

Warner Music Group Corp.  
Form 10-Q  
May 15, 2012  
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**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 March 31, 2012

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)

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**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

There is no public market for the Registrant's common stock. As of May 15, 2012 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 AI Entertainment Holdings LLC (formerly Airplanes Music LLC), which is an affiliate of Access Industries, Inc.

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

	March 31, 2012	September 30, 2011
	(in millions)	
<b>Assets</b>		
Current assets:		
Cash and equivalents	\$ 272	\$ 154
Accounts receivable, less allowances of \$73 and \$40 million	306	385
Inventories	27	29
Royalty advances expected to be recouped within one year	129	135
Deferred tax assets	54	54
Other current assets	50	45
<b>Total current assets</b>	<b>838</b>	<b>802</b>
Royalty advances expected to be recouped after one year	158	173
Property, plant and equipment, net	172	182
Goodwill	1,376	1,372
Intangible assets subject to amortization, net	2,588	2,678
Intangible assets not subject to amortization	102	102
Other assets	70	71
<b>Total assets</b>	<b>\$ 5,304</b>	<b>\$ 5,380</b>
<b>Liabilities and Equity</b>		
Current liabilities:		
Accounts payable	\$ 143	\$ 165
Accrued royalties	1,004	974
Accrued liabilities	202	217
Accrued interest	89	55
Deferred revenue	102	101
Other current liabilities	3	10
<b>Total current liabilities</b>	<b>1,543</b>	<b>1,522</b>
Long-term debt	2,212	2,217
Deferred tax liabilities	401	411
Other noncurrent liabilities	136	148
<b>Total liabilities</b>	<b>4,292</b>	<b>4,298</b>
<b>Commitments and Contingencies (See Note 8)</b>		
Equity:		
Common stock (\$0.001 par value; 10,000 shares authorized; 1,000 shares issued and outstanding)		
Additional paid-in capital	1,129	1,129
Accumulated deficit	(93)	(31)
Accumulated other comprehensive loss, net	(41)	(33)
<b>Total Warner Music Group Corp. equity</b>	<b>995</b>	<b>1,065</b>
Noncontrolling interest	17	17
<b>Total equity</b>	<b>1,012</b>	<b>1,082</b>

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Total liabilities and equity	\$ 5,304	\$ 5,380
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See accompanying notes.

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

	Successor Three Months Ended March 31, 2012	Predecessor Three Months Ended March 31, 2011	Successor Six Months Ended March 31, 2012	Predecessor Six Months Ended March 31, 2011
	(in millions, except per share data)			
Revenues	\$ 628	\$ 684	\$ 1,407	\$ 1,462
Costs and expenses:				
Cost of revenues	(323)	(359)	(747)	(790)
Selling, general and administrative expenses (a)	(233)	(252)	(501)	(518)
Transaction costs		(2)		(2)
Amortization expense	(50)	(55)	(98)	(109)
Total costs and expenses	(606)	(668)	(1,346)	(1,419)
Operating income	22	16	61	43
Interest expense, net	(56)	(47)	(113)	(94)
Other income (expense), net	2	(1)		(1)
Loss before income taxes	(32)	(32)	(52)	(52)
Income tax expense	(2)	(7)	(8)	(5)
Net loss	(34)	(39)	(60)	(57)
Less: (income) loss attributable to noncontrolling interest	(2)	1	(2)	1
Net loss attributable to Warner Music Group Corp.	\$ (36)	\$ (38)	\$ (62)	\$ (56)
Net loss per common share attributable to Warner Music Group Corp.:				
Basic		\$ (0.25)		\$ (0.37)
Diluted		\$ (0.25)		\$ (0.37)
Weighted average common shares:				
Basic		150.5		150.2
Diluted		150.5		150.2
(a) Includes depreciation expense of:	\$ (13)	\$ (11)	\$ (25)	\$ (20)

See accompanying notes.

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

	<b>Successor Six Months Ended March 31, 2012</b>	<b>Predecessor Six Months Ended March 31, 2011</b>
	(in millions)	
<b>Cash flows from operating activities</b>		
Net loss	\$ (60)	\$ (57)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization expense	123	129
Deferred income taxes	(9)	(8)
Non-cash interest (income) expense	(1)	6
Non-cash share-based compensation expense		7
Other non-cash items		(1)
Changes in operating assets and liabilities:		
Accounts receivable	76	105
Inventories	2	7
Royalty advances	21	(35)
Accounts payable and accrued liabilities	(62)	(154)
Royalties payable	26	(16)
Accrued interest	34	1
Other balance sheet changes	(4)	9
Net cash provided by (used in) operating activities	146	(7)
<b>Cash flows from investing activities</b>		
Investments and acquisitions of businesses	(5)	(57)
Acquisition of publishing rights	(13)	(47)
Proceeds from the sale of music catalog	2	
Capital expenditures	(13)	(22)
Net cash used in investing activities	(29)	(126)
<b>Cash flows from financing activities</b>		
Distributions to noncontrolling interest holders	(2)	(1)
Net cash used in financing activities	(2)	(1)
Effect of exchange rate changes on cash and equivalents	3	14
Net increase (decrease) in cash and equivalents	118	(120)
Cash and equivalents at beginning of period	154	439
Cash and equivalents at end of period	\$ 272	\$ 319

See accompanying notes.

