defendants agreed to pay compensation to the record companies that brought the action, including us. In connection with this settlement, we recorded a \$12 million benefit to general and administrative expenses in the consolidated statements of operation for the three and nine months ended June 30, 2011. These amounts were recorded net of the estimated amounts payable to our artists in respect of royalties.

Expanding Business Models to Offset Declines in Physical Sales

Digital Sales

A key part of our strategy to offset declines in physical sales is to expand digital sales. New digital models have enabled us to find additional ways to generate revenues from our music content. In the early stages of the transition from physical to digital sales, overall sales have decreased as the increases in digital sales have not yet met or exceeded the decrease in physical sales. Part of the reason for this gap is the shift in consumer purchasing patterns made possible from new digital models. In the digital space, consumers are now presented with the opportunity to not only purchase entire albums, but to unbundle albums and purchase only favorite tracks as single-track downloads. While to date, sales of online and mobile downloads have constituted the majority of our digital Recorded Music and Music Publishing revenue, that may change over time as new digital models, such as access models (models that typically bundle the purchase of a mobile device with access to music) and streaming subscription services, continue to develop. In the aggregate, we believe that growth in revenue from new digital models has the potential to offset physical declines and drive overall future revenue growth. In the digital space, certain costs associated with physical products, such as manufacturing, distribution, inventory and return costs, do not apply. Partially eroding that benefit are increases in mechanical copyright royalties payable to music publishers which apply in the digital space. While there are some digital-specific variable costs and infrastructure investments necessary to produce, market and sell music in digital formats, we believe it is reasonable to expect that digital margins will generally be higher than physical margins as a result of the elimination of certain costs associated with physical products. As consumer purchasing patterns change over time and new digital models are launched, we may see fluctuations in contribution margin depending on the overall sales mix.

Expanded-Rights Deals

Edgar Filing: Warner Music Group Corp. - Form 10-Q

We have also been seeking to expand our relationships with recording artists as another means to offset declines in physical revenues in Recorded Music. For example, we have been signing recording artists to expanded-rights deals for the last several years. Under these expanded-rights deals, we participate in the recording artist's revenue streams, other than from recorded music sales, such as live performances, merchandising and sponsorships. We believe that additional revenue from these revenue streams will help to offset declines in physical revenue over time. As we have generally signed newer artists to these deals, increased non-traditional revenue from these deals is expected to come several years after these deals have been signed as the artists become more successful and are able to generate revenue other than from recorded music sales. While non-traditional Recorded Music revenue, which includes revenue from expanded-rights deals as well as revenue from our artist services business, was less than 10% of our total revenue in fiscal 2010, we believe this revenue should continue to grow and represent a larger proportion of our revenue over time. We also

Table of Contents

believe that the strategy of entering into expanded-rights deals and continuing to develop our artist services business will contribute to Recorded Music growth over time. Margins for the various non-traditional Recorded Music revenue streams can vary significantly. The overall impact on margins will, therefore, depend on the composition of the various revenue streams in any particular period. For instance, revenue from touring under our expanded-rights deals typically flows straight through to net income with little incremental cost. Revenue from our management business and revenue from sponsorship and touring under expanded-rights deals are all high margin, while merchandise revenue under expanded-rights deals and concert promotion revenue from our concert promotion businesses tend to be lower margin than our traditional revenue streams from recorded music and music publishing.

The Merger

Pursuant to the Merger Agreement, on the Closing Date, Merger Sub merged with and into the Company with the Company surviving as a wholly-owned subsidiary of Parent.

On the Closing Date, in connection with the Merger, each outstanding share of common stock of the Company (other than any shares owned by the Company or its wholly-owned subsidiaries, or by Parent and its affiliates, or by any stockholders who were entitled to and who properly exercised appraisal rights under Delaware law, and shares of unvested restricted stock granted under the Company's equity plan) was cancelled and converted automatically into the right to receive the Merger Consideration.

Equity contributions totaling \$1.1 billion from Parent, together with (i) the proceeds from the sale of (a) \$150 million aggregate principal amount of 9.50% Senior Secured Notes due 2016 (the Secured WMG Notes) initially issued by WM Finance Corp., (the Initial OpCo Issuer), (b) \$765 million aggregate principal amount of 11.50% Senior Notes due 2018 initially issued by the Initial OpCo Issuer, (the Unsecured WMG Notes) and (c) \$150 million aggregate principal amount of 13.75% Senior Notes due 2019 (the Holdings Notes) and together with the Secured WMG Notes and the Unsecured WMG Notes, the Notes) initially issued by WM Holdings Finance Corp., (the Initial Holdings Issuer) and (ii) cash on hand at the Company, were used, among other things, to finance the aggregate Merger Consideration, to make payments in satisfaction of other equity-based interests in the Company under the Merger Agreement, to repay certain of the Company's existing indebtedness and to pay related transaction fees and expenses. On the Closing Date, (i) Acquisition Corp. became the obligor under the Secured WMG Notes and the Unsecured WMG Notes as a result of the merger of Initial OpCo Issuer with and into Acquisition Corp. (the OpCo Merger) and (ii) Holdings became the obligor under the Holdings Notes as a result of the merger of Initial Holdings Issuer with and into Holdings (the Holdings Merger). On the Closing Date, the Company also entered into, but did not draw under, a new \$60 million revolving credit facility.

In connection with the Merger, the Company also refinanced certain of its existing consolidated indebtedness, including (i) the repurchase and redemption by Holdings of its approximately \$258 million in fully accreted principal amount outstanding 9.5% Senior Discount Notes due 2014 (the Existing Holdings Notes), and the satisfaction and discharge of the related indenture and (ii) the repurchase and redemption by Acquisition Corp. of its \$465 million in aggregate principal amount outstanding 7 3/8% Dollar-denominated Senior Subordinated Notes due 2014 and £100 million in aggregate principal amount of its outstanding 8 1/8% Sterling-denominated Senior Subordinated Notes due 2014 (the Existing Acquisition Corp. Notes) and together with the Existing Holdings Notes, the Existing Notes), and the satisfaction and discharge of the related indenture, and payment of related tender offer or call premiums and accrued interest on the Existing Notes.

Approximately \$5 million and \$7 million of expense was incurred by the Company during the three and nine months ended June 30, 2011, respectively, in connection with the consummation of the Merger.

Management Agreement

Upon completion of the Merger, the Company and Holdings entered into a management agreement with Access, dated as of the Closing Date (the Management Agreement), pursuant to which Access will provide the Company and its subsidiaries, with financial, investment banking, management, advisory and other services. Pursuant to the Management Agreement, the Company, or one or more of its subsidiaries, will pay Access a specified annual fee, plus expenses, and a specified transaction fee for certain types of transactions completed by Holdings or one or more of its subsidiaries, plus expenses.

Table of Contents**RESULTS OF OPERATIONS****Three Months Ended June 30, 2011 Compared with Three Months Ended June 30, 2010***Consolidated Historical Results**Revenues*

Our revenues were composed of the following amounts (in millions):

	For the Three Months Ended June 30,		2011 vs. 2010	
	2011	2010	\$ Change	% Change
Revenue by Type				
Physical and other	\$ 295	\$ 297	\$ (2)	-1%
Digital	191	169	22	13%
Licensing	59	53	6	11%
Total Recorded Music	545	519	26	5%
Mechanical	38	50	(12)	-24%
Performance	59	50	9	18%
Synchronization	30	24	6	25%
Digital	15	13	2	15%
Other	4	2	2	100%
Total Music Publishing	146	139	7	5%
Intersegment elimination	(5)	(6)	1	-17%
Total Revenue	\$ 686	\$ 652	\$ 34	5%
Revenue by Geographical Location				
U.S. Recorded Music	\$ 227	\$ 247	\$ (20)	-8%
U.S. Publishing	49	54	(5)	-9%
Total U.S.	276	301	(25)	-8%
International Recorded Music	318	272	46	17%
International Publishing	97	85	12	14%
Total International	415	357	58	16%
Intersegment eliminations	(5)	(6)	1	-17%
Total Revenue	\$ 686	\$ 652	\$ 34	5%

Total Revenue

Total revenues increased by \$34 million, or 5%, to \$686 million for the three months ended June 30, 2011 from \$652 million for the three months ended June 30, 2010. Prior to intersegment eliminations, Recorded Music and Music Publishing revenues represented 79% and 21% of total revenues for the three months ended June 30, 2011 and 2010. Prior to intersegment eliminations, U.S. and international revenues represented 40% and 60% of total revenues for the three months ended June 30, 2011, compared to 46% and 54% of total revenues for the three months ended June 30, 2010. Excluding the favorable impact of foreign currency exchange rates, total revenues decreased \$7 million, or 1%.

Total digital revenues after intersegment eliminations increased by \$24 million, or 13%, to \$203 million for the three months ended June 30, 2011 from \$179 million for the three months ended June 30, 2010. Total digital revenues represented 30% and 27% of consolidated revenues for

Edgar Filing: Warner Music Group Corp. - Form 10-Q

the three months ended June 30, 2011 and 2010, respectively. Prior to intersegment eliminations, total digital revenues for the three months ended June 30, 2011 were comprised of U.S. revenues of \$117 million and international revenues of \$89 million, or 57% and 43% of total digital revenues, respectively. Prior to intersegment eliminations, total digital revenues for the three months ended June 30, 2010 were comprised of U.S. revenues of \$109 million and international revenues of \$73 million, or 60% and 40% of total digital revenues, respectively.

Recorded Music revenues increased by \$26 million, or 5%, to \$545 million for the three months ended June 30, 2011 from \$519 million for the three months ended June 30, 2010. Prior to intersegment eliminations, Recorded Music revenues represented 79% of consolidated revenues, for the three months ended June 30, 2011 and 2010. U.S. Recorded Music revenues were \$227 million and \$247 million, or 42% and 48% of Recorded Music revenues for the three months ended June 30, 2011 and 2010, respectively. International Recorded Music revenues were \$318 million and \$272 million, or 58% and 52% of consolidated Recorded Music revenues for the three months ended June 30, 2011 and 2010, respectively. The overall revenue growth reflected increases in digital revenue, licensing revenue and revenue from our European concert promotion businesses, partially offset by declines in physical sales.

Table of Contents

The increase in digital revenue was driven by the growth in digital downloads in the U.S. and internationally and emerging digital revenue streams such as Spotify and YouTube, partially offset by the continued decline in global mobile revenue primarily related to lower ringtone demand. Licensing revenue growth was driven primarily by increases in the licensing of recorded music assets in film, television and compilations. The increases in our European concert promotion business reflected a stronger touring schedule, mostly in France, as compared with the prior-year quarter. The decline in physical revenue in the current quarter versus the prior year was the result of physical declines reflecting the ongoing impact of the transition from physical to digital sales in the recorded music industry. Excluding the favorable impact of foreign currency exchange rates, total Recorded Music revenues decreased by \$3 million, or 1%.

Music Publishing revenues increased by \$7 million, or 5%, to \$146 million for the three months ended June 30, 2011 from \$139 million for the three months ended June 30, 2010. Prior to intersegment eliminations, Music Publishing revenues represented 21% of consolidated revenues, for the three months ended June 30, 2011 and 2010, respectively. U.S. Music Publishing revenues were \$49 million and \$54 million, or 34% and 39% of Music Publishing revenues for the three months ended June 30, 2011 and 2010, respectively. International Music Publishing revenues were \$97 million and \$85 million, or 66% and 61% of Music Publishing revenues for the three months ended June 30, 2011 and 2010, respectively.

The growth in Music Publishing revenue was driven primarily by increases in performance revenue, synchronization revenue, digital revenue and other revenue, partially offset by expected decreases in mechanical revenue. The increase in performance revenue was driven by the results of recent acquisitions and the timing of cash collections in Europe and Latin America. Synchronization revenue results reflected the improvement of the U.S. advertising market and renewals on certain licensing deals. The increase in digital revenue reflected growth in global digital downloads and certain streaming services. Other music publishing revenue increased primarily as a result of higher print revenue in the U.S. The expected decrease in mechanical revenue reflected the ongoing impact of the transition from physical to digital sales in the recorded music industry and the prior period benefit from the shift to accrual-based accounting for a U.S.-based collection society. Excluding the favorable impact of foreign currency exchange rates, total Music Publishing revenues decreased by \$4 million, or 3%.

Revenue by Geographical Location

U.S. revenues decreased by \$25 million, or 8%, to \$276 million for the three months ended June 30, 2011 from \$301 million for the three months ended June 30, 2010. The overall decrease in the U.S. Recorded Music business reflected the continued decline in mobile revenue primarily related to lower ringtone demand and declines in physical sales in the recorded music industry, partially offset by growth in digital downloads and increases in the licensing of recorded music assets in film, television and compilations. The overall decrease in the U.S. Music Publishing business was driven primarily by an expected decrease in mechanical revenue, partially offset by increases in performance revenue, synchronization revenue, digital revenue and other revenue.

International revenues increased by \$58 million, or 16%, to \$415 million for the three months ended June 30, 2011 from \$357 million for the three months ended June 30, 2010. Excluding the favorable impact of foreign currency exchange rates, total international revenues increased \$18 million. The overall increase in the international Recorded Music business reflected growth in global digital downloads and emerging digital streaming services such as Spotify and success from our European concert promotion business which reflected a stronger touring schedule, mostly in France and Italy, as compared with the prior-year quarter. Revenue growth in France and Japan was partially offset by declines in the U.K. and other parts of Europe. The overall increase in the international Music Publishing business was driven by increases in performance revenue, synchronization revenue and digital revenue.

Cost of revenues

Our cost of revenues is composed of the following amounts (in millions):

	For the Three Months Ended		2011 vs. 2010	
	2011	2010	\$ Change	% Change
Artist and repertoire costs	\$ 224	\$ 228	\$ (4)	-2%
Product costs	133	106	27	25%
Licensing costs	21	19	2	11%
Total cost of revenues	\$ 378	\$ 353	\$ 25	7%

Edgar Filing: Warner Music Group Corp. - Form 10-Q

Our cost of revenues increased by \$25 million, or 7%, to \$378 million for the three months ended June 30, 2011 from \$353 million for the three months ended June 30, 2010. Expressed as a percentage of revenues, cost of revenues were 55% for the three months ended June 30, 2011 and 54% for the three months ended June 30, 2010.

Artist and repertoire costs decreased by \$4 million, or 2%, to \$224 million for the three months ended June 30, 2011 from \$228 million for the three months ended June 30, 2010. Expressed as a percentage of revenues, artist and repertoire costs decreased from

Table of Contents

35% for the three months ended June 30, 2010 to 33% in the three months ended June 30, 2011, primarily as a result of the timing of artist and repertoire spending and revenue mix.

Product costs increased by \$27 million, or 25%, to \$133 million for the three months ended June 30, 2011 from \$106 million for the three months ended June 30, 2010. Expressed as a percentage of revenues, product costs increased from 16% for the three months ended June 30, 2010 to 19% in the three months ended June 30, 2011. The increase in product costs was driven by higher non-traditional recorded music business costs related to the increase in revenue from our European concert promotion businesses, partially offset by effective supply chain management and the continuing change in mix from physical to digital sales.

Licensing costs increased \$2 million, or 11%, to \$21 million for the three months ended June 30, 2011 from \$19 million for the three months ended June 30, 2010. Licensing costs as a percentage of licensing revenues were 36% for the three months ended June 30, 2011 and 2010. The increase in licensing costs was driven by the increase in licensing revenue and changes in revenue mix.

Selling, general and administrative expenses

Our selling, general and administrative expense is composed of the following amounts (in millions):

	For the Three Months Ended June 30,		2011 vs. 2010	
	2011	2010	\$ Change	% Change
General and administrative expense (1)	\$ 131	\$ 130	\$ 1	1%
Selling and marketing expense	98	98		
Distribution expense	13	17	(4)	-24%
Total selling, general and administrative expense	\$ 242	\$ 245	\$ (3)	-1%

(1) Includes depreciation expense of \$11 million and \$10 million for the three months ended June 30, 2011 and 2010, respectively. Total selling, general and administrative expense decreased by \$3 million, or 1%, to \$242 million for the three months ended June 30, 2011 from \$245 million for the three months ended June 30, 2010. Expressed as a percentage of revenues, selling, general and administrative expenses decreased from 38% for the three months ended June 30, 2010 to 35% for the three months ended June 30, 2011.

General and administrative expense increased by \$1 million, or 1%, to \$131 million for the three months ended June 30, 2011 from \$130 million for the three months ended June 30, 2010. Expressed as a percentage of revenues, general and administrative expense decreased from 20% for the three months ended June 30, 2010 to 19% for the three months ended June 30, 2011, primarily as a result of the benefit from the LimeWire settlement, partially offset by expenses incurred in connection with the consummation of the Merger.

Selling and marketing expense remained flat at \$98 million for the three months ended June 30, 2011 and 2010. Expressed as a percentage of revenues, selling and marketing expense decreased from 15% for the three months ended June 30, 2010 to 14% for the three months ended June 30, 2011.

Distribution expense decreased by \$4 million, or 24%, to \$13 million for the three months ended June 30, 2011 from \$17 million for the three months ended June 30, 2010. The decrease in distribution expense was driven by the ongoing transition from physical to digital sales. Expressed as a percentage of revenues, distribution expense decreased from 3% for the three months ended June 30, 2010 to 2% for the three months ended June 30, 2011.

Table of Contents**Reconciliation of Consolidated Historical OIBDA to Operating Income and Net Loss Attributable to Warner Music Group Corp.**

As previously described, we use OIBDA as our primary measure of financial performance. The following table reconciles OIBDA to operating income, and further provides the components from operating income to net loss attributable to Warner Music Group Corp. for purposes of the discussion that follows (in millions):

	For the Three Months Ended June 30,		2011 vs. 2010	
	2011	2010	\$ Change	% Change
OIBDA	\$ 77	\$ 64	\$ 13	20%
Depreciation expense	(11)	(10)	(1)	10%
Amortization expense	(56)	(55)	(1)	2%
Operating income (loss)	10	(1)	11	
Interest expense, net	(47)	(46)	(1)	2%
Other income, net	6	1	5	
Loss before income taxes	(31)	(46)	15	-33%
Income tax expense	(15)	(9)	(6)	67%
Net loss	(46)	(55)	9	-16%
Less: loss attributable to noncontrolling interest				
Net loss attributable to Warner Music Group Corp.	\$ (46)	\$ (55)	\$ 9	-16%

OIBDA

Our OIBDA increased by \$13 million to \$77 million for the three months ended June 30, 2011 as compared to \$64 million for the three months ended June 30, 2010. Expressed as a percentage of revenues, total OIBDA margin increased from 10%, for the three months ended June 30, 2010, to 11% for the three months ended June 30, 2011. Our OIBDA increase was primarily driven by the increase in revenue, the benefit from the LimeWire settlement, lower distribution expense and lower artist and repertoire costs, partially offset by the increase in product costs and by expenses incurred in connection with the consummation of the Merger noted above.

