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)

x **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)

Delaware	**13-4271875**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**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 x

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 x (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 x

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

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

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, 2011	Three Months Ended June 30, 2010	Nine Months Ended June 30, 2011	Nine Months Ended June 30, 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	Common Stock 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.

6

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 reissuances 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

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

	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)

9

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):

	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):

	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.

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	Music publishing	Corporate expenses and eliminations	Total
June 30, 2011				
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	Recorded music	Music publishing	Corporate expenses and eliminations	Total
June 30, 2011				
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)		
Other Current Assets:				
Foreign Currency Forward Exchange Contracts (a)	$	$ 2	$	$ 2
Other Current Liabilities:				
Foreign Currency Forward Exchange Contracts (a)	$	$ (3)	$	$ (3)
Other Non-Current Liabilities:				
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)

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)

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

18

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)

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