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

	Common Shares	Stock Value	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Warner Music Group Corp. Equity	Noncontrolling Interests	Total Equity
	(in millions, except per share amounts)							
Balance at September 30, 2011	1,000	\$ 0.001	\$ 1,129	\$ (31)	\$ (33)	\$ 1,065	\$ 17	\$ 1,082
Comprehensive loss:								
Net loss				(62)		(62)	2	(60)
Foreign currency translation adjustment					(8)	(8)		(8)
Total comprehensive loss						(70)	2	(68)
Noncontrolling interests							(2)	(2)
Balance at March 31, 2012	1,000	\$ 0.001	\$ 1,129	\$ (93)	\$ (41)	\$ 995	\$ 17	\$ 1,012

See accompanying notes.



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**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, AI Entertainment Holdings LLC (formerly 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 Parent (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 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 \$8.25 in cash, without interest and less applicable withholding taxes (collectively, the Merger Consideration).

On the Closing Date, 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. The Company has continued to file reports with the SEC pursuant to the Exchange Act in accordance with certain covenants contained in the instruments governing the Company's outstanding indebtedness. Additionally, the Company filed two exchange offer registration statements with the SEC in connection with the registration of its guarantee of the 11.50% Senior Notes due 2018 issued by Acquisition Corp. and the 13.75% Senior Notes due 2019 issued by Holdings, both of which became effective on March 16, 2012. As a result, the Company is currently required to file reports pursuant to Section 15(d) of the Exchange Act. The Company has included condensed consolidating financial information as a condition to omitting separate financial statements for Acquisition Corp. and Holdings under Section 15(d) of the Exchange Act as permitted by Rule 3-10 of Regulation S-X.

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.

Although the Company continued as the same legal entity after the Merger, the accompanying consolidated financial statements are presented for the Predecessor and Successor relating to the periods preceding and succeeding the Merger, respectively. As a result of the Company applying the acquisition method of accounting, the Successor period financial statements reflect a new basis of accounting, while the Predecessor financial statements have been prepared using the Company's historical cost basis of accounting. As a result, the Predecessor and Successor financial statements are not comparable. There have been no changes in the business operations of the Company due to the Merger.

See Note 4 for further discussion on the Merger and purchase price. The accounting for this transaction has been pushed down to the Company's financial statements.

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.

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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

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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 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, East West, Elektra, Nonesuch, Reprise, Roadrunner, Rykodisc, Sire and Word.

Outside the U.S., Recorded Music activities are conducted in more than 50 countries primarily through various subsidiaries, affiliates and non-affiliated licensees, which the Company sometimes refers to collectively as Warner Music International, or WMI. 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, 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 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. The Company is also selling recorded music products through other digital distribution channels such as streaming or subscription services. 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 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.

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The Company's Music Publishing operations include Warner/Chappell, its global Music Publishing company, headquartered in Los Angeles 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

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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 and further expanded its production music operations with the acquisitions of Groove Addicts Production Music Library and Carlin Recorded Music Library in 2010 and 615 Music in 2011, collectively branded as Warner/Chappell Production Music.

## **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 six month periods ended March 31, 2012 are not necessarily indicative of the results that may be expected for the twelve months ended September 30, 2012.

The consolidated balance sheet at September 30, 2011 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 twelve months ended September 30, 2011 (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.

Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) Topic 810, Consolidation ( ASC 810 ) requires the Company first evaluate its investments to determine if any investments qualify as a variable interest entity ( VIE ). A VIE is consolidated if the Company is deemed to be the primary beneficiary of the VIE, which is the party involved with the VIE that has 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. If an entity is not deemed to be a VIE, the Company consolidates the entity if the Company has a controlling voting interest.

The Company maintains a 52-53 week fiscal year ending on the Friday nearest to each reporting date. As such, all references to March 31, 2012 and March 31, 2011 relate to the three and six-month periods ended March 30, 2012 and March 25, 2011, respectively. For convenience purposes, the Company continues to date its financial statements as of March 31.

The Company has performed a review of all subsequent events through the date the financial statements were issued, and has determined no additional disclosures are necessary.

### **New Accounting Pronouncements**

During the second quarter of fiscal 2012, the Company adopted ASU 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*. ASU 2011-04 provides a consistent definition of fair value and ensures that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for level 3 fair value measurements. The adoption of this standard update did not have a significant impact on the Company's consolidated financial statements.

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In June 2011, the FASB issued ASU 2011-05, *Presentation of Comprehensive Income*. ASU 2011-05 requires entities to present items of net income and other comprehensive income either in one continuous statement, referred to as the statement of comprehensive income, or in two separate, but consecutive, statements of net income and other comprehensive income. In addition, in December 2011, the FASB issued ASU 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. ASU 2011-12 defers the requirement to present components of reclassifications of comprehensive income on the statement of comprehensive income, with all other requirements of ASU 2011-05 unaffected. Both ASU 2011-05 and 2011-12 will be effective as of October 1, 2012 for the Company and are not expected to have a significant impact on our financial statements, other than presentation.

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In September 2011, the FASB issued ASU 2011-08, *Testing Goodwill for Impairment*. ASU 2011-08 provides entities with an option to perform a qualitative assessment to determine whether further impairment testing is necessary. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. This standard is not expected to have a significant impact on our 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 loss, net of related taxes:

	Foreign Currency Translation Loss	Minimum Pension Liability Adjustment	Derivative Financial Instruments Gain	Accumulated Other Comprehensive Loss
	(in millions)			
<b>Balance at September 30, 2011</b>	<b>\$ (35)</b>	<b>\$ 1</b>	<b>\$ 1</b>	<b>\$ (33)</b>
Activity through March 31, 2012	(8)			(8)
<b>Balance at March 31, 2012</b>	<b>\$ (43)</b>	<b>\$ 1</b>	<b>\$ 1</b>	<b>\$ (41)</b>

**4. Merger**

As further described in Note 1, as a result of the Merger, effective as of July 20, 2011, the Company was acquired by Parent. Transaction costs of approximately \$53 million were expensed as follows: \$10 million and \$43 million from July 20, 2011 to September 30, 2011 (Successor) and from October 1, 2010 to July 19, 2011 (Predecessor), respectively.