See Business Segment Results presented hereinafter for a discussion of OIBDA by business segment.

Depreciation expense

Our depreciation expense increased from \$10 million, for the three months ended June 30, 2010, to \$11 million for the three months ended June 30, 2011, primarily related to recently completed capital projects.

Amortization expense

Amortization expense increased from \$55 million, for the three months ended June 30, 2010, to \$56 million for the three months ended June 30, 2011.

Operating income

Our operating income increased \$11 million to \$10 million, for the three months ended June 30, 2011 as compared to operating loss of \$1 million for the three months ended June 30, 2010. The increase in operating income was a result of the increase in OIBDA noted above, partially offset by increases in depreciation and amortization expense.

Interest expense, net

Edgar Filing: Warner Music Group Corp. - Form 10-Q

Our interest expense, net, increased \$1 million, or 2%, to \$47 million for the three months ended June 30, 2011 as compared to \$46 million for the three months ended June 30, 2010. The increase was primarily driven by changes in foreign currency exchange rates related to our sterling denominated notes.

See [Financial Condition and Liquidity](#) for more information.

Other income, net

Other income for the three months ended June 30, 2011 and 2010 included net hedging gains on foreign exchange contracts, which represent currency exchange movements associated with inter-company receivables and payables that are short term in nature, offset by equity in earnings on our share of net income on investments recorded in accordance with the equity method of accounting for an unconsolidated investee. In addition, other income increased as a result of the settlement of an income tax audit in Germany reimbursable to us by Time Warner under the terms of the 2004 Acquisition.

Table of Contents*Income tax expense*

Income tax expense increased to \$15 million for the three months ended June 30, 2011 from \$9 million for the three months ended June 30, 2010. The increase in income tax expense was primarily due to an increase in tax reserves relating to the settlement of an income tax audit in Germany.

We are currently under examination by various taxing authorities. The accrual for uncertain tax positions has increased by \$15 million for the three months ended June 30, 2011 to \$31 million as a result of the German income tax audit. We expect that \$21 million of this total will be paid during the next twelve months, and \$17 million of the payment will be reimbursed by Time Warner under the terms of the 2004 Acquisition.

Net loss

Our net loss decreased by \$9 million, to a net loss of \$46 million for the three months ended June 30, 2011 as compared to net loss of \$55 million for the three months ended June 30, 2010. The improvement was a result of increase in OIBDA and the increase in other income, partially offset by an increase in income tax expense.

Business Segment Results

Revenue, OIBDA and operating income (loss) by business segment are as follows (in millions):

	For the Three Months Ended June 30,		2011 vs. 2010	
	2011	2010	\$ Change	% Change
Recorded Music				
Revenue	\$ 545	\$ 519	\$ 26	5%
OIBDA	84	65	19	29%
Operating income	\$ 40	\$ 21	19	90%
Music Publishing				
Revenue	\$ 146	\$ 139	\$ 7	5%
OIBDA	22	18	4	22%
Operating income	\$ 2	\$ 1	1	100%
Corporate expenses and eliminations				
Revenue	\$ (5)	\$ (6)	\$ 1	17%
OIBDA	(29)	(19)	(10)	53%
Operating loss	\$ (32)	\$ (23)	(9)	39%
Total				
Revenue	\$ 686	\$ 652	\$ 34	5%
OIBDA	77	64	13	20%
Operating income (loss)	\$ 10	\$ (1)	11	

*Recorded Music**Revenues*

Recorded Music revenues increased by \$26 million, or 5%, to \$545 million for the three months ended June 30, 2011 from \$519 million for the three months ended June 30, 2010. Prior to intersegment eliminations, Recorded Music revenues represented 79% of consolidated revenues, for the three months ended June 30, 2011 and 2010. U.S. Recorded Music revenues were \$227 million and \$247 million, or 42% and 48% of Recorded Music revenues for the three months ended June 30, 2011 and 2010, respectively. International Recorded Music revenues were \$318 million and \$272 million, or 58% and 52% of consolidated Recorded Music revenues for the three months ended June 30, 2011 and 2010, respectively. The overall revenue growth reflected increases in digital revenue, licensing revenue and revenue from our European concert promotion businesses, partially offset by declines in physical sales. The increase in digital revenue was driven by the growth in digital downloads in the U.S. and internationally and emerging digital revenue streams such as Spotify and YouTube, partially offset by the continued decline in global mobile revenue primarily related to lower ringtone demand. Licensing revenue growth was driven primarily by increases in the licensing of recorded music assets in film, television and compilations. The increases in our European concert promotion business reflected a stronger touring schedule, mostly in France and Italy, as compared with the prior-year quarter. The decline in physical revenue in the current

Edgar Filing: Warner Music Group Corp. - Form 10-Q

quarter versus the prior year was the result of physical declines reflecting the ongoing impact of the transition from physical to digital sales in the recorded music industry. Excluding the favorable impact of foreign currency exchange rates, total Recorded Music revenues decreased by \$3 million, or 1%.

Table of Contents*Cost of revenues*

Recorded Music cost of revenues is composed of the following amounts (in millions):

	For the Three Months Ended June 30,		2011 vs. 2010	
	2011	2010	\$ Change	% Change
Artist and repertoire costs	\$ 123	\$ 129	\$ (6)	-5%
Product costs	133	106	27	25%
Licensing costs	21	19	2	11%
Total cost of revenues	\$ 277	\$ 254	\$ 23	9%

Recorded Music cost of revenues increased \$23 million, or 9%, for the three months ended June 30, 2011. The increase in product costs was driven by higher non-traditional recorded music business costs related to the increase in revenue from our European concert promotion businesses, partially offset by effective supply chain management and the continuing change in mix from physical to digital sales. The increase in licensing costs was driven primarily by the increase in licensing revenue and changes in revenue mix. The decrease in artist and repertoire costs was driven by the timing of artist and repertoire spending and revenue mix. Expressed as a percentage of Recorded Music revenues, cost of revenues increased from 49% for the three months ended June 30, 2010, to 51% for the three months ended June 30, 2011, due primarily to costs associated with our European concert promotion businesses.

Selling, general and administrative expense

Recorded Music selling, general and administrative expense is composed of the following amounts (in millions):

	For the Three Months Ended June 30,		2011 vs. 2010	
	2011	2010	\$ Change	% Change
General and administrative expense (1)	\$ 82	\$ 92	\$ (10)	-11%
Selling and marketing expense	96	96		
Distribution expense	13	17	(4)	-24%
Total selling, general and administrative expense	\$ 191	\$ 205	\$ (14)	-7%

(1) Includes depreciation expense of \$7 million and \$5 million for the three months ended June 30, 2011 and 2010, respectively.

Recorded Music selling, general and administrative expense decreased \$14 million, for the three months ended June 30, 2011. The decrease in general and administrative expense was driven by severance charges of \$3 million taken during the current-year quarter as compared with \$7 million taken during the prior-year quarter and the benefit from the LimeWire settlement. The decrease in distribution expense was driven by the ongoing transition from physical to digital sales. Expressed as a percentage of Recorded Music revenues, selling, general and administrative expense decreased from 39% for the three months ended June 30, 2010 to 35% for the three months ended June 30, 2011.

OIBDA and Operating Income

Recorded Music operating income included the following (in millions):

Edgar Filing: Warner Music Group Corp. - Form 10-Q

	For the Three Months Ended		2011 vs. 2010	
	2011	2010	\$ Change	% Change
OIBDA	\$ 84	\$ 65	\$ 19	29%
Depreciation and amortization	(44)	(44)		
Operating income	\$ 40	\$ 21	\$ 19	90%

Recorded Music OIBDA increased by \$19 million, or 29%, to \$84 million for the three months ended June 30, 2011 compared to \$65 million for the three months ended June 30, 2010. Expressed as a percentage of Recorded Music revenues, Recorded Music OIBDA margin increased to 15% for the three months ended June 30, 2011 from 13% for the three months ended June 30, 2010. Our Recorded Music OIBDA increase was driven by the increase in revenue, the benefit from the LimeWire settlement, lower distribution expense, lower artist and repertoire costs and lower severance charges, partially offset by the increase in product costs noted above.

Recorded Music operating income increased by \$19 million, or 90%, due to the increase in OIBDA noted above.

Table of Contents*Music Publishing**Revenues*

Music Publishing revenues increased by \$7 million, or 5%, to \$146 million for the three months ended June 30, 2011 from \$139 million for the three months ended June 30, 2010. Prior to intersegment eliminations, Music Publishing revenues represented 21% of consolidated revenues, for the three months ended June 30, 2011 and 2010. U.S. Music Publishing revenues were \$49 million and \$54 million, or 34% and 39% of Music Publishing revenues for the three months ended June 30, 2011 and 2010, respectively. International Music Publishing revenues were \$97 million and \$85 million, or 66% and 61% of Music Publishing revenues for the three months ended June 30, 2011 and 2010, respectively.

The growth in Music Publishing revenue was driven by increases in performance revenue, synchronization revenue, digital revenue and other revenue, partially offset by expected decreases in mechanical revenue. The increase in performance revenue was driven by the results of recent acquisitions and the timing of cash collections in Europe and Latin America. Synchronization revenue results reflected the improvement of the U.S. advertising market and renewals on certain licensing deals. The increase in digital revenue reflected growth in global digital downloads and certain streaming services. Other music publishing revenue increased primarily as a result of higher print revenue in the U.S. The expected decrease in mechanical revenue reflected the ongoing impact of the transition from physical to digital sales in the recorded music industry and the prior period benefit from the shift to accrual-based accounting for a U.S.-based collection society. Excluding the favorable impact of foreign currency exchange rates, total Music Publishing revenues decreased by \$4 million, or 3%.

Cost of revenues

Music Publishing cost of revenues is composed of the following amounts (in millions):

	For the Three Months Ended		2011 vs. 2010	
	2011	2010	\$ Change	% Change
Artist and repertoire costs	\$ 106	\$ 104	\$ 2	2%
Total cost of revenues	\$ 106	\$ 104	2	2%

Music Publishing cost of revenues increased \$2 million, or 2%, to \$106 million for the three months ended June 30, 2011, from \$104 million for the three months ended June 30, 2010. Expressed as a percentage of Music Publishing revenues, Music Publishing cost of revenues decreased to 73% for the three months ended June 30, 2011 from 75% for the three months ended June 30, 2010. The decrease was driven by the timing of artist and repertoire spend and changes in revenue mix.

Selling, general and administrative expense

Music Publishing selling, general and administrative expense is comprised of the following amounts (in millions):

	For the Three Months Ended		2011 vs. 2010	
	2011	2010	\$ Change	% Change
General and administrative expense (1)	\$ 18	\$ 18		
Selling and marketing expense	1		1	100%
Total selling, general and administrative expense	\$ 19	\$ 18	\$ 1	6%

Edgar Filing: Warner Music Group Corp. - Form 10-Q

(1) Includes depreciation expense of \$1 million for the three months ended June 30, 2011 and 2010. Music Publishing selling, general and administrative expense increased to \$19 million for the three months ended June 30, 2011 as compared with \$18 million for the three months ended June 30, 2010. Expressed as a percentage of Music Publishing revenues, Music Publishing selling, general and administrative expense remained flat at 13% for the three months ended June 30, 2011 and 2010.

Table of Contents*OIBDA and Operating Income*

Music Publishing operating income includes the following (in millions):

	For the Three Months Ended June 30,		2011 vs. 2010	
	2011	2010	\$ Change	% Change
OIBDA	\$ 22	\$ 18	\$ 4	22%
Depreciation and amortization	(20)	(17)	(3)	18%
Operating income	\$ 2	\$ 1	\$ 1	100%

Music Publishing OIBDA increased \$4 million to \$22 million for the three months ended June 30, 2011 from \$18 million for the three months ended June 30, 2010. Expressed as a percentage of Music Publishing revenues, Music Publishing OIBDA margin was 15% and 13% for the three months ended June 30, 2011 and 2010, respectively. The increase in OIBDA was driven primarily by the increase in revenue and changes in revenue mix.

Music Publishing operating income increased by \$1 million due to the increase in OIBDA noted above, partially offset by an increase in depreciation and amortization expense driven by the recent acquisition of music publishing rights.

Corporate Expenses and Eliminations

Our OIBDA loss from corporate expenses and eliminations increased from \$19 million for the three months ended June 30, 2010 to \$29 million for the three months ended June 30, 2011, primarily as a result of severance charges of \$5 million taken during the current-year quarter as compared with \$2 million taken during the prior-year quarter and expenses incurred in connection with the consummation of the Merger.

Our operating loss from corporate expenses and eliminations increased from \$23 million for the three months ended June 30, 2010 to \$32 million for the three months ended June 30, 2011, primarily as a result of our increase in OIBDA loss.

Table of Contents**RESULTS OF OPERATIONS****Nine Months Ended June 30, 2011 Compared with Nine Months Ended June 30, 2010***Consolidated Historical Results**Revenues*

Our revenues were composed of the following amounts (in millions):

	For the Nine Months Ended June 30,		2011 vs. 2010	
	2011	2010	\$ Change	% Change
Revenue by Type				
Physical and other	\$ 1,001	\$ 1,138	\$ (137)	-12%
Digital	574	530	44	8%
Licensing	193	168	25	15%
Total Recorded Music	1,768	1,836	(68)	-4%
Mechanical	111	137	(26)	-19%
Performance	153	155	(2)	-1%
Synchronization	85	73	12	16%
Digital	43	41	2	5%
Other	11	8	3	38%
Total Music Publishing	403	414	(11)	-3%
Intersegment elimination	(14)	(18)	4	-22%
Total Revenue	\$ 2,157	\$ 2,232	\$ (75)	-3%
Revenue by Geographical Location				
U.S. Recorded Music	\$ 730	\$ 780	\$ (50)	-6%
U.S. Publishing	149	155	(6)	-4%
Total U.S.	879	935	(56)	-6%
International Recorded Music	1,038	1,056	(18)	-2%
International Publishing	254	259	(5)	-2%
Total International	1,292	1,315	(23)	-2%
Intersegment eliminations	(14)	(18)	4	-22%
Total Revenue	\$ 2,157	\$ 2,232	\$ (75)	-3%

Total Revenue

Total revenues decreased by \$75 million, or 3%, to \$2.157 billion for the nine months ended June 30, 2011 from \$2.232 billion for the nine months ended June 30, 2010. Prior to intersegment eliminations, Recorded Music and Music Publishing revenues represented 81% and 19% and 82% and 18% of total revenues for the nine months ended June 30, 2011 and 2010, respectively. Prior to intersegment eliminations, U.S. and international revenues represented 40% and 60% of total revenues for the nine months ended June 30, 2011, respectively, compared to 42% and 58% for the nine months ended June 30, 2010, respectively. Excluding the favorable impact of foreign currency exchange rates, total revenues decreased \$99 million, or 4%.

Edgar Filing: Warner Music Group Corp. - Form 10-Q

Total digital revenues after intersegment eliminations increased by \$48 million, or 9%, to \$610 million for the nine months ended June 30, 2011 from \$562 million for the nine months ended June 30, 2010. Total digital revenues represented 28% and 25% of consolidated revenues for the nine months ended June 30, 2011 and 2010, respectively. Prior to intersegment eliminations, total digital revenues for the nine months ended June 30, 2011 were comprised of U.S. revenues of \$353 million and international revenues of \$264 million, or 57% and 43% of total digital revenues, respectively. Prior to intersegment eliminations, total digital revenues for the nine months ended June 30, 2010 were comprised of U.S. revenues of \$344 million and international revenues of \$227 million, or 60% and 40% of total digital revenues, respectively.

Recorded Music revenues decreased by \$68 million, or 4%, to \$1.768 billion for the nine months ended June 30, 2011 from \$1.836 billion for the nine months ended June 30, 2010. Prior to intersegment eliminations, Recorded Music revenues represented 81% and 82% of consolidated revenues, for the nine months ended June 30, 2011 and 2010, respectively. U.S. Recorded Music revenues were \$730 million and \$780 million, or 41% and 42% of Recorded Music revenues for the nine months ended June 30, 2011 and 2010, respectively. International Recorded Music revenues were \$1.038 billion and \$1.056 billion, or 59% and 58% of consolidated Recorded Music revenues for the nine months ended June 30, 2011 and 2010, respectively. This performance reflected a

Table of Contents

competitive holiday release schedule and declines in physical sales, partially offset by increases in digital revenue, licensing revenue and revenue from our European concert promotion businesses. The increases in digital revenue have not yet fully offset the decline in physical revenue. Digital revenues increased by \$44 million, or 8%, for the nine months ended June 30, 2011, driven by the growth in digital downloads in the U.S. and International and emerging new digital revenue streams such as Spotify and YouTube, partially offset by the continued decline in global mobile revenue primarily related to lower ringtone demand. Licensing revenues increased \$25 million, or 15%, to \$193 million for the nine months ended June 30, 2011, driven primarily by increases in the licensing of recorded music assets in film and television as well as compilations. The increases in our European concert promotion business reflected a stronger touring schedule, mostly in France. In addition, revenue from expanded-rights deals in the U.S. increased as a result of merchandising revenue associated with certain domestic artists. Excluding the favorable impact of foreign currency exchange rates, total Recorded Music revenues decreased by \$85 million, or 5%.

Music Publishing revenues decreased by \$11 million, or 3%, to \$403 million for the nine months ended June 30, 2011 from \$414 million for the nine months ended June 30, 2010. Prior to intersegment eliminations, Music Publishing revenues represented 19% and 18% of consolidated revenues for the nine months ended June 30, 2011 and 2010, respectively. U.S. Music Publishing revenues were \$149 million and \$155 million, or 37% of Music Publishing revenues for the nine months ended June 30, 2011 and 2010, respectively. International Music Publishing revenues were \$254 million and \$259 million, or 63% of Music Publishing revenues for the nine months ended June 30, 2011 and 2010. Excluding the favorable impact of foreign currency exchange rates, total Music Publishing revenues decreased by \$18 million, or 4%, for the nine months ended June 30, 2011.