The Merger was accounted for in accordance with FASB ASC Topic 805, *Business Combinations*, using the acquisition method of accounting. The assets and liabilities of the Company, including identifiable intangible assets, have been measured at their fair value primarily using Level 3 inputs (see Note 12 for additional information on fair value inputs). Determining the fair value of the assets acquired and liabilities assumed requires judgment and involves the use of significant estimates and assumptions, including assumptions with respect to future cash inflows and outflows, discount rates, asset lives and market multiples, among other items. The use of different estimates and judgments could yield materially different results.

The table below presents the consideration transferred and the final allocation of purchase price to the assets and liabilities acquired as a result of the Merger:

	(in millions)
Cash paid to acquire outstanding WMG shares	\$ 1,228
Cash paid to settle equity awards	50
<b>Total cash consideration</b>	<b>1,278</b>
Less: Cash paid by WMG	(179)
<b>Net Investment</b>	<b>1,099</b>
WMG shares previously held by Parent	30
<b>Total consideration to be allocated</b>	<b>\$ 1,129</b>



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### Fair Value of assets acquired and liabilities assumed:

Cash	\$	140
Accounts receivable		331
Inventory		28
Artist advances*		341
Property, plant and equipment		182
Intangible assets		2,879
Other assets*		117
Current liabilities*		(1,544)
Deferred income tax liabilities		(363)
Deferred revenue		(115)

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Other noncurrent liabilities*	(173)
Debt	(2,049)
Noncontrolling interests	(17)
Fair value of net assets acquired	(243)
Goodwill recorded*	1,372
Total consideration allocated	\$ 1,129

\* Amounts have been adjusted as a result of changes in the final purchase price allocation related to the Merger. Goodwill is calculated as the excess of the consideration paid over the net assets recognized. The goodwill recorded as part of the Merger primarily reflects the expected value to be generated from the continued transition of the music industry and the expected resulting cost savings, as well as any intangible assets that do not qualify for separate recognition. Goodwill has been allocated to our reportable segments as follows: Recorded Music \$908 million and Music Publishing \$464 million.

The components of the intangible assets identified in the table above and the related useful lives, segregated by our reportable segments, are as follows:

	Value (in millions)	Useful Life
<b>Recorded Music</b>		
Trademarks/trade names	\$ 51	Indefinite
Trademarks/trade names	7	7 years
Catalog	560	5-11 years
Artist contracts	520	8-12 years
<b>Music Publishing</b>		
Trademarks/trade names	\$ 51	Indefinite
Copyrights	1,530	28 years
Songwriter contracts	160	29 years

**5. Goodwill and Intangible Assets****Goodwill**

The following analysis details the changes in goodwill for each reportable segment during the six months ended March 31, 2012:

	Recorded Music	Music Publishing (in millions)	Total
<b>Balance at September 30, 2011*</b>	<b>\$ 908</b>	<b>\$ 464</b>	<b>\$ 1,372</b>
Acquisitions	5		5
Dispositions			
Other adjustments	(1)		(1)
<b>Balance at March 31, 2012</b>	<b>\$ 912</b>	<b>\$ 464</b>	<b>\$ 1,376</b>

\* Amounts have been adjusted as a result of changes in the final purchase price allocation related to the Merger.

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The Company performs its annual goodwill impairment test in accordance with ASC 350 during the fourth quarter of each fiscal year. The Company may conduct an earlier review if events or circumstances occur that would suggest the carrying value of the Company's goodwill may not be recoverable. No indicators of impairment were identified during the current period that required the Company to perform an interim assessment or recoverability test.

**Table of Contents****Other Intangible Assets**

Other intangible assets consist of the following:

	March 31, 2012	September 30, 2011
	(in millions)	
Intangible assets subject to amortization:		
Recorded music catalog (a)	\$ 546	\$ 551
Music publishing copyrights (a)	1,502	1,486
Artist and songwriter contracts (a)	667	672
Trademarks	7	7
	2,722	2,716
Accumulated amortization	(134)	(38)
Total net intangible assets subject to amortization	2,588	2,678
Intangible assets not subject to amortization:		
Trademarks and brands	102	102
Total net other intangible assets	\$ 2,690	\$ 2,780

- (a) During the six months ended March 31, 2012, the Company finalized the allocation of intangible assets on a legal entity basis as of the Closing Date. As a result of the allocation to entities with foreign currencies, the September 30, 2011 balance sheet has been adjusted to reflect the foreign currency translation of these assets since the acquisition date. The aggregate adjustments included a decrease to intangible assets of approximately \$40 million, a decrease to deferred income taxes of approximately \$9 million and a decrease to Other Comprehensive Income of approximately \$31 million, net of tax.

**6. Debt****Debt Capitalization**

Long-term debt consisted of the following:

	March 31, 2012	September 30, 2011
	(in millions)	
Revolving Credit Facility (a)	\$	\$
9.5% Existing Secured Notes due 2016 Acquisition Corp (b)	1,157	1,162
9.5% Secured WMG Notes due 2016 Acquisition Corp (c)	156	157
11.5% Unsecured WMG Notes due 2018 Acquisition Corp (d)	749	748
13.75% Holdings Notes due 2019 Holdings (e)	150	150
Total long term debt	\$ 2,212	\$ 2,217

- (a) Reflects \$60 million of commitments under the Revolving Credit Facility, less letters of credit outstanding of approximately \$1 million at March 31, 2012. There were no loans outstanding under the Revolving Credit Facility as of March 31, 2012.

(b)

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- 9.5% Existing Secured Notes due 2016; face amount of \$1.1 billion plus unamortized premiums of \$57 million and \$62 million at March 31, 2012 and September 30, 2011, respectively.
- (c) 9.5% Secured WMG Notes due 2016; face amount of \$150 million plus unamortized premiums of \$6 million and \$7 million at March 31, 2012 and September 30, 2011, respectively.
- (d) 11.5% Unsecured WMG Notes due 2018; face amount of \$765 million less unamortized discounts of \$16 million and \$17 million at March 31, 2012 and September 30, 2011, respectively.
- (e) 13.75% Holdings Notes due 2019; face amount of \$150 million.

### **Revolving Credit Facility**

In connection with the Merger, Acquisition Corp. ( Borrower ) entered into a 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 ). The Revolving Credit Facility provides for a revolving credit facility in the amount of up to \$60 million for general corporate purposes and includes a letter of credit sub-facility. The final maturity of the Revolving Credit Facility is July 19, 2016.

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### *Interest Rates and Fees*

Borrowings under the Revolving Credit Facility 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

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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 Credit Agreement bears a commitment fee on the unutilized portion 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. WMG Acquisition Corp. is also required to pay certain upfront fees to lenders and agency fees to the agent under the Credit Agreement, in the amounts and at the times agreed between the relevant parties.

### *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 Credit Agreement 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 Credit Agreement contains customary representations and warranties and customary affirmative and negative covenants. There are no financial covenants included in the Revolving Credit Facility, 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).

### **Existing Secured Notes**

Acquisition Corp. issued \$1.1 billion aggregate principal amount of its 9.5% Senior Secured Notes due 2016 (the Existing Secured Notes) in 2009. 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 was equal to the difference between the stated principal amount and the issue price. Following the Merger, in accordance with the acquisition method of accounting described in Note 1, these notes were recorded at fair value. This resulted in the elimination of the predecessor discount and the establishment of a \$65 million successor premium based on market data as of the closing date of the Merger. This premium will be amortized using the effective interest rate method and reported as a component within 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 9.5% per annum.

Prepayments of the Existing Secured Notes are allowed, subject to certain terms in the indenture governing the Existing Secured Notes, including the prepayment amount and the redemption price, which varies based on the timing of the prepayment. In addition, payment of accrued and unpaid interest also would be required at the time of any prepayment. In the event of a change in control, as defined in the indenture governing the Existing Secured Notes, 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.

### *Ranking and Guarantees*

The Existing Secured Notes are senior secured obligations of Acquisition Corp. that rank senior in right of payment to Acquisition Corp.'s subordinated indebtedness. 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.

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On December 8, 2011, the Company issued a guarantee whereby it agreed to fully and unconditionally guarantee, on a senior secured basis, the payments of Acquisition Corp. on the Existing Secured Notes.

### *Covenants, Representations and Warranties*

The Existing Secured Notes contain customary representations and warranties and customary affirmative and negative covenants. The indenture for the Existing Secured Notes contains a number of covenants that, among other things limit (subject to



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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.

### **Secured WMG Notes**

On the Closing Date, WM Finance Corp. issued \$150 million aggregate principal amount of 9.5% Senior Secured Notes due 2016 (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 WM Finance Corp. and Wells Fargo Bank, National Association as Trustee (the Trustee ). Following the completion of the Merger, Acquisition Corp. and certain of its domestic subsidiaries (the Guarantors ) entered into a Supplemental Indenture with the Trustee, pursuant to which (i) Acquisition Corp. became a party to the Indenture and assumed the obligations of the WM Finance Corp. 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.

The Secured WMG Notes were issued at 104.75% of their face value for total proceeds of \$157 million, with an effective interest rate of 8.32%. The original issue premium (OIP) was \$7 million, which is the difference between the stated principal amount and the issue price. The OIP will be amortized over the term of the Secured WMG Notes using the effective interest rate method and reported as an offset to non cash interest expense. In conjunction with this transaction, the Company incurred \$15 million of financing costs which were deferred and will be amortized over the term of the Senior WMG Notes and included as a component within non-cash interest expense. The Secured WMG Notes mature on June 15, 2016 and bear interest payable semi-annually on June 15 and Dec 15 at a fixed rate of 9.5%.

Prepayments of the Secured WMG Notes are allowed, subject to certain terms in the Secured WMG Notes Indenture, including the prepayment amount and the redemption price, which varies based on the timing of the prepayment. In addition, payment of accrued and unpaid interest also would be required at the time of any prepayment. 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.

### **Ranking and Guarantees**

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

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.

On December 8, 2011, the Company issued a guarantee whereby it agreed to fully and unconditionally guarantee, on a senior secured basis, the payments of Acquisition Corp. on the Secured WMG Notes.

### **Covenants, Representations and Warranties**

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.

Unsecured WMG Notes

On the Closing Date, the WM Finance Corp. issued \$765 million aggregate principal amount of 11.5% Senior Unsecured Notes due 2018 (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 WM Finance Corp. and Wells Fargo Bank, National Association as Trustee (the Trustee ). Following the completion of the Merger, Acquisition Corp. and certain of its domestic subsidiaries (the Guarantors ) entered into a Supplemental Indenture with the Trustee, pursuant to which (i) Acquisition Corp. became a party to the Indenture and

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assumed the obligations of WM Finance Corp. 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.