The decrease in Music Publishing revenues was driven primarily by expected decreases in mechanical revenue and performance revenue, partially offset by an increase in synchronization revenue, digital revenue and other revenue. Expected decreases in mechanical revenue reflected the ongoing impact of the transition from physical to digital sales in the recorded music industry, the timing of cash collections, an interim reduction in royalty rates related to radio performances in the U.S. and the prior-year benefit from the shift to accrual-based accounting for a U.S.-based collection society. Performance revenue declined primarily as a result of our decision not to renew a low-margin administration deal in the prior year, partially offset by results of recent acquisitions. Synchronization revenue results reflected the improvement of the U.S. advertising market and renewals on certain licensing deals. The increase in digital revenue reflected growth in global digital downloads and certain streaming services. Other music publishing revenue increased primarily as a result of higher print revenue in the U.S.

Revenue by Geographical Location

U.S. revenues decreased by \$56 million, or 6%, to \$879 million for the nine months ended June 30, 2011 from \$935 million for the nine months ended June 30, 2010. The overall decline in the U.S. Recorded Music business reflected a competitive holiday release schedule, declines in physical sales in the recorded music industry and declines in mobile revenues primarily related to lower ringtone demand, partially offset by increases in digital revenue, licensing revenue and revenue from expanded-right deals with certain domestic artists. U.S. Music Publishing revenue decreased by \$6 million, or 4%.

International revenues decreased by \$23 million, or 2%, to \$1.292 billion for the nine months ended June 30, 2011 from \$1.315 billion for the nine months ended June 30, 2010. Excluding the favorable impact of foreign currency exchange rates, total international revenues decreased \$47 million or 4%. Revenue growth in France and Japan was more than offset by weakness in the rest of the world. An increase in digital revenue, primarily as a result of continued growth in global downloads and emerging digital streaming services and revenue from our European concert promotion businesses was more than offset by contracting demand for physical product, which reflected a competitive holiday release schedule as well as the ongoing impact of the transition from physical to digital sales in the recorded music industry.

Cost of revenues

Our cost of revenues is composed of the following amounts (in millions):

	For the Nine Months Ended		2011 vs. 2010	
	2011	2010	\$ Change	% Change
Artist and repertoire costs	\$ 709	\$ 724	\$ (15)	-2%
Product costs	397	412	(15)	-4%
Licensing costs	71	57	14	25%
Total cost of revenues	\$ 1,177	\$ 1,193	\$ (16)	-1%

Edgar Filing: Warner Music Group Corp. - Form 10-Q

Our cost of revenues decreased by \$16 million, or 1%, to \$1.177 billion for the nine months ended June 30, 2011 from \$1.193 billion for the nine months ended June 30, 2010. Expressed as a percentage of revenues, cost of revenues were 55% and 53% for the nine months ended June 30, 2011 and 2010, respectively.

Artist and repertoire costs decreased by \$15 million, or 2%, to \$709 million for the nine months ended June 30, 2011 from \$724 million for the nine months ended June 30, 2010. The decrease in artist and repertoire costs was primarily driven by decreased revenues for the current-year period. Artist and repertoire costs increased as a percentage of revenues from 32% for the nine months

Table of Contents

ended June 30, 2010 to 33% in the nine months ended June 30, 2011 as a result of the prior-year impact of a cost-recovery benefit related to the termination of certain artist recording contracts and an adjustment in Music Publishing royalty reserves.

Product costs decreased by \$15 million, or 4%, to \$397 million for the nine months ended June 30, 2011 from \$412 million for the nine months ended June 30, 2010. The decrease in product costs was driven by effective supply chain management and the continuing change in mix from physical to digital sales, partially offset by higher non-traditional recorded music business costs related to the increase in revenue from our European concert promotion businesses. Expressed as a percentage of revenues product costs remained flat at 18% for the nine months ended June 30, 2011 and 2010.

Licensing costs increased \$14 million, or 25%, to \$71 million for the nine months ended June 30, 2011 from \$57 million for the nine months ended June 30, 2010, primarily as a result of the increase in licensing revenues. Licensing costs as a percentage of licensing revenues increased from 34% for the nine months ended June 30, 2010 to 37% for the nine months ended June 30, 2011, primarily as a result of changes in revenue mix.

Selling, general and administrative expenses

Our selling, general and administrative expense is composed of the following amounts (in millions):

	For the Nine Months Ended		2011 vs. 2010	
	2011	2010	\$ Change	% Change
General and administrative expense (1)	\$ 409	\$ 415	\$ (6)	-1%
Selling and marketing expense	310	337	(27)	-8%
Distribution expense	43	52	(9)	-17%
Total selling, general and administrative expense	\$ 762	\$ 804	\$ (42)	-5%

(1) Includes depreciation expense of \$31 million and \$28 million for the nine months ended June 30, 2011 and 2010, respectively. Total selling, general and administrative expense decreased by \$42 million, or 5%, to \$ 762 million for the nine months ended June 30, 2011 from \$804 million for the nine months ended June 30, 2010. Expressed as a percentage of revenues, selling, general and administrative expenses decreased to 35% for the nine months ended June 30, 2011 from 36% for the nine months ended June 30, 2010, respectively.

General and administrative expenses decreased by \$6 million, or 1%, to \$409 million for the nine months ended June 30, 2011 from \$415 million for the nine months ended June 30, 2010. The decrease in general and administrative expense was driven by the benefit from the LimeWire settlement, the realization of cost savings from management initiatives taken in prior periods and lower bad debt expense in the current-year period, partially offset by expenses incurred in connection with the consummation of the Merger and severance charges of \$26 million taken during the current year as compared with \$20 million taken during the prior-year period. Expressed as a percentage of revenues, general and administrative expenses remained flat at 19% for the nine months ended June 30, 2011 and 2010.

Selling and marketing expense decreased by \$27 million, or 8%, to \$310 million for the nine months ended June 30, 2011 from \$337 million for the nine months ended June 30, 2010, primarily due to lower variable marketing expense as a result of our efforts to better align spending on selling and marketing expense with revenues earned. Expressed as a percentage of revenues, selling and marketing expense decreased from 15% for the nine months ended June 30, 2010 to 14% for the nine months ended June 30, 2011.

Distribution expense decreased by \$9 million, or 17%, to \$43 million for the nine months ended June 30, 2011 from \$52 million for the nine months ended June 30, 2010. The decrease in distribution expense was driven by the ongoing transition from physical to digital sales. Expressed as a percentage of revenues, distribution expense remained flat at 2% for the nine months ended June 30, 2011 and 2010.

Table of Contents**Reconciliation of Consolidated Historical OIBDA to Operating Income and Net Loss Attributable to Warner Music Group Corp.**

As previously described, we use OIBDA as our primary measure of financial performance. The following table reconciles OIBDA to operating income, and further provides the components from operating income to net loss attributable to Warner Music Group Corp. for purposes of the discussion that follows (in millions):

	For the Nine Months Ended June 30,		2011 vs. 2010	
	2011	2010	\$ Change	% Change
OIBDA	\$ 249	\$ 263	\$ (14)	-5%
Depreciation expense	(31)	(28)	(3)	11%
Amortization expense	(165)	(165)		
Operating income	53	70	(17)	-24%
Interest expense, net	(141)	(143)	2	-1%
Other income (expense), net	5	(2)	7	
Loss before income taxes	(83)	(75)	(8)	11%
Income tax expense	(20)	(24)	4	-17%
Net loss	(103)	(99)	(4)	4%
Less: loss attributable to noncontrolling interest	1	2	(1)	-50%
Net loss attributable to Warner Music Group Corp.	\$ (102)	\$ (97)	\$ (5)	5%

OIBDA

Our OIBDA decreased by \$14 million to \$249 million for the nine months ended June 30, 2011 as compared to \$263 million for the nine months ended June 30, 2010. Expressed as a percentage of revenues, total OIBDA margin remained flat at 12% for the nine months ended June 30, 2011 and 2010. Our OIBDA decrease was primarily driven by the decrease in revenue, an increase in severance charges in the current-year period, increased licensing costs, expenses incurred in connection with the consummation of the Merger as well as the prior-year quarter impact of a cost-recovery benefit related to the termination of certain artist recording contracts and an adjustment in Music Publishing royalty reserves. The decrease was partially offset by decreases in artist and repertoire costs, product costs, distribution costs, selling and marketing expense as well as the benefit from the LimeWire settlement in the current-year period, lower bad debt expense in the current-year period and the realization of cost savings from management initiatives taken in prior periods.

See *Business Segment Results* presented hereinafter for a discussion of OIBDA by business segment.

Depreciation expense

Our depreciation expense increased from \$28 million for the nine months ended June 30, 2010, to \$31 million for the nine months ended June 30, 2011, primarily due to recently completed capital projects.

Amortization expense

Amortization expense remained flat at \$165 million for the nine months ended June 30, 2011 and 2010.

Operating income

Our operating income decreased \$17 million to \$53 million, for the nine months ended June 30, 2011 as compared to operating income of \$70 million for the nine months ended June 30, 2010. The decrease in operating income was primarily a result of the decrease in OIBDA and the increase in depreciation expense noted above.

Edgar Filing: Warner Music Group Corp. - Form 10-Q

Interest expense, net

Our interest expense, net, decreased \$2 million, or 1%, to \$141 million for the nine months ended June 30, 2011 as compared to \$143 million for the nine months ended June 30, 2010. The decrease was primarily driven by changes in foreign currency exchange rates related to our sterling denominated notes.

See [Financial Condition and Liquidity](#) for more information.

Table of Contents*Other income (expense), net*

Other income (expense) for the nine months ended June 30, 2011 and 2010 included net hedging gains on foreign exchange contracts, which represent currency exchange movements associated with inter-company receivables and payables that are short term in nature, offset by equity in earnings on our share of net income on investments recorded in accordance with the equity method of accounting for an unconsolidated investee. In addition, other income increased as a result of the settlement of an income tax audit in Germany reimbursable to us by Time Warner under the terms of the 2004 Acquisition.

Income tax expense

Income tax expense decreased to \$20 million for the nine months ended June 30, 2011 from \$24 million for the nine months ended June 30, 2010. The decrease in income tax expense was primarily due to losses in foreign territories and one-time benefits related to acquisitions during the nine months ended June 30, 2011, offset by additional tax reserves.

We are currently under examination by various taxing authorities. The accrual for uncertain tax positions has increased by \$21 million for the nine months ended June 30, 2011 to \$31 million as a result of the aforementioned German income tax audit. We expect that \$21 million of this total will be paid during the next twelve months, and \$17 million of the payment will be reimbursed by Time Warner under the terms of the 2004 Acquisition.

Net loss

Our net loss increased by \$4 million, to a net loss of \$103 million for the nine months ended June 30, 2011 as compared to net loss of \$99 million for the nine months ended June 30, 2010. The increase was a result of decreased OIBDA, an increase in depreciation expense, partially offset by the decrease in interest expense, the decrease in income tax expense and the change in other income (expense).

Noncontrolling interests

The loss attributable to noncontrolling interests was \$1 million and \$2 million for the nine months ended June 30, 2011 and 2010, respectively.

Business Segment Results

Revenue, OIBDA and operating income (loss) by business segment are as follows (in millions):

	For the Nine Months Ended June 30,		2011 vs. 2010	
	2011	2010	\$ Change	% Change
Recorded Music				
Revenue	\$ 1,768	\$ 1,836	\$ (68)	-4%
OIBDA	228	227	1	
Operating income	\$ 97	\$ 95	2	2%
Music Publishing				
Revenue	\$ 403	\$ 414	\$ (11)	-3%
OIBDA	90	101	(11)	-11%
Operating income	\$ 33	\$ 48	\$ (15)	-31%
Corporate expenses and eliminations				
Revenue	\$ (14)	\$ (18)	\$ 4	22%
OIBDA	(69)	(65)	(4)	6%
Operating loss	\$ (77)	\$ (73)	\$ (4)	5%
Total				
Revenue	\$ 2,157	\$ 2,232	\$ (75)	-3%
OIBDA	249	263	(14)	-5%
Operating income	\$ 53	\$ 70	\$ (17)	-24%

Recorded Music

Edgar Filing: Warner Music Group Corp. - Form 10-Q

Revenues

Recorded Music revenues decreased by \$68 million, or 4%, to \$1.768 billion for the nine months ended June 30, 2011 from \$1.836 billion for the nine months ended June 30, 2010. Prior to intersegment eliminations, Recorded Music revenues represented 81% and 82% of consolidated revenues, for the nine months ended June 30, 2011 and 2010, respectively. U.S. Recorded Music revenues were \$730 million and \$780 million, or 41% and 42% of Recorded Music revenues for the nine months ended June 30, 2011

Table of Contents

and 2010, respectively. International Recorded Music revenues were \$1.038 billion and \$1.056 billion, or 59% and 58% of consolidated Recorded Music revenues for the nine months ended June 30, 2011 and 2010, respectively. This performance reflected a competitive holiday release schedule and declines in physical sales, partially offset by increases in digital revenue, licensing revenue and revenue from our European concert promotion businesses. The increases in digital revenue have not yet fully offset the decline in physical revenue. Digital revenues increased by \$44 million, or 8%, for the nine months ended June 30, 2011, driven by the growth in digital downloads in the U.S. and International and emerging new digital revenue streams such as Spotify and YouTube, partially offset by the continued decline in global mobile revenue primarily related to lower ringtone demand. Licensing revenues increased \$25 million, or 15%, to \$193 million for the nine months ended June 30, 2011, driven primarily by increases in the licensing of recorded music assets in film and television as well as compilations. The increases in our European concert promotion business reflected a stronger touring schedule, mostly in France. In addition, revenue from expanded-rights deals in the U.S. increased as a result of merchandising revenue associated with certain domestic artists. Excluding the favorable impact of foreign currency exchange rates, total Recorded Music revenues decreased by \$85 million, or 5%.

Cost of revenues

Recorded Music cost of revenues is composed of the following amounts (in millions):

	For the Nine Months Ended June 30,		2011 vs. 2010	
	2011	2010	\$ Change	% Change
Artist and repertoire costs	\$ 461	\$ 477	\$ (16)	-3%
Product costs	398	412	(14)	-3%
Licensing costs	71	57	14	25%
Total cost of revenues	\$ 930	\$ 946	\$ (16)	-2%

Recorded Music cost of revenues decreased \$16 million, or 2%, for the nine months ended June 30, 2011. Expressed as a percentage of Recorded Music revenues, cost of revenues increased from 52% for the nine months ended June 30, 2010 to 53% for the nine months ended June 30, 2011. The decrease in artist and repertoire costs of \$16 million was primarily driven by decreased revenues for the current-year period. In addition, the prior-year period included a cost-recovery benefit related to the termination of certain artist contracts. The decrease in product costs was driven by effective supply chain management and the continuing change in mix from physical to digital sales, partially offset by higher non-traditional recorded music business costs related to the increase in revenue from our European concert promotion businesses. The increase in licensing costs of \$14 million was driven primarily by the increase in licensing revenue and changes in revenue mix.

Selling, general and administrative expense

Recorded Music selling, general and administrative expense is composed of the following amounts (in millions):

	For the Nine Months Ended June 30,		2011 vs. 2010	
	2011	2010	\$ Change	% Change
General and administrative expense (1)	\$ 282	\$ 297	\$ (15)	-5%
Selling and marketing expense	305	331	(26)	-8%
Distribution expense	43	52	(9)	-17%
Total selling, general and administrative expense	\$ 630	\$ 680	\$ (50)	-7%

(1) Includes depreciation expense of \$20 million and \$17 million for the nine months ended June 30, 2011 and 2010, respectively. Recorded Music selling, general and administrative expense decreased \$50 million or 7%, for the nine months ended June 30, 2011. Expressed as a percentage of Recorded Music revenues, selling, general and administrative expense decreased from 37% for the nine months ended June 30, 2010 to 36% for the nine months ended June 30, 2011. The decrease in selling and marketing expense was primarily the result of our

Edgar Filing: Warner Music Group Corp. - Form 10-Q

efforts to better align selling and marketing expenses with revenues earned, the timing of our releases and the effect of continued cost-management efforts. The decrease in general and administrative expense was driven by the benefit from the LimeWire settlement, lower bad debt expense and the realization of cost savings from management initiatives taken in prior periods, partially offset by an increase in stock compensation expense of \$3 million related to the modifications of existing restricted stock award agreements. The decrease in distribution expense was driven by the ongoing transition from physical to digital sales.

Table of Contents*OIBDA and Operating Income*

Recorded Music operating income included the following (in millions):

	For the Nine Months		2011 vs. 2010	
	2011	2010	\$ Change	% Change
OIBDA	\$ 228	\$ 227	\$ 1	
Depreciation and amortization	(131)	(132)	1	-1%
Operating income	\$ 97	\$ 95	\$ 2	2%

Recorded Music OIBDA increased by \$1 million to \$228 million for the nine months ended June 30, 2011 compared to \$227 million for the nine months ended June 30, 2010. Expressed as a percentage of Recorded Music revenues, Recorded Music OIBDA margin increased from 12% for the nine months ended June 30, 2010 to 13% for the nine months ended June 30, 2011. Our OIBDA increase was primarily driven by decreases in artist and repertoire costs, product costs, distribution costs, selling and marketing expense as well as the benefit from the LimeWire settlement in the current-year period, lower bad debt expense and the realization of cost savings from management initiatives taken in prior periods, partially offset by an increase in licensing costs, an increase in professional fees associated with the Merger as well as the prior-year quarter impact of a cost-recovery benefit related to the termination of certain artist contracts.

Recorded Music operating income increased by \$2 million, due primarily to the decrease in OIBDA noted above.

*Music Publishing**Revenues*

Music Publishing revenues decreased by \$11 million, or 3%, to \$403 million for the nine months ended June 30, 2011 from \$414 million for the nine months ended June 30, 2010. Prior to intersegment eliminations, Music Publishing revenues represented 19% and 18% of consolidated revenues for the nine months ended June 30, 2011 and 2010, respectively. U.S. Music Publishing revenues were \$149 million and \$155 million, or 37% of Music Publishing revenues for the nine months ended June 30, 2011 and 2010, respectively. International Music Publishing revenues were \$254 million and \$259 million, or 63% of Music Publishing revenues for the nine months ended June 30, 2011 and 2010. Excluding the favorable impact of foreign currency exchange rates, total Music Publishing revenues decreased by \$18 million, or 4%, for the nine months ended June 30, 2011.