The Unsecured WMG Notes were issued at 97.673% of their face value for total proceeds of \$747 million, with an effective interest rate of 12%. The OID was \$17 million and will be amortized over the term of the Unsecured WMG Notes using the effective interest rate method and reported as non cash interest expense. In conjunction with this transaction, the Company incurred \$26 million of financing costs which were deferred and will be amortized over the term of the Unsecured WMG Notes and included as a component within non-cash interest expense. The Unsecured WMG Notes mature on October 1, 2018 and bear interest payable semi-annually on April 1 and October 1 at fixed rate of 11.5%.

Prepayments of the Unsecured WMG Notes are allowed, subject to certain terms in the Unsecured WMG Notes Indenture, including the prepayment amount and the redemption price, which varies based on the timing of the prepayment. In addition, payment of accrued and unpaid interest also would be required at the time of any prepayment. 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.

### *Ranking and Guarantees*

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.

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.

On December 8, 2011, the Company issued a guarantee whereby it agreed to fully and unconditionally guarantee, on a senior unsecured basis, the payments of Acquisition Corp. on the Unsecured WMG Notes.

### *Covenants, Representations and Warranties*

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.

### *Exchange Offer*

In connection with the issuance of the Unsecured WMG Notes, Acquisition Corp. entered into a registration rights agreement relating to the Unsecured WMG Notes, pursuant to which Acquisition Corp. agreed to use its commercially reasonable efforts to file, and did initially file on January 25, 2012, a registration statement with the SEC (as amended, the WMG Exchange Offer Registration Statement ), to permit holders to exchange the Unsecured WMG Notes (the Old Unsecured WMG Notes ) for registered notes with terms substantially identical to the Old Unsecured WMG Notes, except the exchange notes would not contain certain terms with respect to the payment of additional interest or transfer restrictions. On March 16, 2012, the WMG Exchange Offer Registration Statement was declared effective by the SEC, and Acquisition Corp. completed the exchange offer on April 25, 2012. On the settlement date, Acquisition Corp. accepted for exchange \$708 million aggregate principal amount of Old Unsecured WMG Notes.

### **Senior Holdings Notes**

On the Closing Date, the Initial Holdings Issuer issued \$150 million aggregate principal amount of the 13.75% Senior Notes due 2019 (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 Merger, Holdings entered into a 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.

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The Holdings Notes were issued at 100% of their face value. In conjunction with this transaction, the Company incurred \$8 million of financing costs which were deferred and will be amortized on over the term of the Holdings Notes and included as a component within non-cash interest expense. The Holdings Notes mature on October 1, 2019 and bear interest payable semi-annually on April 1 and October 1 at fixed rate of 13.75%.

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Prepayments of the Holdings Notes are allowed, subject to certain terms in the Holdings Notes Indenture, including the prepayment amount and the redemption price, which varies based on the timing of the prepayment. In addition, payment of accrued and unpaid interest also would be required at the time of any prepayment. 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.

### *Ranking and Guarantees*

The Holdings Notes are 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.

The Holdings Notes are not guaranteed by any of its subsidiaries. On August 2, 2011 the Company issued a guarantee whereby it agreed to fully and unconditionally guarantee, on a senior unsecured basis, the payments of Holdings related to the Holdings Notes.

### *Covenants, Representations and Warranties*

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.

### *Exchange Offer*

In connection with the issuance of the Holdings Notes, Holdings entered into a registration rights agreement relating to the Holdings Notes, pursuant to which Holdings agreed to use its commercially reasonable efforts to file, and did initially file on January 25, 2012, a registration statement with the SEC (as amended, the Holdings Exchange Offer Registration Statement), to permit holders to exchange the Holdings Notes (the Old Holdings Notes) for registered notes with terms substantially identical to the Old Holdings Notes, except the exchange notes would not contain certain terms with respect to the payment of additional interest or transfer restrictions. On March 16, 2012, the Holdings Exchange Offer Registration Statement was declared effective by the SEC, and Holdings completed the exchange offer on April 25, 2012. On the settlement date, Holdings accepted for exchange \$81.475 million aggregate principal amount of Old Holdings Notes.

### *Maturities*

As of March 31, 2012, there are no scheduled maturities of long-term debt until 2016 (\$1.250 billion). Thereafter, \$915 million is scheduled to mature. In addition, the final maturity of the Revolving Credit Facility is July 19, 2016.

### *Interest Expense*

Total interest expense, net was \$56 million and \$47 million for the three months ended March 31, 2012 (Successor) and March 31, 2011 (Predecessor), respectively, and \$113 million and \$94 million for the six months ended March 31, 2012 (Successor) and March 31, 2011 (Predecessor), respectively. The weighted-average interest rate of the Company's total debt was 10.5% for the three and six months ended March 31, 2012 (Successor) and 8.9% for the three and six months ended March 31, 2011 (Predecessor).

## **7. Share-based Compensation**

In connection with the Merger, the vesting of all outstanding unvested Predecessor options and certain unvested restricted stock awards was accelerated immediately prior to closing. As a result of the acceleration there were no outstanding equity awards of the Company as of July 20, 2011 and thereafter.

In total, the Company recognized non-cash compensation expense related to its stock-based compensation plans of \$5 million and \$7 million for the three and six months ended March 31, 2011 (Predecessor), respectively. As there were no outstanding equity awards subsequent to July 20,

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2011 the Company did not recognize any non-cash compensation expense for the three and six months ended March 31, 2012.

**8. Commitments and Contingencies**

The Company is involved in various litigation and regulatory proceedings arising in the normal course of business. Where it is determined, in consultation with counsel based on litigation and settlement risks, that a loss is probable and estimable in a given matter, the Company establishes an accrual. In none of the currently pending proceedings is the amount of accrual material. An

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estimate of the reasonably possible loss or range of loss in excess of the amounts already accrued cannot be made at this time due to various factors typical in contested proceedings, including (1) uncertain damage theories and demands; (2) a less than complete factual record; (3) uncertainty concerning legal theories and their resolution by courts or regulators; and (4) the unpredictable nature of the opposing party and its demands. However, the Company cannot predict with certainty the outcome of any litigation or the potential for future litigation. As such, it continuously monitors these proceedings as they develop and adjusts any accrual or disclosure as needed. Regardless of the outcome, litigation could have an adverse impact on the Company, including its brand value, because of defense costs, diversion of management resources and other factors and it could have a material effect on its results of operations for a given reporting period.

### *Pricing of Digital Music Downloads*

On December 20, 2005 and February 3, 2006, the Attorney General of the State of New York served us with requests for information in connection with an industry-wide investigation as to the pricing of digital music downloads. On February 28, 2006, the Antitrust Division of the U.S. Department of Justice served us with a Civil Investigative Demand, also seeking information relating to the pricing of digitally downloaded music. Both investigations were ultimately closed, but subsequent to the announcements of the investigations, more than thirty putative class action lawsuits were filed concerning the pricing of digital music downloads. The lawsuits were consolidated 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. On October 9, 2008, the District Court issued an order dismissing the case as to all defendants, including us. But on January 12, 2010, the Second Circuit vacated the judgment of the District Court and remanded the case for further proceedings and on January 10, 2011, the Supreme Court denied the defendants' petition for Certiorari.

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. The renewed motion was based mainly on arguments made in defendants' original motion to dismiss, but not addressed by the District Court. On July 18, 2011, the District Court granted defendants' motion in part, and denied it in part. Notably, all claims on behalf of the CD-purchaser class were dismissed with prejudice. However, a wide variety of state and federal claims remain, for the class of Internet Music purchasers. The parties have filed amended pleadings complying with the court's order, and the case is proceeding into discovery, which is currently scheduled to be substantially completed by May 31, 2012. The parties are scheduled to confer at the end of August 2012 on a class certification briefing schedule, for a determination by the District Court as to whether class treatment is appropriate. The case will proceed into discovery, 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. Regardless of the merits of the claims, this and any related litigation could continue to be costly, and divert the time and resources of management.

### *Music Download Putative Class Action Suits*

Five putative class action lawsuits have been filed against the Company in Federal Court in the Northern District of California. The lawsuits, which were brought by various recording artists, all allege that the Company has improperly calculated the royalties due them for certain digital music sales under the terms of their recording contracts. The named plaintiffs purport to raise these claims on their own behalf and, as a putative class action, on behalf of other similarly situated artists. Plaintiffs base their claims on a previous ruling that held another recorded music company had breached the specific recording contracts at issue in that case through its payment of royalties for music downloads and ringtones. In the wake of that ruling, a number of recording artists have initiated suits seeking similar relief against all of the major record companies. Here too, plaintiffs seek to have the interpretation of the contracts in that prior case applied to their different and separate contracts.

On April 10, 2012, the Company filed a motion to dismiss various claims in one of the lawsuits, with the intention of filing similar motions in the remaining suits, on the various applicable response dates. Meanwhile, certain plaintiffs' counsel moved to be appointed as interim lead counsel, and other plaintiffs' counsel moved to consolidate the various actions. On April 23, 2012, the court issued an order setting out a more orderly process for dealing with the various cases. It set May 24, 2012 for a Case Management Conference for all five actions, and set the same day as the hearing date for the Plaintiffs' various outstanding motions. In addition, the Court removed the Company's motion to dismiss from the calendar, with new dates to be set on or after May 24, 2012.



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No other dates have been set in the litigation. The Company intends to defend against these lawsuits vigorously, but is unable to predict the outcome of these suits. Regardless of the merits of the claims, this and any related litigation could continue to be costly, and divert the time and resources of management.

### *Final Settlement of Class Actions Related to the Merger*

The Company awaits a decision on the application for approval by the Supreme Court for the State of New York of the previously disclosed settlement of the claims filed against, inter alia, the Company and its directors in 2011 on behalf of a class of the Company's shareholders in the action entitled *Cournoyer v. Warner Music Group Corp. et al.*, Index No. 651367/2011 (the *Cournoyer Action*). The *Cournoyer Action*, as well as two related actions, were brought in connection with the Merger.

As previously disclosed, the settlement did not involve any monetary payment to the class of shareholders. Instead, the Company agreed to publicly disclose additional information about the Merger in a filing that it made with the SEC on June 13, 2011.

## **9. 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) which is discussed further in Note 12.

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 consolidated balance sheets. The Company monitors its positions with, and the credit quality of, the financial institutions that are party to any of its financial transactions.

## **Interest Rate Risk Management**

The Company has \$2.212 billion of debt outstanding at March 31, 2012. Based on the level of interest rates prevailing at March 31, 2012, the fair value of this fixed-rate debt was approximately \$2.351 billion. The fair value of the Company's debt instruments are determined using quoted market prices from less active markets or by using quoted market prices for instruments with identical terms and maturities; both approaches are considered a Level 2 measurement.

Further, based on the amount of its fixed-rate debt, a 25 basis point increase or decrease in the level of interest rates would increase or decrease the fair value of the fixed-rate debt by approximately \$14 million. This potential increase or decrease is based on the simplified assumption that the level of fixed-rate debt remains constant with an immediate increase or decrease in the level of interest rates with no subsequent changes in rates for the remainder of the period.

The Company monitors its positions with, and the credit quality of, the financial institutions that are party to any of its financial transactions.