The decrease in Music Publishing revenues was driven primarily by expected decreases in mechanical revenue and performance revenue, partially offset by an increase in synchronization revenue, digital revenue and other revenue. Expected decreases in mechanical revenue reflected the ongoing impact of the transition from physical to digital sales in the recorded music industry, the timing of cash collections, an interim reduction in royalty rates related to radio performances in the U.S. and the prior-year benefit from the shift to accrual-based accounting for a U.S.-based collection society. Performance revenue declined primarily as a result of our decision not to renew a low-margin administration deal in the prior year, partially offset by results of recent acquisitions. Synchronization revenue results reflected the improvement of the U.S. advertising market and renewals on certain licensing deals. The increase in digital revenue reflected growth in global digital downloads and certain streaming services. Other music publishing revenue increased primarily as a result of higher print revenue in the U.S.

Cost of revenues

Music Publishing cost of revenues is composed of the following amounts (in millions):

	For the Nine Months Ended		2011 vs. 2010	
	2011	2010	\$ Change	% Change

Edgar Filing: Warner Music Group Corp. - Form 10-Q

Artist and repertoire costs	\$ 262	\$ 265	\$ (3)	-1%
Total cost of revenues	\$ 262	\$ 265	\$ (3)	-1%

Music Publishing cost of revenues decreased \$3 million, or 1%, to \$262 million for the nine months ended June 30, 2011, from \$265 million for the nine months ended June 30, 2010. The decrease in cost of revenues was driven primarily a combination of lower revenues in the current-year quarter and lower costs associated with a low-margin administration deal which we decided not to renew, partially offset by the timing of artist and repertoire spend as well as an adjustment to royalty reserves in the prior-year period. Expressed as a percentage of Music Publishing revenues, Music Publishing cost of revenues increased to 65% for the nine months ended June 30, 2011 from 64% for the nine months ended June 30, 2010, primarily as a result of an adjustment to royalty reserves in the prior-year period.

Table of Contents*Selling, general and administrative expense*

Music Publishing selling, general and administrative expense is comprised of the following amounts (in millions):

	For the Nine Months		2011 vs. 2010	
	2011	Ended June 30, 2010	\$ Change	% Change
General and administrative expense (1)	\$ 53	\$ 51	\$ 2	4%
Selling and marketing expense	1		1	100%
Total selling, general and administrative expense	\$ 54	\$ 51	\$ 3	6%

(1) Includes depreciation expense of \$3 million for the nine months ended June 30, 2011 and 2010.

Music Publishing selling, general and administrative expense increased to \$54 million for the nine months ended June 30, 2011 as compared with \$51 million for the nine months ended June 30, 2010. Expressed as a percentage of Music Publishing revenues, Music Publishing selling, general and administrative expense increased to 13% for the nine months ended June 30, 2011 from 12% for the nine months ended June 30, 2010. The increase was primarily as a result of severance charges taken during the current-year period as well as overhead and closing costs associated with recent production music acquisitions, partially offset by cost-reduction initiatives by management.

OIBDA and Operating Income

Music Publishing operating income includes the following (in millions):

	For the Nine Months		2011 vs. 2010	
	2011	Ended June 30, 2010	\$ Change	% Change
OIBDA	\$ 90	\$ 101	\$ (11)	-11%
Depreciation and amortization	(57)	(53)	(4)	8%
Operating income	\$ 33	\$ 48	\$ (15)	-31%

Music Publishing OIBDA decreased \$11 million to \$90 million for the nine months ended June 30, 2011 from \$101 million for the nine months ended June 30, 2010. Expressed as a percentage of Music Publishing revenues, Music Publishing OIBDA margin was 22% and 24% for the nine months ended June 30, 2011 and 2010, respectively. The decrease in OIBDA was due primarily to lower revenues.

Music Publishing operating income decreased by \$15 million due primarily to the decrease in OIBDA noted above and an increase in depreciation and amortization expense driven by the recent acquisition of music publishing rights.

Corporate Expenses and Eliminations

Our OIBDA loss from corporate expenses and eliminations increased from \$65 million for the nine months ended June 30, 2010 to \$69 million for the nine months ended June 30, 2011, primarily as a result of expenses incurred in connection with the consummation of the Merger, partially offset by the realization of cost savings from management initiatives taken in prior periods.

Our operating loss from corporate expenses and eliminations increased from \$73 million for the nine months ended June 30, 2010 to \$77 million for the nine months ended June 30, 2011 due to the decrease in OIBDA loss noted above.

Table of Contents**FINANCIAL CONDITION AND LIQUIDITY****Financial Condition**

At June 30, 2011, we had \$1.952 billion of debt, \$290 million of cash and equivalents (net debt of \$1.662 billion, defined as total debt less cash and equivalents and short-term investments) and a \$338 million Warner Music Group Corp. shareholders' deficit. This compares to \$1.945 billion of debt, \$439 million of cash and equivalents (net debt of \$1.506 billion, defined as total debt less cash and equivalents and short-term investments) and a \$265 million shareholders' deficit at September 30, 2010. Net debt increased by \$156 million as a result of (i) a \$149 million decrease in cash and equivalents, (ii) a \$4 million increase related to the accretion on our Senior Secured Notes and (iii) a \$3 million increase related to the impact of foreign exchange rates on our Sterling-denominated Senior Subordinated Notes.

The \$73 million increase in Warner Music Group Corp.'s shareholders' deficit during the nine months ended June 30, 2011 consisted of \$102 million of net loss for the nine months ended June 30, 2011, partially offset by \$10 million of stock-based compensation, \$6 million of exercised stock options, foreign currency exchange movements of \$11 million and \$2 million related to deferred gains on derivative financial instruments.

Pursuant to the Merger Agreement, on the Closing Date, Merger Sub merged with and into the Company with the Company surviving as a wholly-owned subsidiary of Parent. Parent funded the Merger Consideration through cash on hand at the Company at closing, equity financing obtained from Parent and debt financing obtained by third party lenders. In connection with the Merger, the Company also refinanced certain of its existing consolidated indebtedness. See Overview The Merger.

Cash Flows

The following table summarizes our historical cash flows. The financial data for the three months ended June 30, 2011 and 2010 are unaudited and are derived from our interim financial statements included elsewhere herein. The cash flow is comprised of the following in millions:

	Nine Months Ended June 30, 2011	Nine Months Ended June 30, 2010
Cash (used in) provided by:		
Operating activities	\$ (18)	\$ 100
Investing activities	(151)	(61)
Financing activities	5	(2)

Operating Activities

Cash used in operating activities was \$18 million for the nine months ended June 30, 2011 compared with cash provided by operations of \$100 million for the nine months ended June 30, 2010. The \$118 million increase in cash used in operations reflected the decrease in OIBDA, the timing of artist and repertoire spend compared to the prior-year period, the variable timing of working capital requirements which included the timing of sales and collections in the period, an increase in cash paid for severance, partially offset by a slight decrease in cash paid for taxes. Included in the current period cash interest was \$12 million for the three months ended December 31, 2010 related to the Holdings Senior Discount Notes, which accreted to their full principal amount due at maturity on December 15, 2009. We made initial cash interest payments on the Holdings Senior Discount Notes in June 2010. As a result, cash interest amounted to \$176 million for the nine months ended June 30, 2011 as compared with \$169 million for the nine months ended June 30, 2010.

Investing Activities

Cash used in investing activities was \$151 million for the nine months ended June 30, 2011 as compared with \$61 million for the nine months ended June 30, 2010. The \$151 million of cash used in investing consisted of \$59 million to acquire businesses, net of cash acquired, \$58 million to acquire music publishing rights and \$34 million for capital expenditures. The \$61 million of cash used in investing activities in the nine months ended June 30, 2010 consisted of cash used to acquire music publishing rights of \$39 million, cash used for acquisitions totaling \$1 million, net of cash acquired and capital expenditures of \$30 million, partially offset by \$9 million of cash proceeds received in connection with the sale of our equity investment in lala media, inc.

Financing Activities

Edgar Filing: Warner Music Group Corp. - Form 10-Q

Cash provided for financing activities was \$5 million for the nine months ended June 30, 2011 as compared with cash used in financing activities of \$2 million for the nine months ended June 30, 2010. The \$5 million of cash provided for financing consisted of \$6 million related to proceeds from the exercise of stock options, partially offset by \$1 million of distributions to our noncontrolling interest holders. Cash used in financing activities for the nine months ended June 30, 2010 consisted of distributions to our noncontrolling interest holders.

Table of Contents

Liquidity Following the Transactions

Following the consummation of the Merger and the transactions related to the Merger, we are highly leveraged and a substantial portion of our liquidity needs will arise from debt service requirements associated with indebtedness incurred in connection with the Merger and the related transactions and from working capital requirements, capital expenditure requirements, strategic acquisitions and investments, and repurchases of Acquisition Corp. s or Holdings outstanding notes in open market purchases, privately negotiated purchases or otherwise, that Parent may elect to make in the future. Our sources of liquidity following the Merger and the related transactions are our existing cash resources, cash flows from operations and available borrowing capacity under our revolving credit facility. We believe that our existing and anticipated sources of cash will be sufficient to support our existing operations over the next fiscal year.

Following the completion of the Merger and the related transactions, our long-term debt consists of \$1.1 billion aggregate principal amount of Existing Secured Notes, \$150 million aggregate principal amount of New Secured Notes, \$765 million of Unsecured Notes and \$150 million of Holdings Unsecured Notes. In addition we are currently able to borrow up to approximately \$60 million under the revolving credit facility. We will be required to comply with certain covenants and restrictions in the instruments governing our indebtedness.

Liquidity

Our primary sources of liquidity are the cash flows generated from our subsidiaries operations, available cash and equivalents and short-term investments and funds available for drawing under the revolving credit facility. These sources of liquidity are needed to fund our debt service requirements, working capital requirements, capital expenditure requirements, strategic acquisitions and investments, and any dividends or repurchases of our outstanding notes or common stock in open market purchases, privately negotiated purchases or otherwise, we may elect to pay or make in the future. We believe that our existing sources of cash will be sufficient to support our existing operations over the next fiscal year.

As of June 30, 2011, our long-term debt consisted of \$1.1 billion aggregate principal amount of Existing Secured Notes less unamortized discount of \$31 million, \$625 million of Existing Acquisition Corp. Notes and \$258 million of Existing Holdings Notes.

Existing Indebtedness as of June 30, 2011

Existing Secured Notes

As of June 30, 2011, Acquisition Corp. had \$1.069 billion of debt represented by the Acquisition Corp. Senior Secured Notes (the Existing Secured Notes). The Existing Secured Notes were issued at 96.289% of their face value for total net proceeds of \$1.059 billion, with an effective interest rate of 10.25%. The original issue discount (OID) was \$41 million. The OID is equal to the difference between the stated principal amount and the issue price. The OID will be amortized over the term of the Existing Secured Notes using the effective interest rate method and reported as non-cash interest expense. The Existing Secured Notes mature on June 15, 2016 and bear interest payable semi-annually on June 15 and December 15 of each year at a fixed rate of 9.50% per annum.

The Existing Secured Notes are senior secured obligations of Acquisition Corp. that rank senior in right of payment to Acquisition Corp. s subordinated indebtedness, including its existing senior subordinated notes. The obligations under the Existing Secured Notes are fully and unconditionally guaranteed on a senior secured basis by each of Acquisition Corp. s existing direct or indirect wholly owned U.S. subsidiaries and any such subsidiaries that guarantee other indebtedness of Acquisition Corp. in the future. The Existing Secured Notes are not guaranteed by Holdings. All obligations under the Existing Secured Notes and the guarantees of those obligations are secured by first-priority liens, subject to permitted liens, in the assets of Holdings, Acquisition Corp., and the subsidiary guarantors that previously secured our senior secured credit facility, which consist of the shares of Acquisition Corp., Acquisition Corp. s assets and the assets of the subsidiary guarantors, except for certain excluded assets.

At any time prior to June 15, 2012, Acquisition Corp., at its option, may redeem up to 35% of the aggregate principal amount of the Senior Secured Notes at a redemption price of 109.50% of the principal amount of the Existing Secured Notes redeemed, plus accrued and unpaid interest with the proceeds of an Equity Offering, as defined in the indenture, provided that after such redemption at least 50% of the originally issued Existing Secured Notes remain outstanding. Prior to June 15, 2013, Acquisition Corp. may redeem some or all of the Existing Secured Notes at a price equal to 100% of the principal amount plus a make whole premium, as defined in the indenture. The Existing Secured Notes are also redeemable in whole or in part, at Acquisition Corp. s option, at any time on or after June 15, 2013 for the following redemption prices, plus accrued and unpaid interest:

Edgar Filing: Warner Music Group Corp. - Form 10-Q

Twelve month period beginning June 15,	Percentage
2013	104.750%
2014	102.375%
2015 and thereafter	100.000%

Table of Contents

Upon the consummation and closing of a Major Music/Media Transaction, as defined in the indenture, at any time prior to June 15, 2013, the Existing Secured Notes may be redeemed in whole or in part, at Acquisition Corp.'s option, at a redemption price of 104.75% plus accrued and unpaid interest. In the event of a change in control, as defined in the indenture, each holder of the Existing Secured Notes may require Acquisition Corp. to repurchase some or all of its respective Existing Secured Notes at a purchase price equal to 101% plus accrued and unpaid interest.

The indenture for the Existing Secured Notes contains a number of covenants that, among other things, limit (subject to certain exceptions), the ability of Acquisition Corp. and its restricted subsidiaries to (i) incur additional debt or issue certain preferred shares; (ii) pay dividends on or make distributions in respect of its capital stock or make other restricted payments (as defined in the indenture); (iii) make certain investments; (iv) sell certain assets; (v) create liens on certain debt; (vi) consolidate, merge, sell or otherwise dispose of all or substantially all of its assets; (vii) sell or otherwise dispose of its Music Publishing business; (viii) enter into certain transactions with affiliates and (ix) designate its subsidiaries as unrestricted subsidiaries.

Acquisition Corp. used the net proceeds from the Existing Secured Notes offering, plus approximately \$335 million in existing cash, to repay in full all amounts due under its senior secured credit facility and pay related fees and expenses. In connection with the repayment, Acquisition Corp. terminated its revolving credit facility.

The Existing Secured Notes remain outstanding following the Merger. In connection with the Merger, in May 2011, the Company received the requisite consents from holders of the Existing Secured Notes to amend the indenture governing the notes such that the Merger would not constitute a Change of Control as defined therein.

Existing Acquisition Corp. Notes

As of June 30, 2011, Acquisition Corp. has outstanding two tranches of senior subordinated notes due in 2014: \$465 million principal amount of U.S. dollar-denominated notes and £100 million principal amount of Sterling-denominated notes (together, the Existing Acquisition Corp. Notes). The Existing Acquisition Corp. Notes mature on April 15, 2014 and bear interest payable semi-annually on April 15 and October 15 of each year at a fixed rate of 7.375% per annum on the \$465 million dollar notes and 8.125% per annum on the £100 million Sterling-denominated notes.

The indenture governing the Existing Acquisition Corp. Notes limits our ability and the ability of our restricted subsidiaries to incur additional indebtedness or issue certain preferred shares; to pay dividends on or make other distributions in respect of our capital stock or make other restricted payments; to make certain investments; to sell certain assets; to create liens on certain debt without securing the notes; to consolidate, merge, sell or otherwise dispose of all or substantially all of our assets; to enter into certain transactions with affiliates and to designate our subsidiaries as unrestricted subsidiaries. Subject to certain exceptions, the indenture governing the notes permits us and our restricted subsidiaries to incur additional indebtedness, including secured indebtedness, and to make certain restricted payments and investments.

In connection with the Merger and the related transactions, we have repurchased or called for redemption and satisfied and discharged all of the outstanding Existing Acquisition Corp. Notes.

Existing Holdings Notes

As of June 30, 2011, Holdings had \$258 million of debt represented by the Existing Holdings Notes. The Existing Holdings Notes were issued at a discount and had an initial accreted value of \$630.02 per \$1,000 principal amount at maturity. Prior to December 15, 2009, no cash interest payments accrued. However, interest accrued on the Existing Holdings Notes in the form of an increase in the accreted value of such notes such that the accreted value of the Existing Holdings Notes equaled the principal amount at maturity of \$258 million on December 15, 2009. Thereafter, cash interest on the Existing Holdings Notes is payable semi-annually on June 15 and December 15 of each year at a fixed rate of 9.5% per annum with the initial cash interest payment paid on June 15, 2010. The Existing Holdings Notes mature on December 15, 2014.

The indenture governing the Existing Holdings Notes limits our ability and the ability of our restricted subsidiaries to incur additional indebtedness or issue certain preferred shares; to pay dividends on or make other distributions in respect of its capital stock or make other restricted payments; to make certain investments; to sell certain assets; to create liens on certain debt without securing the notes; to consolidate, merge, sell or otherwise dispose of all or substantially all of its assets; to enter into certain transactions with affiliates; and to designate its subsidiaries as unrestricted subsidiaries. Subject to certain exceptions, the indenture governing the notes permits Holdings and its restricted subsidiaries to incur additional indebtedness, including secured indebtedness, and to make certain restricted payments and investments.

Edgar Filing: Warner Music Group Corp. - Form 10-Q

In connection with the Merger and the related transactions, we have repurchased or called for redemption and satisfied and discharged all of the outstanding Existing Holdings Notes.

Table of Contents***Indebtedness Following the Merger****Refinancing of Existing Notes*

On July 20, 2011 (the *Early Acceptance Date*), each of Holdings and Acquisition Corp. accepted for purchase in connection with their previously announced tender offers and related consent solicitations in respect of the Existing Notes, such Existing Notes as had been tendered at or prior to 5:00 p.m., New York City time, on July 11, 2011 (the *Early Consent Time*). Each of Holdings and Acquisition Corp. then issued a notice of redemption relating to all Existing Notes not accepted for payment on the Early Acceptance Date. Following payment for the Existing Notes tendered at or prior to the Early Consent Time, each of Holdings and Acquisition Corp. deposited with Wells Fargo Bank, National Association, as trustee (the *Trustee*) under (i) the Indenture, dated as of April 8, 2004, as amended, among Acquisition Corp., the subsidiary guarantors party thereto and the Trustee (the *Warner Music Group Existing Indenture*), relating to the Existing Acquisition Corp. Notes, and (ii) the Indenture, dated as of December 23, 2004, among Holdings, the Company, as guarantor, and the Trustee (the *Holdings Existing Indentures*), relating to the Existing Holdings Notes (such indenture, together with the Acquisition Corp. Existing Indenture, the *Existing Indentures*), funds sufficient to satisfy all obligations remaining under the Existing Indentures with respect to the Existing Notes not accepted for payment on the Early Acceptance Date. The Trustee then entered into a Satisfaction and Discharge of Indenture, each dated as of July 21, 2011, with respect to each Existing Indenture. On July 27, 2011, each of Holdings and Acquisition Corp. accepted for purchase such Existing Notes as were tendered after the Early Acceptance Date and prior to 12:00 am on July 26, 2011.