## **Foreign Currency Risk Management**

Historically, the Company has used, and continues to use, foreign exchange forward contracts and foreign exchange options primarily to hedge the risk that unremitted or future royalties and license fees owed to its domestic companies for the sale, or anticipated sale, of U.S.-copyrighted products abroad may be adversely affected by changes in foreign currency exchange rates. The Company focuses on managing the level of exposure to the risk of foreign currency exchange rate fluctuations on its major currencies, which include the euro, British pound sterling, Japanese yen, Canadian dollar, Swedish krona and Australian dollar. In addition, the Company currently hedges foreign currency risk associated with financing transactions such as third-party and inter-company debt and other balance sheet items.

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For royalty related hedges, the Company records foreign exchange contracts at fair value on its balance sheet and the related gains or losses on these contracts are deferred in equity (as a component of comprehensive loss). These deferred gains and losses are recognized in income in the period in which the related royalties and license fees being hedged are received and recognized in income. However, to the extent that any of these contracts are not considered to be perfectly effective in offsetting the change in the value of the royalties and license fees being hedged, any changes in fair value relating to the ineffective portion of these contracts are immediately recognized in income, and have been immaterial. For hedges of financing transactions and other balance sheet items, hedge gains and losses are taken directly to the statement of operations since there is an equal and offsetting statement of operations entry related to the underlying exposure. Gains and losses on foreign exchange contracts generally are included as a component of other income (expense), net, in the Company's consolidated statement of operations.

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As of March 31, 2012, the Company had outstanding hedge contracts for the sale of \$263 million and the purchase of \$15 million of foreign currencies at fixed rates. As of March 31, 2012, there was no material impact to the Company's comprehensive loss related to foreign exchange hedging. As of September 30, 2011, the Company had outstanding hedge contracts for the sale of \$211 million and the purchase of \$37 million of foreign currencies at fixed rates. As of September 30, 2011, the Company had \$3 million of deferred losses in comprehensive loss related to foreign exchange hedging.

**10. 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 twelve months ended September 30, 2011. 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:

Three Months Ended	Recorded music	Music publishing	Corporate expenses and eliminations (in millions)	Total
<b>March 31, 2012 (Successor)</b>				
Revenues	\$ 503	\$ 128	\$ (3)	\$ 628
OIBDA	48	54	(17)	85
Depreciation expense	(7)	(2)	(4)	(13)
Amortization expense	(34)	(16)		(50)
Operating income (loss)	\$ 7	\$ 36	\$ (21)	\$ 22
<b>March 31, 2011 (Predecessor)</b>				
Revenues	\$ 552	\$ 137	\$ (5)	\$ 684
OIBDA	54	50	(22)	82
Depreciation expense	(7)	(1)	(3)	(11)
Amortization expense	(37)	(18)		(55)
Operating income (loss)	\$ 10	\$ 31	\$ (25)	\$ 16
Six Months Ended	Recorded music	Music publishing	Corporate expenses and eliminations (in millions)	Total
<b>March 31, 2012 (Successor)</b>				
Revenues	\$ 1,164	\$ 251	\$ (8)	\$ 1,407
OIBDA	150	72	(38)	184
Depreciation expense	(15)	(3)	(7)	(25)
Amortization expense	(67)	(31)		(98)
Operating income (loss)	\$ 68	\$ 38	\$ (45)	\$ 61

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<b>March 31, 2011 (Predecessor)</b>				
Revenues	\$ 1,214	\$ 257	\$ (9)	\$ 1,462
OIBDA	144	68	(40)	172
Depreciation expense	(13)	(2)	(5)	(20)
Amortization expense	(74)	(35)		(109)
Operating income (loss)	\$ 57	\$ 31	\$ (45)	\$ 43

**Table of Contents****11. Additional Financial Information****Cash Interest and Taxes**

The Company made interest payments of approximately \$79 million and \$88 million during the six months ended March 31, 2012 (Successor) and March 31, 2011 (Predecessor), respectively. The Company paid approximately \$24 million and \$10 million of income and withholding taxes, net of refunds, during the six months ended March 31, 2012 (Successor) and March 31, 2011 (Predecessor), respectively. The \$24 million of cash tax payments during the six months ended March 31, 2012 (Successor) includes a \$15 million payment relating to the settlement of an income tax audit in Germany. This payment was fully reimbursed to the Company by Time Warner Inc. under the terms of the 2004 acquisition of substantially all of the interests of the recorded music and music publishing businesses of Time Warner Inc.

**12. 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 March 31, 2012 and September 30, 2011. Derivatives not designated as hedging instruments represent the balances in other current assets and other current liabilities below and the gains and losses on these financial instruments are included as a component of other income, net in the statement of operations.

	Fair Value Measurements as of March 31, 2012			
	(Level 1)	(Level 2)	(Level 3)	Total
	(in millions)			
<i>Other Current Assets:</i>				
Foreign Currency Forward Exchange Contracts (a)	\$	\$ 1	\$	\$ 1
<i>Other Current Liabilities:</i>				
Foreign Currency Forward Exchange Contracts (a)	\$	\$ (3)	\$	\$ (3)
<i>Other Non-Current Liabilities:</i>				
Contractual Obligations (b)	\$	\$	\$ (13)	\$ (13)
	Fair Value Measurements as of September 30, 2011			
	(Level 1)	(Level 2)	(Level 3)	Total

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	(in millions)			
<i>Other Current Assets:</i>				
Foreign Currency Forward Exchange Contracts (a)	\$	\$	9	\$ 9
<i>Other Current Liabilities:</i>				
Foreign Currency Forward Exchange Contracts (a)	\$	\$	(3)	\$ (3)
<i>Other Non-Current Liabilities:</i>				
Contractual Obligations (b)	\$	\$	(13)	\$ (13)

- (a) The fair value of the 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.