Following the closing of the Merger and the related transactions, including the refinancing of certain indebtedness existing as of June 30, 2011, we would have had pro forma total consolidated indebtedness as of June 30, 2011 as follows (in millions):

Revolving Credit Facility (a)	\$
9.5% Senior Secured Notes due 2016 Acquisition Corp. (b)	1,069
9.5% Senior Secured Notes due 2016 Acquisition Corp. (c)	157
11.5% Senior Unsecured Notes due 2018 Acquisition Corp. (d)	747
13.75% Senior Notes due 2019 Holdings	150
Total long term debt	 \$ 2,123

- (a) Reflects \$60 million of commitments under the Revolving Credit Facility which was undrawn at closing of the Merger.
- (b) 9.5% Senior Secured Notes due 2016; face amount of \$1.1 billion less unamortized discount of \$31 million.
- (c) 9.5% Senior Secured Notes due 2016; face amount of \$150 million plus unamortized premium of \$7 million.
- (d) 11.5% Senior Unsecured Notes due 2018; face amount of \$765 million less unamortized discount of \$18 million.

*New Debt***Revolving Credit Facility**

In connection with the Merger, Acquisition Corp. entered into a credit agreement (the *Credit Agreement*) for a senior secured revolving credit facility with Credit Suisse AG, as administrative agent, and the other financial institutions and lenders from time to time party thereto (the *Revolving Credit Facility*).

General

Acquisition Corp. is the borrower (the *Borrower*) under the Revolving Credit Facility. The Revolving Credit Facility provides for a revolving credit facility in the amount of up to \$60 million (the *Commitments*) and includes a letter of credit sub-facility. Amounts are available under the Revolving Credit Facility in U.S. dollars. The Revolving Credit Facility permits loans after the Merger for general corporate purposes. The Revolving Credit Facility may also be utilized to issue letters of credit on or after the Closing Date.

The final maturity of the Revolving Credit Facility will be five years from the Closing Date.

Interest Rates and Fees

Edgar Filing: Warner Music Group Corp. - Form 10-Q

The loans under the Credit Agreement bear interest at Borrower's election at a rate equal to (i) the rate for deposits in U.S. dollars in the London interbank market (adjusted for maximum reserves) for the applicable interest period (LIBOR rate), plus 4% per annum, or (ii) the base rate, which is the highest of (x) the corporate base rate established by the administrative agent from time to time, (y) the overnight federal funds rate plus 0.5% and (z) the one-month LIBOR rate plus 1.0% per annum, plus, in each case, 3% per annum. The LIBOR rate shall be deemed to be not less than 1.5%.

If there is a payment default at any time, then the interest rate applicable to overdue principal will be the rate otherwise applicable to such loan plus 2.00% per annum. Default interest will also be payable on other overdue amounts at a rate of 2.00% per annum above the amount that would apply to an alternative base rate loan.

The Revolving Credit Facility bears a commitment fee equal to 0.50%, payable quarterly in arrears, based on the utilization of the Revolving Credit Facility. The Revolving Credit Facility bears customary letter of credit fees. Acquisition Corp. is also required to pay certain upfront fees to lenders and agency fees to the agent under the Revolving Credit Facility, in the amounts and at the times agreed between the relevant parties.

Prepayments

If, at any time, the aggregate amount of outstanding loans (including letters of credit outstanding thereunder) exceeds the Commitments, prepayments of the loans (and after giving effect to such prepayment the cash collateralization of letters of credit) will be required in an amount equal to such excess. The application of proceeds from mandatory prepayments shall not reduce the aggregate amount of then effective commitments under the Facility and amounts prepaid may be reborrowed, subject to then effective commitments under the Facility.

Voluntary reductions of the unutilized portion of the Commitments and prepayments of borrowings under the Revolving Credit

Table of Contents

Facility are permitted at any time, in minimum principal amounts to be agreed upon, without premium or penalty, subject to reimbursement of the Lenders' redeployment costs actually incurred in the case of a prepayment of LIBOR-based borrowings other than on the last day of the relevant interest period.

Guarantee; Security

Acquisition Corp. and certain of its domestic subsidiaries entered into a Subsidiary Guaranty, dated as of the Closing Date (the "Subsidiary Guaranty") pursuant to which all obligations under the Revolving Credit Facility are guaranteed by Acquisition Corp.'s existing subsidiaries that guarantee the Existing Secured Notes and each other direct and indirect wholly owned U.S. subsidiary, other than certain excluded subsidiaries.

All obligations of the Borrower and each guarantor are secured by substantially all assets of the Borrower, Holdings and each subsidiary guarantor to the extent required under the security agreement securing the Existing Secured Notes and the Secured WMG Notes, including a perfected pledge of all the equity interests of the Borrower and of any subsidiary guarantor, mortgages on certain real property and certain intellectual property.

Covenants, Representations and Warranties

The Revolving Credit Facility contains customary representations and warranties and customary affirmative and negative covenants. The negative covenants are limited to the following: limitations on dividends on, and redemptions and purchases of, equity interests and other restricted payments, limitations on prepayments, redemptions and repurchases of certain debt, limitations on liens, limitations on loans and investments, limitations on debt, guarantees and hedging arrangements, limitations on mergers, acquisitions and asset sales, limitations on transactions with affiliates, limitations on changes in business conducted by the Borrower and its subsidiaries, limitations on restrictions on ability of subsidiaries to pay dividends or make distributions, limitations on amendments of subordinated debt and unsecured bonds and limitations on capital expenditures. The negative covenants are subject to customary and other specified exceptions.

There are no financial covenants included in the Credit Agreement, other than a springing leverage ratio, which will be tested only when there are loans outstanding under the Revolving Credit Facility in excess of \$5 million (excluding letters of credit).

Events of Default

Events of default under the Credit Agreement are limited to nonpayment of principal, interest or other amounts, violation of covenants, incorrectness of representations and warranties in any material respect, cross default and cross acceleration of certain material debt, bankruptcy, material judgments, ERISA events, actual or asserted invalidities of the Credit Agreement, guarantees or security documents and a change of control, in each case subject to customary notice and grace period provisions.

Secured WMG Notes Indenture

On the Closing Date, the Initial OpCo Issuer issued \$150 million aggregate principal amount of the Secured WMG Notes pursuant to the Indenture, dated as of the Closing Date (as amended and supplemented, the "Secured WMG Notes Indenture"), between the Initial OpCo Issuer and Wells Fargo Bank, National Association as Trustee (the "Trustee"). Following the completion of the OpCo Merger on the Closing Date, Acquisition Corp. and certain of its domestic subsidiaries (the "Guarantors") entered into a Supplemental Indenture, dated as of the Closing Date (the "Secured WMG Notes First Supplemental Indenture"), with the Trustee, pursuant to which (i) Acquisition Corp. became a party to the Indenture and assumed the obligations of the Initial OpCo Issuer under the Secured WMG Notes and (ii) each Guarantor became a party to the Secured WMG Notes Indenture and provided an unconditional guarantee on a senior secured basis of the obligations of Acquisition Corp. under the Secured WMG Notes.

Interest on the Secured WMG Notes is payable in cash. Interest on the Secured WMG Notes is payable on June 15 and December 15 of each year, commencing on December 15, 2011.

Ranking

The Secured WMG Notes are Acquisition Corp.'s senior secured obligations and are secured on an equal and ratable basis with all future indebtedness secured with the same security arrangements as the Secured WMG Notes. The Secured WMG Notes rank senior in right of payment to Acquisition Corp.'s subordinated indebtedness, including its existing senior notes; rank equally in right of payment with all of the Company's future senior indebtedness, including indebtedness under any future senior secured credit facility; and are structurally subordinated in right of payment to all existing and future indebtedness and other liabilities of any of Acquisition Corp.'s non-guarantor subsidiaries (other than

Edgar Filing: Warner Music Group Corp. - Form 10-Q

indebtedness and liabilities owed to Acquisition Corp. or one of its subsidiary guarantors (as such term is defined below)).

Table of Contents*Guarantees*

The Secured WMG Notes are fully and unconditionally guaranteed on a senior secured basis by each of Acquisition Corp.'s existing direct or indirect wholly-owned domestic subsidiaries and by any such subsidiaries that guarantee other indebtedness of Acquisition Corp. in the future. Such subsidiary guarantors are collectively referred to herein as the subsidiary guarantors, and such subsidiary guarantees are collectively referred to herein as the subsidiary guarantees. Each subsidiary guarantee is a senior secured obligation of such subsidiary guarantor and is secured on an equal and ratable basis with all future obligations of such subsidiary guarantor that are secured with the same security arrangements as the guarantee of the Secured WMG Notes (which would include the subsidiary guarantor's guarantee of any future senior secured credit facility) by first priority liens, subject to permitted liens, on the collateral owned by such subsidiary guarantor securing any future senior secured credit facility. Each subsidiary guarantee ranks senior in right of payment to all subordinated obligations of the subsidiary guarantor, including the subsidiary guarantor's guarantee of Acquisition Corp.'s existing senior subordinated notes; is *pari passu* in right of payment with all of the subsidiary guarantor's existing and future senior obligations, including the subsidiary guarantor's guarantee of any future senior secured credit facility; and is structurally subordinated in right of payment to all existing and future indebtedness and other liabilities of any non-guarantor subsidiary of the subsidiary guarantor (other than indebtedness and liabilities owed to Acquisition Corp. or one of its subsidiary guarantors). Any subsidiary guarantee of the Secured WMG Notes may be released in certain circumstances. The Secured WMG Notes are not guaranteed by Holdings.

Optional Redemption

Acquisition Corp. may redeem the Secured WMG Notes, in whole or in part, at any time prior to June 15, 2013, at a price equal to 100% of the principal amount thereof, plus the applicable make-whole premium.

The Secured WMG Notes may also be redeemed, in whole or in part, at any time prior to June 15, 2013, upon the consummation and closing of a Major Music/Media Transaction (as defined in the Indenture), at a redemption price equal to 104.750% of the principal amount of the Secured WMG Notes redeemed plus accrued and unpaid interest and special interest, if any, on the Secured WMG Notes to be redeemed to the applicable redemption date, subject to the right of holders of the Secured WMG Notes on the relevant record date to receive interest due on the relevant interest payment date.

On or after June 15, 2013, Acquisition Corp. may redeem all or a part of the Secured WMG Notes, at its option, at the redemption prices (expressed as percentages of principal amount) set forth below plus accrued and unpaid interest and special interest, if any, on the Secured WMG Notes to be redeemed to the applicable redemption date, if redeemed during the twelve-month period beginning on June 15 of the years indicated below:

Year	Percentage
2013	104.750%
2014	102.375%
2015 and thereafter	100.000%

In addition, at any time prior to June 15, 2012, Acquisition Corp. may on any one or more occasions redeem up to 35% of the aggregate principal amount of Secured WMG Notes at a redemption price equal to 109.50% of the principal amount thereof, plus accrued and unpaid interest and special interest, if any, to the date of redemption, subject to the rights of holders of Secured WMG Notes on the relevant record date to receive interest on the relevant interest payment date, with the net cash proceeds of an equity offering by Acquisition Corp. or a contribution to its common equity capital made with the net cash proceeds of an equity offering by the Acquisition Corp.'s direct or indirect parent; provided that: (1) at least 50% of the aggregate principal amount of Secured WMG Notes originally issued under the Secured WMG Notes Indenture (excluding Secured WMG Notes held by Acquisition Corp. and its subsidiaries) remains outstanding immediately after the occurrence of such redemption; and (2) the redemption occurs within 90 days of the date of, and may be conditioned upon, the closing of such equity offering.

Change of Control

Upon the occurrence of a change of control, which is defined in the Secured WMG Notes Indenture, each holder of the Secured WMG Notes has the right to require Acquisition Corp. to repurchase some or all of such holder's Secured WMG Notes at a purchase price in cash equal to 101% of the principal amount thereof, plus accrued and unpaid interest, if any, to the repurchase date. A change of control includes, among other events, either a sale of Acquisition Corp.'s Recorded Music business or a sale of its Music Publishing business. A sale of the Acquisition Corp.'s Recorded Music Business will not constitute a change of control where Acquisition Corp. has made an offer to redeem all the Secured WMG Notes in connection with such sale.

Covenants

53

Table of Contents

The Secured WMG Notes Indenture contains covenants limiting, among other things, Acquisition Corp.'s ability and the ability of most of its subsidiaries to: incur additional debt or issue certain preferred shares; pay dividends on or make distributions in respect of its capital stock or make investments or other restricted payments; create restrictions on the ability of its restricted subsidiaries to pay dividends to it or make certain other intercompany transfers; sell certain assets; create liens on certain debt; consolidate, merge, sell or otherwise dispose of all or substantially all of its assets; sell or otherwise dispose of its Music Publishing business; and enter into certain transactions with its affiliates.

Events of Default

The Secured WMG Notes Indenture also provides for events of default which, if any of them occurs, would permit or require the principal of and accrued interest on the Secured WMG Notes to become or to be declared due and payable.

Supplemental Indenture to Existing Secured WMG Notes Indenture

Acquisition Corp. entered into a supplemental indenture, dated as of the Closing Date (the Existing Secured WMG Notes Supplemental Indenture), that supplements the Indenture, dated as of May 28, 2009, among Acquisition Corp., the guarantors party thereto and Wells Fargo Bank, National Association, as trustee (such indenture, as amended and supplemented, the Existing Secured WMG Notes Indenture) pursuant to which Acquisition Corp. had previously issued \$1,100 million of aggregate principal amount of its 9.50% Senior Secured Notes due 2014 (the Existing Secured WMG Notes). Pursuant to the Existing Secured WMG Notes Supplemental Indenture, certain subsidiaries of Acquisition Corp. that had not previously been parties to the Existing Secured WMG Notes Indenture, agreed to become parties thereto and to unconditionally guarantee, on a senior secured basis, payment of the Existing Secured WMG Notes.

Unsecured WMG Notes Indenture

On the Closing Date, the Initial OpCo Issuer issued \$765 million aggregate principal amount of the Unsecured WMG Notes pursuant to the Indenture, dated as of the Closing Date (as amended and supplemented, the Unsecured WMG Notes Indenture), between the Initial OpCo Issuer and Wells Fargo Bank, National Association as Trustee (the Trustee). Following the completion of the OpCo Merger on the Closing Date, Acquisition Corp. and certain of its domestic subsidiaries (the Guarantors) entered into a Supplemental Indenture, dated as of the Closing Date (the Unsecured WMG Notes First Supplemental Indenture), with the Trustee, pursuant to which (i) Acquisition Corp. became a party to the Indenture and assumed the obligations of the Initial OpCo Issuer under the Unsecured WMG Notes and (ii) each Guarantor became a party to the Unsecured WMG Notes Indenture and provided an unconditional guarantee of the obligations of Acquisition Corp. under the Unsecured WMG Notes.

Interest on the Unsecured WMG Notes is payable in cash. Interest on the Unsecured WMG Notes is payable on April 1 and October 1 of each year, commencing on October 1, 2011.

Ranking

The Unsecured WMG Notes and the related guarantees are Acquisition Corp.'s and the guarantors' general unsecured senior obligations and rank senior to all their future debt that is expressly subordinated in right of payment to the Unsecured WMG Notes. The Unsecured WMG Notes rank equally with all of Acquisition Corp.'s existing and future liabilities that are not so subordinated, effectively subordinated to all of Acquisition Corp.'s and the guarantors' existing and future secured indebtedness to the extent of the assets securing that indebtedness, including the Secured WMG Notes, indebtedness under the Revolving Credit Facility and the Existing Secured Notes, and are structurally subordinated to all of the liabilities of Acquisition Corp.'s subsidiaries that do not guarantee the Unsecured WMG Notes, to the extent of the assets of those subsidiaries.

Guarantees

The Unsecured WMG Notes are guaranteed, on a senior unsecured basis, by substantially all of Acquisition Corp.'s subsidiaries that guarantee the Revolving Credit Facility, Existing Secured Notes and Secured WMG Notes.

Optional Redemption

Acquisition Corp. may redeem the Unsecured WMG Notes, in whole or in part, at any time prior to October 1, 2014, at a price equal to 100% of the principal amount thereof, plus the applicable make-whole premium.

Edgar Filing: Warner Music Group Corp. - Form 10-Q

On or after October 1, 2014, Acquisition Corp. may redeem all or a part of the Unsecured WMG Notes, at its option, at the redemption prices (expressed as percentages of principal amount) set forth below plus accrued and unpaid interest and special interest,

Table of Contents

if any, on the Unsecured WMG Notes to be redeemed to the applicable redemption date, if redeemed during the twelve-month period beginning on October 1 of the years indicated below:

Year	Percentage
2014	108.625%
2015	105.750
2016	102.875%
2017 and thereafter	100.000%

In addition, at any time (which may be more than once) before October 1, 2014, Acquisition Corp. may redeem up to 35% of the aggregate principal amount of the Unsecured WMG Notes with the proceeds of certain equity offerings at a redemption price of 111.50%, plus accrued and unpaid interest and special interest, if any, to the applicable redemption date.

Covenants

The Unsecured WMG Notes Indenture contains covenants that, among other things, limit Acquisition Corp.'s ability and the ability of most of its subsidiaries to: incur additional debt or issue certain preferred shares; pay dividends on or make distributions in respect of its capital stock or make investments or other restricted payments; create restrictions on the ability of its restricted subsidiaries to pay dividends to Acquisition Corp. or make certain other intercompany transfers; sell certain assets; create liens on certain debt; consolidate, merge, sell or otherwise dispose of all or substantially all of its assets. Upon the occurrence of certain events constituting a change of control, Acquisition Corp. is required to make an offer to repurchase all of Unsecured WMG Notes (unless otherwise redeemed) at a purchase price equal to 101% of their principal amount, plus accrued and unpaid interest and special interest, if any to the repurchase date.

Events of Default

Events of default under the Indenture are limited to: the nonpayment of principal or interest when due, failure to comply with the merger covenant therein, failure to comply with obligation to make a change of control offer (other than a failure to purchase the Unsecured WMG Notes), failure to comply with its other agreements contained in the Unsecured WMG Notes or the Unsecured WMG Notes Indenture, the failure of any subsidiary guarantor with its obligations under its guarantee, failure to pay any indebtedness for borrowed money after final maturity or cross acceleration of material debt, bankruptcy event of default, judgment default or a failure of any guarantee of a significant subsidiary to be in full force and effect.

Holdings Notes Indenture

On the Closing Date, the Initial Holdings Issuer issued \$150 million aggregate principal amount of the Holdings Notes pursuant to the Indenture, dated as of the Closing Date (as amended and supplemented, the Holdings Notes Indenture), between the Initial Holdings Issuer and Wells Fargo Bank, National Association as Trustee (the Trustee). Following the completion of the Holdings Merger on the Closing Date, Holdings entered into a Supplemental Indenture, dated as of the Closing Date (the Holdings Notes First Supplemental Indenture), with the Trustee, pursuant to which Holdings became a party to the Indenture and assumed the obligations of the Initial Holdings Issuer under the Holdings Notes.

Interest on the Holdings Notes is payable in cash. Interest on the Holdings Notes is payable on April 1 and October 1 of each year, commencing on October 1, 2011.

Ranking

The Holdings Notes is Holdings' general unsecured senior obligations and rank senior to all its future debt that is expressly subordinated in right of payment to the Holdings Notes. The Holdings Notes rank equally with all of Holdings' existing and future liabilities that are not so subordinated, are structurally subordinated to all of the liabilities of Holdings' subsidiaries, to the extent of the assets of those subsidiaries, and are effectively junior to the Secured WMG Notes, the Existing Secured Notes and indebtedness under the Revolving Credit Facility to the extent of the value of Holdings' assets subject to liens securing such indebtedness.

Guarantee

The Holdings Notes are not guaranteed by any of its subsidiaries.

Optional Redemption

Table of Contents

Holdings may redeem the Holdings Notes, in whole or in part, at any time prior to October 1, 2015, at a price equal to 100% of the principal amount thereof, plus the applicable make-whole premium.

On or after October 1, 2015, Holdings may redeem all or a part of the Holdings Notes, at its option, at the redemption prices (expressed as percentages of principal amount) set forth below plus accrued and unpaid interest and special interest, if any, on the Holdings Notes to be redeemed to the applicable redemption date, if redeemed during the twelve-month period beginning on October 1 of the years indicated below:

Year	Percentage
2015	106.875
2016	103.438%
2017 and thereafter	100.000%

In addition, at any time (which may be more than once) before October 1, 2015, Holdings may redeem up to 35% of the aggregate principal amount of the Holdings Notes with the proceeds of certain equity offerings at a redemption price of 113.75%, plus accrued and unpaid interest and special interest, if any, to the applicable redemption date.

Covenants

The Holdings Notes Indenture contains covenants that, among other things, limit Holdings ability and the ability of most of its subsidiaries to: incur additional debt or issue certain preferred shares; create liens on certain debt; pay dividends on or make distributions in respect of its capital stock or make investments or other restricted payments; create restrictions on the ability of its restricted subsidiaries to pay dividends to Holdings or make certain other intercompany transfers; sell certain assets; consolidate, merge, sell or otherwise dispose of all or substantially all of its assets; and enter into certain transactions with affiliates. Upon the occurrence of certain events constituting a change of control, Holdings is required to make an offer to repurchase all of the Holdings Notes (unless otherwise redeemed) at a purchase price equal to 101% of their principal amount, plus accrued and unpaid interest, if any to the repurchase date.

Events of Default

Events of default under the Indenture are limited to: the nonpayment of principal or interest when due, failure to comply with the merger covenant therein, failure to comply with obligation to make a change of control offer (other than a failure to purchase the Secured WMG Notes), failure to comply with its other agreements contained in the Secured WMG Notes or the Secured WMG Notes Indenture, the failure of any subsidiary guarantor with its obligations under its guarantee, failure to pay any indebtedness for borrowed money after final maturity or cross acceleration of material debt, bankruptcy event of default, judgment default or a failure of any guarantee of a significant subsidiary to be in full force and effect.

Guarantee of Holdings Notes

On August 2, 2011 the Company issued a guarantee whereby it agreed to fully and unconditionally guarantee (the Holdings Notes Guarantee), on a senior unsecured basis, the payments of Holdings on the Holdings Notes.

Dividends

In connection with the consummation of the Merger and the related transactions, cash on hand at the Company was used, among other things, to finance the aggregate Merger Consideration, to make payments in satisfaction of other equity-based interests in the Company under the Merger Agreement, to repay certain of the Company s existing indebtedness and to pay related transaction fees and expenses. See Overview The Merger.

Covenant Compliance

See Existing Secured Notes and Indebtedness Following the Merger above for a description of the covenants governing the Existing Secured Notes and new indebtedness incurred in connection with the Merger.

Summary

Edgar Filing: Warner Music Group Corp. - Form 10-Q

Management believes that, following completion of the Merger and the related transactions, funds generated from our operations and borrowings under the Revolving Credit Facility will be sufficient to fund our debt service requirements, working capital requirements and capital expenditure requirements for the foreseeable future. However, our ability to continue to fund these items and to reduce debt may be affected by general economic, financial, competitive, legislative and regulatory factors, as well as other industry-specific factors such as the ability to control music piracy and the continued industry-wide decline of CD sales. We

Table of Contents

or any of our affiliates may also, from time to time depending on market conditions and prices, contractual restrictions, our financial liquidity and other factors, seek to repurchase our debt securities in open market purchases, privately negotiated purchases or otherwise. The amounts involved in any such transactions, individually or in the aggregate, may be material and may be funded from available cash or from additional borrowings. In addition, we may from time to time, depending on market conditions and prices, contractual restrictions, our financial liquidity and other factors, seek to refinance our outstanding indebtedness with existing cash and/or with funds provided from additional borrowings.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As discussed in Note 18 to our audited consolidated financial statements for the fiscal year ended September 30, 2010, we are exposed to market risk arising from changes in market rates and prices, including movements in foreign currency exchange rates. As of June 30, 2011, other than as described below, there have been no material changes to the Company's exposure to market risk since September 30, 2010.

We have transactional exposure to changes in foreign currency exchange rates relative to the U.S. dollar due to the global scope of our operations. We use foreign exchange contracts, primarily to hedge the risk that unremitted or future royalties and license fees owed to our U.S. companies for the sale, or anticipated sale, of U.S.-copyrighted products abroad may be adversely affected by changes in foreign currency exchange rates. We focus on managing the level of exposure to the risk of foreign currency exchange rate fluctuations on our major currencies, which include the Euro, British pound sterling, Japanese yen, Canadian dollar, Swedish krona, and Australian dollar. During the three months ended June 30, 2011, we had outstanding hedge contracts for the sale of \$133 million and the purchase of \$73 million of foreign currencies at fixed rates. During the current-year quarter, certain of our foreign exchange contracts expired and new foreign exchange contracts were renewed with similar features.

The fair value of foreign exchange contracts is subject to changes in foreign currency exchange rates. For the purpose of assessing the specific risks, we use a sensitivity analysis to determine the effects that market risk exposures may have on the fair value of our financial instruments. For foreign exchange forward contracts outstanding at June 30, 2011, assuming a hypothetical 10% depreciation of the U.S. dollar against foreign currencies from prevailing foreign currency exchange rates and assuming no change in interest rates, the fair value of the foreign exchange forward contracts would have decreased by \$6 million. Because our foreign exchange contracts are entered into for hedging purposes, these losses would be largely offset by gains on the underlying transactions.

We are exposed to foreign currency exchange rate risk with respect to our £100 million principal amount of Sterling-denominated notes that were issued in April 2004. These sterling notes mature on April 15, 2014. As of June 30, 2011, these sterling notes had a carrying value of approximately \$160 million. Based on the principal amount of Sterling-denominated notes outstanding as of June 30, 2011 and assuming that all other market variables are held constant (including the level of interest rates), a 10% weakening or strengthening of the U.S. dollar compared to the British pound sterling would not have an impact on the fair value of these sterling notes, since these notes are completely hedged as of June 30, 2011.

ITEM 4. CONTROLS AND PROCEDURES*Certification*

The certifications of the principal executive officer and the principal financial officer (or persons performing similar functions) required by Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended (the *Certifications*) are filed as exhibits to this report. This section of the report contains the information concerning the evaluation of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) (*Disclosure Controls*) and changes to internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) (*Internal Controls*) referred to in the *Certifications* and this information should be read in conjunction with the *Certifications* for a more complete understanding of the topics presented.

Introduction

The Securities and Exchange Commission's rules define *disclosure controls and procedures* as controls and procedures that are designed to ensure that information required to be disclosed by public companies in the reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. *Disclosure controls and procedures* include, without limitation, controls and procedures designed to ensure that information required to be disclosed by public companies in the reports that they file or submit under the Exchange Act is accumulated and communicated to a company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Edgar Filing: Warner Music Group Corp. - Form 10-Q

The Securities and Exchange Commission's rules define internal control over financial reporting as a process designed by, or under the supervision of, a public company's principal executive and principal financial officers, or persons performing similar functions, and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles, or U.S. GAAP, including those policies and procedures that: (i) pertain to the maintenance of records

Table of Contents

that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company, (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Our management, including the principal executive officer and principal financial officer, does not expect that our Disclosure Controls or Internal Controls will prevent or detect all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the limitations in any and all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. Further, the design of any control system is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of these inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected even when effective Disclosure Controls and Internal Controls are in place.

Evaluation of Disclosure Controls and Procedures

Based on our management's evaluation (with the participation of our principal executive officer and principal financial officer), as of the end of the period covered by this report, our principal executive officer and principal financial officer have concluded that our Disclosure Controls provided reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act will be recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, including that such information is accumulated and communicated to management, including the principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There have been no changes, other than as noted below, in our internal controls over financial reporting or other factors during the quarter ended June 30, 2011 that have materially affected, or are reasonably likely to materially affect, our internal controls.

In October 2010, we implemented a new SAP enterprise resource planning application in the U.S. for fiscal 2011. While we will experience changes in internal controls over financial reporting in fiscal 2011 as the implementation occurs throughout the fiscal year, we expect to be able to transition to the new processes and controls with no negative impact to our internal control environment. If we fail to effectively implement the SAP application or if the SAP application fails to operate as designed or intended, it may impact our ability to process transactions accurately and efficiently.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Pricing of Digital Music Downloads

On December 20, 2005 and February 3, 2006, the Attorney General of the State of New York served the Company with requests for information in connection with an industry-wide investigation as to whether the practices of industry participants concerning the pricing of digital music downloads violate Section 1 of the Sherman Act, New York State General Business Law §§ 340 et seq., New York Executive Law §63(12), and related statutes. On February 28, 2006, the Antitrust Division of the U.S. Department of Justice served the Company with a request for information in the form of a Civil Investigative Demand as to whether its activities relating to the pricing of digitally downloaded music violate Section 1 of the Sherman Act. Both investigations have now been closed. Subsequent to the announcements of the above governmental investigations, more than thirty putative class action lawsuits concerning the pricing of digital music downloads were filed and were later consolidated for pre-trial proceedings in the Southern District of New York. The consolidated amended complaint, filed on April 13, 2007, alleges conspiracy among record companies to delay the release of their content for digital distribution, inflate their pricing of CDs and fix prices for digital downloads. The complaint seeks unspecified compensatory, statutory and treble damages. All defendants, including the Company, filed a motion to dismiss the consolidated amended complaint on July 30, 2007. On October 9, 2008, the District Court issued an order dismissing the case as to all defendants, including the Company. On November 20, 2008, plaintiffs filed a Notice of Appeal from the order of the District Court to the Circuit Court for the Second Circuit. Oral argument took place before the Second Circuit Court of Appeals on September 21, 2009.

Edgar Filing: Warner Music Group Corp. - Form 10-Q

On January 12, 2010, the Second Circuit vacated the judgment of the District Court and remanded the case for further proceedings. On January 27, 2010, all defendants, including the Company, filed a petition for rehearing en banc with the Second Circuit. On March 26, 2010, the Second Circuit denied the petition for rehearing en banc. On August 20, 2010 all defendants including the Company, filed a petition for Certiorari before the Supreme Court. The petition was rejected on January 10, 2011. Upon remand to the District Court, all defendants, including the Company, filed a renewed motion to dismiss challenging, among other things, plaintiffs' state law claims and standing to bring certain claims based mainly on arguments made but not addressed by the District Court in defendants' original motion to dismiss. On July 18, 2011, the District Court issued an order granting defendants' motion to dismiss in part and denying it in part. The case will proceed into discovery, including a determination as to whether class treatment is

Table of Contents

appropriate, based on a schedule to be determined by the District Court. The Company intends to defend against these lawsuits vigorously, but is unable to predict the outcome of these suits. Any litigation the Company may become involved in as a result of the inquiries of the Attorney General and Department of Justice, regardless of the merits of the claim, could be costly and divert the time and resources of management.

Other Matters

In addition to the matter discussed above, we are involved in other litigation arising in the normal course of business. Management does not believe that any legal proceedings pending against us will have, individually, or in the aggregate, a material adverse effect on its business. However, we cannot predict with certainty the outcome of any litigation or the potential for future litigation. Regardless of the outcome, litigation can have an adverse impact on our company, including our brand value, because of defense costs, diversion of management resources and other factors.

ITEM 1A. RISK FACTORS

You should carefully consider the following risks and other information in this report before making an investment decision with respect to any of our securities. The risks and uncertainties described below may not be the only ones facing us. Additional risks and uncertainties that we do not currently know about or that we currently believe are immaterial may also adversely impact our business operations. If any of the following risks actually occur, our business, financial condition or results of operations would likely suffer. In such case, the trading price of our securities could fall, and you may lose all or part of the money you paid to buy such securities.

Risks Related to our Business

The recorded music industry has been declining and may continue to decline, which may adversely affect our prospects and our results of operations.

The industry began experiencing negative growth rates in 1999 on a global basis and the worldwide recorded music market has contracted considerably. Illegal downloading of music, CD-R piracy, industrial piracy, economic recession, bankruptcies of record wholesalers and retailers, and growing competition for consumer discretionary spending and retail shelf space may all be contributing to a declining recorded music industry. Additionally, the period of growth in recorded music sales driven by the introduction and penetration of the CD format has ended. While CD sales still generate most of the recorded music revenues, CD sales continue to decline industry-wide and we expect that trend to continue. However, new formats for selling recorded music product have been created, including the legal downloading of digital music and the distribution of music on mobile devices and revenue streams from these new channels have emerged. These new digital revenue streams are important as they are beginning to offset declines in physical sales and represent a growing area of our Recorded Music business. In addition, we are also taking steps to broaden our revenue mix into growing areas of the music business, including sponsorship, fan clubs, artist websites, merchandising, touring, ticketing and artist management. As our expansion into these new areas is recent, we cannot determine how our expansion into these new areas will impact our business. Despite the increase in digital sales, artist services revenues and expanded-rights revenues, revenues from these sources have yet to fully offset declining physical sales on a worldwide industry basis and it is too soon to determine the impact that sales of music through new channels might have on the industry or when the decline in physical sales might be offset by the increase in digital sales, artist services revenues and expanded-rights revenues. Accordingly, the recorded music industry performance may continue to negatively impact our operating results. While it is believed within the recorded music industry that growth in digital sales will re-establish a growth pattern for recorded music sales, the timing of the recovery cannot be established with accuracy nor can it be determined how these changes will affect individual markets. A declining recorded music industry is likely to lead to reduced levels of revenue and operating income generated by our Recorded Music business. Additionally, a declining recorded music industry is also likely to have a negative impact on our Music Publishing business, which generates a significant portion of its revenues from mechanical royalties attributable to the sale of music in CD and other physical recorded music formats.

There may be downward pressure on our pricing and our profit margins and reductions in shelf space.

There are a variety of factors that could cause us to reduce our prices and reduce our profit margins. They are, among others, price competition from the sale of motion pictures in Blu-Ray/DVD-Video format and videogames, the negotiating leverage of mass merchandisers, big-box retailers and distributors of digital music, the increased costs of doing business with mass merchandisers and big-box retailers as a result of complying with operating procedures that are unique to their needs and any changes in costs associated with new digital formats. In addition, we are currently dependent on a small number of leading online music stores, which allows them to significantly influence the prices we can charge in connection with the distribution of digital music. Over the course of the last decade, U.S. mass-market and other stores' share of U.S. physical music sales has continued to grow. While we cannot predict how future competition will impact music retailers, as the music industry continues

Edgar Filing: Warner Music Group Corp. - Form 10-Q

to transform it is possible that the share of music sales by mass-market retailers such as Wal-Mart and Target and online music stores such as Apple's iTunes will continue to grow as a result of the decline of specialty music retailers, which could further increase their negotiating leverage. Several large specialty music retailers, including Tower Records and Musicland, have filed for bankruptcy protection. The declining number of specialty music retailers may not only put pressure on profit margins, but could also impact catalog sales as mass-market retailers generally sell top chart albums only, with a limited range of back catalog. See We are substantially dependent on a limited number of online music

Table of Contents

stores, in particular Apple's iTunes Music Store, for the online sale of our music recordings and they are able to significantly influence the pricing structure for online music stores.

Our prospects and financial results may be adversely affected if we fail to identify, sign and retain artists and songwriters and by the existence or absence of superstar releases and by local economic conditions in the countries in which we operate.

We are dependent on identifying, signing and retaining recording artists with long-term potential, whose debut albums are well received on release, whose subsequent albums are anticipated by consumers and whose music will continue to generate sales as part of our catalog for years to come. The competition among record companies for such talent is intense. Competition among record companies to sell records is also intense and the marketing expenditures necessary to compete have increased as well. We are also dependent on signing and retaining songwriters who will write the hit songs of today and the classics of tomorrow. Our competitive position is dependent on our continuing ability to attract and develop artists whose work can achieve a high degree of public acceptance. Our financial results may be adversely affected if we are unable to identify, sign and retain such artists under terms that are economically attractive to us. Our financial results may also be affected by the existence or absence of superstar artist releases during a particular period. Some music industry observers believe that the number of superstar acts with long-term appeal, both in terms of catalog sales and future releases, has declined in recent years. Additionally, our financial results are generally affected by the worldwide economic and retail environment, as well as the appeal of our Recorded Music catalog and our Music Publishing library.

We may have difficulty addressing the threats to our business associated with home copying and Internet downloading.