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- (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 and any adjustments are included as a component of operating income in the statement of operations. This amount was mainly calculated using unobservable inputs such as the future earnings performance of our various acquisitions and the expected timing of the payment.

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 to 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.

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**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. Holdings has issued and outstanding the 13.75% Senior Notes due 2019 (the Holdings Notes ). In addition, Acquisition Corp. has issued and outstanding two separate series of 9.5% Senior Secured Notes due 2016 (the Secured WMG Notes and the Existing Secured Notes and together the Secured WMG Notes ) and the 11.5% Senior Unsecured Notes due 2018 (the Unsecured WMG Notes ) (together, the Acquisition Corp. Notes ).

The Holdings Notes are guaranteed by the Company. These guarantees are full, unconditional, joint and several. The following condensed consolidating financial statements are presented for the information of the holders of the Holdings Notes and present the results of operations, financial position and cash flows of (i) the Company, which is the guarantor of the Holdings Notes, (ii) Holdings, which is the issuer of the 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 or combined subsidiaries are presented under the equity method of accounting.

The Acquisition Corp. Notes are also guaranteed by the Company and, in addition, are guaranteed by all of Acquisition Corp.'s domestic wholly owned subsidiaries. The Secured WMG Notes are guaranteed on a senior secured basis and the Unsecured WMG Notes are guaranteed on an unsecured senior basis. These guarantees are full, unconditional, joint and several. The following condensed consolidating financial statements are also presented for the information of the holders of the Acquisition Corp. Notes and present the results of operations, financial position and cash flows of (i) Acquisition Corp., which is the issuer of the Acquisition Corp. Notes, (ii) the guarantor subsidiaries of Acquisition Corp., (iii) the non-guarantor subsidiaries of Acquisition Corp. and (iv) the eliminations necessary to arrive at the information for Acquisition Corp. on a consolidated basis. Investments in consolidated subsidiaries are presented under the equity method of accounting. There are no restrictions on Acquisition Corp.'s ability to obtain funds from any of its wholly owned subsidiaries through dividends, loans or advances.

The Company and Holdings are holding companies that conduct substantially all of their business operations through Acquisition Corp. Accordingly, the ability of the Company and Holdings to obtain funds from their subsidiaries is restricted by the indentures for the Existing Secured Notes, the Secured WMG Notes, the Unsecured WMG Notes and the Acquisition Corp. Revolving Credit Facility, and, with respect to the Company, the indenture for the Holdings Notes.



**Table of Contents****WARNER MUSIC GROUP CORP.****Supplementary Information****Consolidating Balance Sheet (Unaudited)****March 31, 2012**

	WMG Acquisition Corp. (issuer)	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	WMG Acquisition Corp. Consolidated (in millions)	WMG Holdings Corp. (issuer)	Warner Music Group Corp.	Eliminations	Warner Music Group Corp. Consolidated
<b>Assets:</b>									
Current assets:									
Cash and equivalents	\$ 44	\$ 75	\$ 143	\$	\$ 262	\$ 10	\$	\$	\$ 272
Accounts receivable, net		147	159		306				306
Inventories		10	17		27				27
Royalty advances expected to be recouped within one year		75	54		129				129
Deferred tax assets		38	16		54				54
Other current assets		5	45		50				50
<b>Total current assets</b>	<b>44</b>	<b>350</b>	<b>434</b>		<b>828</b>	<b>10</b>			<b>838</b>
Royalty advances expected to be recouped after one year		92	66		158				158
Investments in and advances to (from) consolidated subsidiaries	3,288	641		(3,929)		1,061	1,311	(2,372)	
Property, plant and equipment, net		128	44		172				172
Goodwill		1,371	5		1,376				1,376
Intangible assets subject to amortization, net		1,119	1,469		2,588				2,588
Intangible assets not subject to amortization		92	10		102				102
Due (to) from parent companies	(1,319)	(2,025)	(649)	3,916	(77)	393	(316)		
Other assets	37	14	12		63	7			70
<b>Total assets</b>	<b>\$ 2,050</b>	<b>\$ 1,782</b>	<b>\$ 1,391</b>	<b>\$ (13)</b>	<b>\$ 5,210</b>	<b>\$ 1,471</b>	<b>\$ 995</b>	<b>\$ (2,372)</b>	<b>\$ 5,304</b>

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	WMG Acquisition Corp. (issuer)	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	WMG Acquisition Corp. Consolidated (in millions)	WMG Holdings Corp. (issuer)	Warner Music Group Corp.	Eliminations	Warner Music Group Corp. Consolidated
<b>Liabilities and (Deficit)</b>									
<b>Equity:</b>									
Current liabilities:									
Accounts payable	\$	\$ 85	\$ 58	\$	\$ 143	\$	\$	\$	\$ 143
Accrued royalties		615	389		1,004				1,004
Accrued liabilities		84	118		202				202
Accrued interest	79				79	10			89
Deferred revenue		39	63		102				102
Other current liabilities		3			3				3
<b>Total current liabilities</b>	<b>79</b>	<b>826</b>	<b>628</b>		<b>1,533</b>	<b>10</b>			<b>1,543</b>
Long-term debt	2,062				2,062	150			2,212
Deferred tax liabilities		169	232		401				401
Other noncurrent liabilities	12	46	71	7	136				136
<b>Total liabilities</b>	<b>2,153</b>	<b>1,041</b>	<b>931</b>	<b>7</b>	<b>4,132</b>	<b>160</b>			<b>4,292</b>