The combined effect of the decreasing cost of electronic and computer equipment and related technology such as CD burners and the conversion of music into digital formats have made it easier for consumers to obtain and create unauthorized copies of our recordings in the form of, for example, burned CDs and MP3 files. For example, about 95% of the music downloaded in 2008, or more than 40 billion files, were illegal and not paid for, according to the International Federation of the Phonographic Industry (IFPI) 2009 Digital Music Report. IFPI, citing data from third-party company Envisional, also reported in its Recording Industry in Numbers 2011 publication that 23.8% of global Internet traffic is infringing. In addition, while growth of music-enabled mobile consumers offers distinct opportunities for music companies such as ours, it also opens the market up to certain risks from behaviors such as sideloading of unauthorized content and illegitimate user-created ringtones. A substantial portion of our revenue comes from the sale of audio products that are potentially subject to unauthorized consumer copying and widespread digital dissemination without an economic return to us. The impact of digital piracy on legitimate music sales is hard to quantify but we believe that illegal file-sharing has a substantial negative impact on music sales. We are working to control this problem in a variety of ways including further litigation, by lobbying governments for new, stronger copyright protection laws and more stringent enforcement of current laws, through graduated response programs achieved through cooperation with ISPs and legislation being advanced or considered in many countries, through technological measures and by establishing legitimate new media business models. We cannot give any assurances that such measures will be effective. If we fail to obtain appropriate relief through the judicial process or the complete enforcement of judicial decisions issued in our favor (or if judicial decisions are not in our favor), if we are unsuccessful in our efforts to lobby governments to enact and enforce stronger legal penalties for copyright infringement or if we fail to develop effective means of protecting our intellectual property (whether copyrights or other rights such as patents, trademarks and trade secrets) or our entertainment-related products or services, our results of operations, financial position and prospects may suffer.

Organized industrial piracy may lead to decreased sales.

The global organized commercial pirate trade is a significant threat to content industries, including the music sector. A study by Frontier Economics cited by IFPI, estimates that digitally pirated music, movies and software is valued at \$30 billion to \$75 billion. In addition, an economic study conducted by Tera Consultants in Europe found that if left unabated, digital piracy could result in an estimated loss of 240 billion Euros in retail revenues for the creative industries including music in Europe over the period from 2008 - 2015. Unauthorized copies and piracy have contributed to the decrease in the volume of legitimate sales and put pressure on the price of legitimate sales. They have had, and may continue to have, an adverse effect on our business.

Legitimate channels for digital distribution of our creative content are a recent development, and their impact on our business is unclear and may be adverse.

We have positioned ourselves to take advantage of online and mobile technology as a sales distribution channel and believe that the continued development of legitimate channels for digital music distribution holds promise for us in the future. Digital revenue streams of all kinds are important to offset continued declining revenue from physical CD sales industry-wide over time. However, legitimate channels for digital distribution are a recent development and we cannot predict their impact on our business. In digital formats, certain costs associated with physical products such as manufacturing, distribution, inventory and return costs do not apply. Partially eroding that benefit are increases in mechanical copyright royalties payable to music publishers that only apply in the digital space. While there are some digital-specific variable

Edgar Filing: Warner Music Group Corp. - Form 10-Q

costs and infrastructure investments necessary to produce, market and sell music in digital formats, we believe it is reasonable to expect that we will generally derive a higher contribution margin from digital sales than physical sales. However, we cannot be sure that we will generally continue to achieve higher margins from digital sales. Any legitimate digital distribution channel that does develop may result in lower or less profitable sales for us than comparable physical

Table of Contents

sales. In addition, the transition to greater sales through digital channels introduces uncertainty regarding the potential impact of the unbundling of the album on our business. It remains unclear how consumer behavior will continue to change when customers are faced with more opportunities to purchase only favorite tracks from a given album rather than the entire album. In addition, if piracy continues unabated and legitimate digital distribution channels fail to gain consumer acceptance, our results of operations could be harmed. Furthermore, as new distribution channels continue to develop, we may have to implement systems to process royalties on new revenue streams for potential future distribution channels that are not currently known. These new distribution channels could also result in increases in the number of transactions that we need to process. If we are not able to successfully expand our processing capability or introduce technology to allow us to determine and pay royalty amounts due on these new types of transactions in a timely manner, we may experience processing delays or reduced accuracy as we increase the volume of our digital sales, which could have a negative effect on our relationships with artists and brand identity.

We are substantially dependent on a limited number of online music stores, in particular Apple's iTunes Music Store, for the online sale of our music recordings and they are able to significantly influence the pricing structure for online music stores.

We derive an increasing portion of our revenues from sales of music through digital distribution channels. We are currently dependent on a small number of leading online music stores that sell consumers digital music. Currently, the largest U.S. online music store, iTunes, charges U.S. consumers prices ranging from \$0.69 to \$1.29 per single-track download. We have limited ability to increase our wholesale prices to digital service providers for digital downloads as we believe Apple's iTunes controls more than two-thirds of the legitimate digital music track download business in the U.S. If Apple's iTunes were to adopt a lower pricing model or if there were structural change to other download pricing models, we may receive substantially less per download for our music, which could cause a material reduction in our revenues, unless it is offset by a corresponding increase in the number of downloads. Additionally, Apple's iTunes and other online music stores at present accept and make available for sale all the recordings that we and other distributors deliver to them. However, if online stores in the future decide to limit the types or amount of music they will accept from music content owners like us, our revenues could be significantly reduced.

Our involvement in intellectual property litigation could adversely affect our business.

Our business is highly dependent upon intellectual property, an area that has encountered increased litigation in recent years. If we are alleged to infringe the intellectual property rights of a third party, any litigation to defend the claim could be costly and would divert the time and resources of management, regardless of the merits of the claim. There can be no assurance that we would prevail in any such litigation. If we were to lose a litigation relating to intellectual property, we could be forced to pay monetary damages and to cease the sale of certain products or the use of certain technology. Any of the foregoing may adversely affect our business.

Due to the nature of our business, our results of operations and cash flows may fluctuate significantly from period to period.

Our net sales, operating income and profitability, like those of other companies in the music business, are largely affected by the number and quality of albums that we release or that include musical compositions published by us, timing of our release schedule and, more importantly, the consumer demand for these releases. We also make advance payments to recording artists and songwriters, which impact our operating cash flows. The timing of album releases and advance payments is largely based on business and other considerations and is made without regard to the impact of the timing of the release on our financial results. We report results of operations quarterly and our results of operations and cash flows in any reporting period may be materially affected by the timing of releases and advance payments, which may result in significant fluctuations from period to period.

We may be unable to compete successfully in the highly competitive markets in which we operate and we may suffer reduced profits as a result.

The industry in which we operate is highly competitive, is based on consumer preferences and is rapidly changing. Additionally, the music industry requires substantial human and capital resources. We compete with other recorded music companies and music publishers to identify and sign new recording artists and songwriters who subsequently achieve long-term success and to renew agreements with established artists and songwriters. In addition, our competitors may from time to time reduce their prices in an effort to expand market share and introduce new services, or improve the quality of their products or services. We may lose business if we are unable to sign successful recording artists or songwriters or to match the prices or the quality of products and services, offered by our competitors. Our Recorded Music business competes not only with other recorded music companies, but also with the recorded music efforts of live events companies and recording artists who may choose to distribute their own works. Our Music Publishing business competes not only with other music publishing companies, but also with songwriters who publish their own works. Our Recorded Music business is to a large extent dependent on technological developments, including access to and selection and viability of new technologies, and is subject to potential pressure from competitors as a result of their technological developments. For example, our Recorded Music business may be further adversely affected by technological developments that facilitate the piracy of music, such as Internet peer-to-peer file-sharing and CD-R activity, by an inability to enforce our intellectual property rights in digital environments and by a failure to develop successful business models applicable to a digital environment. The Recorded Music business also

Edgar Filing: Warner Music Group Corp. - Form 10-Q

faces competition from other forms of entertainment and leisure activities, such as cable and satellite television, pre-recorded films on DVD, the Internet and computer and videogames.

Table of Contents

Our business operations in some foreign countries subject us to trends, developments or other events which may affect us adversely.

We are a global company with strong local presences, which have become increasingly important as the popularity of music originating from a country's own language and culture has increased in recent years. Our mix of national and international recording artists and songwriters provides a significant degree of diversification for our music portfolio. However, our creative content does not necessarily enjoy universal appeal. As a result, our results can be affected not only by general industry trends, but also by trends, developments or other events in individual countries, including:

limited legal protection and enforcement of intellectual property rights;

restrictions on the repatriation of capital;

fluctuations in interest and foreign exchange rates;

differences and unexpected changes in regulatory environment, including environmental, health and safety, local planning, zoning and labor laws, rules and regulations;

varying tax regimes which could adversely affect our results of operations or cash flows, including regulations relating to transfer pricing and withholding taxes on remittances and other payments by subsidiaries and joint ventures;

exposure to different legal standards and enforcement mechanisms and the associated cost of compliance;

difficulties in attracting and retaining qualified management and employees or rationalizing our workforce;

tariffs, duties, export controls and other trade barriers;

longer accounts receivable settlement cycles and difficulties in collecting accounts receivable;

recessionary trends, inflation and instability of the financial markets;

higher interest rates; and

political instability.

We may not be able to insure or hedge against these risks, and we may not be able to ensure compliance with all of the applicable regulations without incurring additional costs. Furthermore, financing may not be available in countries with less than investment-grade sovereign credit ratings. As a result, it may be difficult to create or maintain profit-making operations in developing countries.

In addition, our results can be affected by trends, developments and other events in individual countries. There can be no assurance that in the future other country-specific trends, developments or other events will not have such a significant adverse effect on our business, results of

operations or financial condition. Unfavorable conditions can depress sales in any given market and prompt promotional or other actions that affect our margins.

Our business may be adversely affected by competitive market conditions and we may not be able to execute our business strategy.

We intend to increase revenues and cash flow through a business strategy which requires us, among other things, to continue to maximize the value of our music assets, to significantly reduce costs to maximize flexibility and adjust to new realities of the market, to continue to act to contain digital piracy and to diversify our revenue streams into growing segments of the music business by entering into expanded-rights deals with recording artists and by operating our artist services businesses and to capitalize on digital distribution and emerging technologies.

Each of these initiatives requires sustained management focus, organization and coordination over significant periods of time. Each of these initiatives also requires success in building relationships with third parties and in anticipating and keeping up with technological developments and consumer preferences and may involve the implementation of new business models or distribution platforms. The results of our strategy and the success of our implementation of this strategy will not be known for some time in the future. If we are unable to implement our strategy successfully or properly react to changes in market conditions, our financial condition, results of operations and cash flows could be adversely affected.

Our ability to operate effectively could be impaired if we fail to attract and retain our executive officers.

Our success depends, in part, upon the continuing contributions of our executive officers, many of whom have been with us since the 2004 Acquisition. Although we have employment agreements with our executive officers, there is no guarantee that they will not leave. The loss of the services of any of our executive officers or the failure to attract other executive officers could have a material adverse effect on our business or our business prospects.

Table of Contents

A significant portion of our Music Publishing revenues is subject to rate regulation either by government entities or by local third-party collection societies throughout the world and rates on other income streams may be set by arbitration proceedings, which may limit our profitability.

Mechanical royalties and performance royalties are the two largest sources of income to our Music Publishing business and mechanical royalties are a significant expense to our Recorded Music business. In the U.S., mechanical rates are set pursuant to an arbitration process under the U.S. Copyright Act unless rates are determined through voluntary industry negotiations and performance rates are set by performing rights societies and subject to challenge by performing rights licensees. Outside the U.S., mechanical and performance rates are typically negotiated on an industry-wide basis. The mechanical and performance rates set pursuant to such processes may adversely affect us by limiting our ability to increase the profitability of our Music Publishing business. If the mechanical rates are set too high it may also adversely affect us by limiting our ability to increase the profitability of our Recorded Music business. In addition, rates our Recorded Music business receives in the U.S. for, among other sources of income and potential income, webcasting and satellite radio are set by an arbitration process under the U.S. Copyright Act unless rates are determined through voluntary industry negotiations. It is important as sales shift from physical to diversified distribution channels that we receive fair value for all of the uses of our intellectual property as our business model now depends upon multiple revenue streams from multiple sources. If the rates for Recorded Music income sources that are established through legally prescribed rate-setting processes are set too low, it could have a material adverse impact on our Recorded Music business or our business prospects.

An impairment in the carrying value of goodwill or other intangible and long-lived assets could negatively affect our operating results and shareholders' deficit.

On June 30, 2011, we had \$1.087 billion of goodwill and \$100 million of indefinite-lived intangible assets. Financial Accounting Standards Codification (ASC) Topic 350, Intangibles—Goodwill and other (ASC 350) requires that we test these assets for impairment annually (or more frequently should indications of impairment arise) by estimating the fair value of each of our reporting units (calculated using a discounted cash flow method) and comparing that value to the reporting units' carrying value. If the carrying value exceeds the fair value, there is a potential impairment and additional testing must be performed. In performing our annual tests and determining whether indications of impairment exist, we consider numerous factors including actual and projected operating results of each reporting unit, external market factors such as market prices for similar assets, the market capitalization of our stock, and trends in the music industry. We tested our goodwill and other indefinite-lived intangible assets for impairment in the fourth quarter of fiscal 2010 and concluded that such assets were not impaired. We continue to believe that conclusion is appropriate. However, future events may occur that could adversely affect the estimated fair value of our reporting units. Such events may include, but are not limited to, strategic decisions made in response to changes in economic and competitive conditions and the impact of the economic environment on our operating results. Failure to achieve sufficient levels of cash flow at our reporting units could also result in impairment charges on goodwill and indefinite-lived intangible assets. If the value of the acquired goodwill or acquired indefinite-lived intangible assets is impaired, our operating results and shareholders' deficit could be adversely affected. We expect that in connection with the Transactions, goodwill will increase by approximately \$798 million on a pro forma basis. Any increase in goodwill will be subject to similar testing for impairment going forward.

We also had \$1.062 billion of definite-lived intangible assets as of June 30, 2011. FASB ASC Topic 360-10-35, (ASC 360-10-35) requires companies to review these assets for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. If similar events occur as enumerated above such that we believe indicators of impairment are present, we would test for recoverability by comparing the carrying value of the asset to the net undiscounted cash flows expected to be generated from the asset. If those net undiscounted cash flows do not exceed the carrying amount, we would perform the next step, which is to determine the fair value of the asset, which could result in an impairment charge. Any impairment charge recorded would negatively affect our operating results and shareholders' deficit.

Unfavorable currency exchange rate fluctuations could adversely affect our results of operations.

The reporting currency for our financial statements is the U.S. dollar. We have substantial assets, liabilities, revenues and costs denominated in currencies other than U.S. dollars. To prepare our consolidated financial statements, we must translate those assets, liabilities, revenues and expenses into U.S. dollars at then-applicable exchange rates. Consequently, increases and decreases in the value of the U.S. dollar versus other currencies will affect the amount of these items in our consolidated financial statements, even if their value has not changed in their original currency. These translations could result in significant changes to our results of operations from period to period. Prior to intersegment eliminations, approximately 60% and 59% of our revenues related to operations in foreign territories for the three and nine months ended June 30, 2011. From time to time, we enter into foreign exchange contracts to hedge the risk of unfavorable foreign currency exchange rate movements. As of June 30, 2011, we have hedged a portion of our material foreign currency exposures related to royalty payments remitted between our foreign affiliates and our U.S. affiliates through the end of the current fiscal year.

We may not have full control and ability to direct the operations we conduct through joint ventures.

Edgar Filing: Warner Music Group Corp. - Form 10-Q

We currently have interests in a number of joint ventures and may in the future enter into further joint ventures as a means of conducting our business. In addition, we structure certain of our relationships with recording artists and songwriters as joint ventures.

Table of Contents

We may not be able to fully control the operations and the assets of our joint ventures, and we may not be able to make major decisions or may not be able to take timely actions with respect to our joint ventures unless our joint venture partners agree.

The enactment of legislation limiting the terms by which an individual can be bound under a personal services contract could impair our ability to retain the services of key artists.

California Labor Code Section 2855 (Section 2855) limits the duration of time any individual can be bound under a contract for personal services to a maximum of seven years. In 1987, Subsection (b) was added, which provides a limited exception to Section 2855 for recording contracts, creating a damages remedy for record companies. Legislation was introduced in New York in 2009 to create a statute similar to Section 2855 to limit contracts between artists and record companies to a term of seven years which term may be reduced to three years if the artist was not represented in the negotiation and execution of such contracts by qualified counsel experienced with entertainment industry law and practices, potentially affecting the duration of artist contracts. There is no assurance that California will not introduce legislation in the future seeking to repeal Subsection (b). The repeal of Subsection (b) of Section 2855 and/or the passage of legislation similar to Section 2855 by other states could materially affect our results of operations and financial position.

We face a potential loss of catalog if it is determined that recording artists have a right to recapture rights in their recordings under the U.S. Copyright Act.

The U.S. Copyright Act provides authors (or their heirs) a right to terminate U.S. licenses or assignments of rights in their copyrighted works in certain circumstances. This right does not apply to works that are works made for hire. Since the effective date of U.S. federal copyright protection for sound recordings (February 15, 1972), virtually all of our agreements with recording artists provide that such recording artists render services under a work-made-for-hire relationship. A termination right exists under the U.S. Copyright Act for U.S. rights in musical compositions that are not works made for hire. If any of our commercially available sound recordings were determined not to be works made for hire, then the recording artists (or their heirs) could have the right to terminate the U.S. federal copyright rights they granted to us, generally during a five-year period starting at the end of 35 years from the date of release of a recording under a post-1977 license or assignment (or, in the case of a pre-1978 grant in a pre-1978 recording, generally during a five-year period starting at the end of 56 years from the date of copyright). A termination of U.S. federal copyright rights could have an adverse effect on our Recorded Music business. From time to time, authors (or their heirs) can terminate our U.S. rights in musical compositions. However, we believe the effect of those terminations is already reflected in the financial results of our Music Publishing business.

If we acquire, combine with or invest in other businesses, we will face certain risks inherent in such transactions.

We may pursue strategic transactions in the future, which could be difficult to implement, disrupt our business or change our business profile significantly.

We do, from time to time, consider opportunistic strategic transactions, which could involve acquisitions, combinations or dispositions of businesses or assets, or strategic alliances or joint ventures with companies engaged in businesses that are similar or complementary to ours. Any such strategic combination could be material. Any future strategic transaction could involve numerous risks, including:

potential disruption of our ongoing business and distraction of management;

potential loss of recording artists or songwriters from our rosters;

difficulty integrating the acquired businesses or segregating assets to be disposed of;

exposure to unknown and/or contingent or other liabilities, including litigation arising in connection with the acquisition, disposition and/or against any businesses we may acquire;

Edgar Filing: Warner Music Group Corp. - Form 10-Q

reputational or other damages to our business as a result of a failure to consummate such a transaction for, among other reasons, failure to gain anti-trust approval; and

changing our business profile in ways that could have unintended consequences.

If we enter into significant strategic transactions in the future, related accounting charges may affect our financial condition and results of operations, particularly in the case of any acquisitions. In addition, the financing of any significant acquisition may result in changes in our capital structure, including the incurrence of additional indebtedness. Conversely, any material disposition could reduce our indebtedness or require the amendment or refinancing of our outstanding indebtedness or a portion thereof. We may not be successful in addressing these risks or any other problems encountered in connection with any strategic transactions. We cannot assure you that if we make any future acquisitions, investments, strategic alliances or joint ventures or enter into any business combination that they will be completed in a timely manner, that they will be structured or financed in a way that will enhance our creditworthiness or that they will meet our strategic objectives or otherwise be successful. We also may not be successful in implementing appropriate operational, financial and management systems and controls to achieve the benefits expected to result from these transactions. Failure to effectively manage any of these transactions could result in material increases in costs or reductions in expected revenues, or both.

Table of Contents

In addition, if any new business in which we invest or which we attempt to develop does not progress as planned, we may not recover the funds and resources we have expended and this could have a negative impact on our businesses or our company as a whole.

We have engaged in substantial restructuring activities in the past, and may need to implement further restructurings in the future and our restructuring efforts may not be successful or generate expected cost savings.

The recorded music industry continues to undergo substantial change. These changes continue to have a substantial impact on our business. See

The recorded music industry has been declining and may continue to decline, which may adversely affect our prospects and our results of operations. Following the 2004 Acquisition, we implemented a broad restructuring plan in order to adapt our cost structure to the changing economics of the music industry. We continue to shift resources from our physical sales channels to efforts focused on digital distribution, emerging technologies and other new revenue streams. In addition, in order to help mitigate the effects of the recorded music transition, we continue our efforts to reduce overhead and manage our variable and fixed cost structure to minimize any impact.

We cannot be certain that we will not be required to implement further restructuring activities, make additions or other changes to our management or workforce based on other cost reduction measures or changes in the markets and industry in which we compete. Our inability to structure our operations based on evolving market conditions could impact our business. Restructuring activities can create unanticipated consequences and negative impacts on the business, and we cannot be sure that any future restructuring efforts will be successful or generate expected cost savings.

We have outsourced our information technology infrastructure and certain finance and accounting functions and may outsource other back-office functions, which will make us more dependent upon third parties.

In an effort to make our information technology, or IT, more efficient and increase our IT capabilities and reduce potential disruptions, as well as generate cost savings, we signed a contract during the first quarter of fiscal 2009 with a third-party service provider to outsource a significant portion of our IT infrastructure functions. This outsourcing initiative was a component of our ongoing strategy to monitor our costs and to seek additional cost savings. As a result, we rely on third parties to ensure that our IT needs are sufficiently met. This reliance subjects us to risks arising from the loss of control over IT processes, changes in pricing that may affect our operating results, and potentially, termination of provisions of these services by our supplier. In addition, in an effort to make our finance and accounting functions more efficient, as well as generate cost savings, we signed a contract during fiscal 2009 with a third-party service provider to outsource certain finance and accounting functions. A failure of our service providers to perform services in a satisfactory manner may have a significant adverse effect on our business. We may outsource other back-office functions in the future, which would increase our reliance on third parties.

Changes to our information technology infrastructure to harmonize our systems and processes may fail to operate as designed and intended.

We regularly implement business process improvement initiatives to harmonize our systems and processes and to optimize our performance. Our current business process initiatives included the delivery of a SAP enterprise resource planning application in the U.S. for fiscal 2011. While we will experience changes in internal controls over financial reporting in fiscal 2011 as the implementation occurs, we expect to be able to transition to the new processes and controls with no negative impact to our internal control environment. If we fail to effectively implement the SAP application or if the SAP application fails to operate as designed and intended, it may impact our ability to process transactions accurately and efficiently.

Access, which indirectly owns all of our outstanding capital stock following the consummation of the Merger, controls our company and may have conflicts of interest with the holders of our debt or us in the future. Access may also enter into, or cause us to enter into, strategic transactions that could change the nature or structure of our business, capital structure or credit profile.

Following the consummation of the Merger, Access indirectly owns all of our common stock, and the actions that Access undertakes as the sole ultimate shareholder may differ from or adversely affect the interests of debt holders. Because Access ultimately controls our voting shares and those of all of our subsidiaries, it has the power, among other things, to affect our legal and capital structure and our day-to-day operations, as well as to elect our directors and those of our subsidiaries, to change our management and to approve any other changes to our operations. Access also has the power to direct us to engage in strategic transactions, with or involving other companies in our industry, including acquisitions, combinations or dispositions, and any such transaction could be material. Any such transaction would carry the risks set forth above under . If we acquire, combine with or invest in other businesses, we will face certain risks inherent in such transactions.

Additionally, Access is in the business of making investments in companies and is actively seeking to acquire interests in businesses that operate in our industry and may compete, directly or indirectly, with us. Access may also pursue acquisition opportunities that may be complementary to

Edgar Filing: Warner Music Group Corp. - Form 10-Q

our business, which could have the effect of making such acquisition opportunities unavailable to us. Access could elect to cause us to enter into business combinations or other transactions with any business or businesses in our industry that Access may acquire or control, or we could become part of a group of companies organized under the ultimate common control of Access that may be operated in a manner different from the manner in which we have historically

Table of Contents

operated. Any such business combination transaction could require that we or such group of companies incur additional indebtedness, and could also require us or any acquired business to make divestitures of assets necessary or desirable to obtain regulatory approval for such transaction. The amounts of such additional indebtedness, and the size of any such divestitures, could be material.

Finally, because we do not have any securities listed on a securities exchange following the consummation of the Merger and the related transactions, we are not subject to certain of the corporate governance requirements of any securities exchange, including any requirement to have any independent directors.

Our reliance on one company as the primary supplier for the manufacturing, packaging and physical distribution of our products in the U.S. and Canada and part of Europe could have an adverse impact on our ability to meet our manufacturing, packaging and physical distribution requirements.

We have recently renewed our agreements with Cinram. On November 16, 2010, we entered into a series of new agreements with Cinram and its affiliates including an agreement with Cinram Manufacturing LLC (formerly Cinram Manufacturing Inc.), Cinram Distribution LLC and Cinram International Inc. for the U.S. and Canada and an agreement with Cinram International Inc., Cinram GmbH and Cinram Operations UK Limited for certain territories within the European Union. We entered into certain amendments to the agreements in January 2011. Both new agreements, as amended, now expire on January 31, 2014. The terms of the new agreements, as amended, remain substantially the same as the terms of the original 2003 agreements, as amended, but now provide us with the option to use third-party vendors for up to a certain percentage of the volume provided to us by Cinram during the 2010 calendar year (and up to a higher percentage upon the occurrence of certain events). In addition, we have expanded termination rights. As Cinram continues to be our primary supplier of manufacturing and distribution services in the U.S., Canada and part of Europe, our continued ability to meet our manufacturing, packaging and physical distribution requirements in those territories depends largely on Cinram's continued successful operation in accordance with the service level requirements mandated by us in our service agreements. If, for any reason, Cinram were to fail to meet contractually required service levels, or were unable to otherwise continue to provide services, we may have difficulty satisfying our commitments to our wholesale and retail customers in the short term until we more fully transitioned to an alternate provider, which could have an adverse impact on our revenues. In February 2011, Cinram announced the successful completion of a refinancing and recapitalization transaction. Any future inability of Cinram to continue to provide services due to financial distress, refinancing issues or otherwise could also require us to switch to substitute suppliers of these services for more services than currently planned. Even though our agreements with Cinram give us a right to terminate based upon failure to meet mandated service levels and now also permit us to use third-party vendors for a portion of our service requirements, and although there are several capable substitute suppliers, it might be costly for us to switch to substitute suppliers for any such services, particularly in the short term, and the delay and transition time associated with finding substitute suppliers could also have an adverse impact on our revenues.

Risks Related to our Leverage

Our substantial leverage on a consolidated basis could adversely affect our ability to raise additional capital to fund our operations, limit our ability to react to changes in the economy or our industry and prevent us from meeting our obligations under our indebtedness.

We are highly leveraged. As of June 30, 2011, our total consolidated indebtedness was \$1.952 billion. Following the closing of the Merger and the related transactions, including the refinancing of certain of our indebtedness existing as of June 30, 2011, we would have had pro forma total consolidated indebtedness of \$2.123 billion. In addition, we would have been able to borrow up to \$60 million under the revolving credit facility.

Our high degree of leverage could have important consequences for our investors. For example, it may:

make it more difficult for us to make payments on our indebtedness;

increase our vulnerability to general economic and industry conditions, including recessions and periods of significant inflation and financial market volatility;

Edgar Filing: Warner Music Group Corp. - Form 10-Q

expose us to the risk of increased interest rates because any borrowings we make under the Revolving Credit Facility will bear interest at variable rates;

require us to use a substantial portion of our cash flow from operations to service our indebtedness, thereby reducing our ability to fund working capital, capital expenditures and other expenses;

limit our ability to refinance existing indebtedness on favorable terms or at all or borrow additional funds in the future for, among other things, working capital, acquisitions or debt service requirements;

limit our flexibility in planning for, or reacting to, changes in our business and the industries in which we operate;

place us at a competitive disadvantage compared to competitors that have less indebtedness; and

limit our ability to borrow additional funds that may be needed to operate and expand our business.

Table of Contents

We and our subsidiaries may be able to incur substantial additional indebtedness in the future, subject to the restrictions contained in our indentures relating to our outstanding notes. If new indebtedness is added to our current debt levels, the related risks that we and our subsidiaries now face could intensify.

We may not be able to generate sufficient cash to service all of our indebtedness, and may be forced to take other actions to satisfy our obligations under our indebtedness, which may not be successful.

Our ability to make scheduled payments on or to refinance our debt obligations depends on our financial condition and operating performance, which is subject to prevailing economic and competitive conditions and to certain financial, business and other factors beyond our control. We may not maintain a level of cash flows from operating activities sufficient to permit us to pay the principal, premium, if any, and interest on our indebtedness.

Holdings, our immediate subsidiary, will rely on our indirect subsidiary Acquisition Corp. and its subsidiaries to make payments on its borrowings. If Acquisition Corp. does not dividend funds to Holdings in an amount sufficient to make such payments, if necessary in the future, Holdings may default under the indenture governing its borrowings, which would result in all such notes becoming due and payable. Because Acquisition Corp.'s debt agreements have covenants that limit its ability to make payments to Holdings, Holdings may not have access to funds in an amount sufficient to service its indebtedness.

Our debt agreements contain restrictions that limit our flexibility in operating our business.

The indentures governing our outstanding notes contain various covenants that limit our ability to engage in specified types of transactions. These covenants limit our ability, Holdings' ability and the ability of our restricted subsidiaries to, among other things:

incur additional debt or issue certain preferred shares;

create liens on certain debt;

pay dividends on or make distributions in respect of our capital stock or make investments or other restricted payments;

sell certain assets;

create restrictions on the ability of our restricted subsidiaries to pay dividends to us or make certain other intercompany transfers;

enter into certain transactions with our affiliates; and

consolidate, merge, sell or otherwise dispose of all or substantially all of our assets.

In addition, the credit agreement governing the Revolving Credit Facility contains a number of covenants that limit our ability and the ability of our restricted subsidiaries to:

pay dividends on, and redeem and purchase, equity interests;

make other restricted payments;

make prepayments on, redeem or repurchase certain debt;

incur certain liens;

enter into certain sale-leaseback transactions;

make certain loans and investments;

incur certain additional debt;

enter into guarantees and hedging arrangements;

enter into mergers, acquisitions and asset sales;

enter into transactions with affiliates;

change the business we and our subsidiaries conduct;

restrict the ability of our subsidiaries to pay dividends or make distributions;

amend the terms of subordinated debt and unsecured bonds; and

make certain capital expenditures.

Our ability to borrow additional amounts under the Revolving Credit Facility will depend upon satisfaction of these covenants. Events beyond our control can affect our ability to meet these covenants.

Table of Contents

Our failure to comply with obligations under the instruments governing their indebtedness may result in an event of default under such instruments. We cannot be certain that we will have funds available to remedy these defaults. A default, if not cured or waived, may permit acceleration of our indebtedness. If our indebtedness is accelerated, we cannot be certain that we will have sufficient funds available to pay the accelerated indebtedness or will have the ability to refinance the accelerated indebtedness on terms favorable to us or at all.

All of these restrictions could affect our ability to operate our business or may limit our ability to take advantage of potential business opportunities as they arise.

If our cash flows and capital resources are insufficient to fund our debt service obligations, we may be forced to reduce or delay investments in recording artists and songwriters, capital expenditures or dividends, or to sell assets, seek additional capital or restructure or refinance our indebtedness. These alternative measures may not be successful and may not permit us to meet our scheduled debt service obligations. In the absence of such operating results and resources, we could face substantial liquidity problems and might be required to dispose of material assets or operations to meet our debt service and other obligations. The indentures governing our outstanding notes restrict our ability to dispose of assets and use the proceeds from dispositions. We may not be able to consummate those dispositions or to obtain the proceeds which we could realize from them and these proceeds may not be adequate to meet any debt service obligations then due.

A reduction in our credit ratings could impact our cost of capital.

Although reductions in our debt ratings may not have an immediate impact on the cost of debt or our liquidity, they may impact the cost of debt and liquidity over the medium term and future access at a reasonable rate to the debt markets may be adversely impacted.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Pursuant to the Merger Agreement, on July 20, 2011, Merger Sub merged with and into the Company with the Company surviving as a wholly-owned subsidiary of Parent and the Company issued 1,000 shares of common stock to Parent to evidence Parent's ownership of the Company as a result of the consummation of the transactions contemplated by the Merger Agreement, including the use of equity contributions totaling \$1.1 billion from Parent, together with (i) the proceeds from the sale of (a) \$150 million aggregate principal amount of 9.50% Senior Secured Notes due 2016, (b) \$765 million aggregate principal amount of 11.50% Senior Notes due 2018 and (c) \$150 million aggregate principal amount of 13.75% Senior Notes due 2019 and (ii) cash on hand at the Company, to, among other things, finance the aggregate Merger Consideration.

The issuance described above was effected in reliance on the exemptions for sales of securities not involving a public offering, as set forth in Section 4(2) of the Securities Act, based on the issuance being a private offering in connection with the initial capitalization of our company. There were no underwriters involved in connection with the issuance of these securities.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Item 3 is not applicable and has been omitted.

ITEM 4. (REMOVED AND RESERVED)

ITEM 5. OTHER INFORMATION

Item 5 is not applicable and has been omitted.

Table of Contents**ITEM 6. EXHIBITS**

The agreements and other documents filed as exhibits to this report are not intended to provide factual information or other disclosure other than with respect to the terms of the agreements or other documents themselves, and you should not rely on them for that purpose. In particular, any representations and warranties made by us in these agreements or other documents were made solely within the specific context of the relevant agreement or document and may not describe the actual state of affairs as of the date they were made or at any other time.

Exhibit No.	Description
2.1	Agreement and Plan of Merger, dated as of May 6, 2011 by and among Warner Music Group Corp., Airplanes Music LLC and Airplanes Merger Sub, Inc. (Schedules and exhibits omitted pursuant to Item 601(b)(2) of Regulation S-K. The Company agrees to furnish supplementally a copy of any omitted schedule to the SEC upon request.) (1)
4.1	Supplemental Indenture, dated as of May 23, 2011, by and among WMG Acquisition Corp., WMG Holdings Corp. and the subsidiary guarantors party thereto, and Wells Fargo Bank, National Association, as Trustee (2)
10.1	Form of Indemnification Agreement between Warner Music Group Corp. and its directors (3)
10.2	Second Amendment, dated as of May 20, 2011, to Restricted Stock Award Agreement, dated as of March 15, 2008 and as amended on January 18, 2011, by and between Warner Music Group Corp. and Edgar Bronfman, Jr. (3)
10.3	Second Amendment, dated as of May 20, 2011, to Restricted Stock Award Agreement, dated as of March 15, 2008 and as amended on January 18, 2011, by and between Warner Music Group Corp. and Lyor Cohen. (3)
10.4	Letter Agreement and Release, dated May 9, 2011, between Warner Music Group Corp. and Michael D. Fleisher.*
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended*
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-15(a) of the Securities Exchange Act of 1934, as amended*
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**
101.1	Financial statements from the Quarterly Report on Form 10-Q of Warner Music Group Corp. for the quarter ended June 30, 2011, filed on August 4, 2011, formatted in XBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Cash Flows, (iv) Consolidated Statement of Deficit and (v) Notes to Consolidated Interim Financial Statements.***

* Filed herewith.

** This certification will be treated as accompanying this Quarterly Report on Form 10-Q and not filed as part of such report for purposes of Section 18 of the Securities Exchange Act, as amended, or otherwise subject the liability of Section 18 of the Securities Exchange Act of 1934, as amended, and this certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that the registrant specifically incorporates it by reference.

*** Furnished herewith pursuant to Rule 406T of Regulation S-T, XBRL (Extensible Business Reporting Language) information is submitted and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

Represents management contract, compensatory plan or arrangement in which directors and/or executive officers are eligible to participate.

(1) Incorporated by reference to Warner Music Group Corp. s Current Report on Form 8-K filed on May 9, 2011 (File No. 001-32502).

(2) Incorporated by reference to Warner Music Group Corp. s Current Report on Form 8-K filed on May 24, 2011 (File No. 001- 32502).

Table of Contents

(3) Incorporated by reference to Warner Music Group Corp. s Current Report on Form 8-K filed on May 20, 2011 (File No. 001-32502).

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

August 4, 2011

WARNER MUSIC GROUP CORP.

By: /s/ EDGAR BRONFMAN, JR.
Name: **Edgar Bronfman, Jr.**
Title: **Chief Executive Officer**
(Principal Executive Officer)

By: /s/ STEVEN MACRI
Name: **Steven Macri**
Title: **Chief Financial Officer (Principal Financial**
Officer and Principal Accounting Officer)