# 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, 2010**

**OR**

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

**Commission File Number 333-121322**

# WMG Acquisition Corp.

**(Exact name of Registrant as specified in its charter)**

| **Delaware** | **68-0576630** |
|---|---|
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |

**75 Rockefeller Plaza**
**New York, NY 10019**
**(Address of principal executive offices)**

**(212) 275-2000**
**(Registrant's telephone number, including area code)**

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

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

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

| | | | |
|---|---|---|---|
| Large accelerated filer | ☐ | Accelerated filer | ☐ |
| Non-accelerated filer | ☒ (Do not check if a smaller reporting company) | Smaller reporting company | ☐ |

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

As of May 4, 2010, 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 indirectly owned by Warner Music Group Corp.

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**WMG ACQUISITION CORP.**

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ITEM 1. FINANCIAL STATEMENTS

## WMG Acquisition Corp.

## Consolidated Balance Sheets (Unaudited)

| | March 31, 2010 | September 30, 2009 |
|---|---|---|
| | (in millions) | |
| **Assets** | | |
| Current assets: | | |
| Cash and equivalents | $ 195 | $ 196 |
| Accounts receivable, less allowances of $107 and $135 million | 406 | 550 |
| Inventories | 38 | 46 |
| Royalty advances expected to be recouped within one year | 157 | 171 |
| Deferred tax assets | 29 | 29 |
| Other current assets | 53 | 48 |
| Total current assets | 878 | 1,040 |
| Royalty advances expected to be recouped after one year | 192 | 209 |
| Investments | 9 | 18 |
| Property, plant and equipment, net | 95 | 100 |
| Goodwill | 1,026 | 1,027 |
| Intangible assets subject to amortization, net | 1,203 | 1,317 |
| Intangible assets not subject to amortization | 100 | 100 |
| Other assets | 61 | 64 |
| Total assets | $ 3,564 | $ 3,875 |
| **Liabilities and Deficit** | | |
| Current liabilities: | | |
| Accounts payable | $ 160 | $ 219 |
| Accrued royalties | 1,103 | 1,185 |
| Accrued liabilities | 216 | 282 |
| Accrued interest | 52 | 57 |
| Deferred revenue | 82 | 113 |
| Other current liabilities | 3 | 14 |
| Total current liabilities | 1,616 | 1,870 |
| Long-term debt | 1,676 | 1,686 |
| Deferred tax liabilities | 159 | 164 |
| Other noncurrent liabilities | 155 | 177 |
| Total liabilities | 3,606 | 3,897 |
| **Commitments and Contingencies** (See Note 10) | | |
| Shareholder’s equity (deficit): | | |
| Common stock | — | — |
| Additional paid-in capital | 137 | 132 |
| Accumulated deficit | (285) | (255) |
| Accumulated other comprehensive income, net | 51 | 42 |
| Total WMG Acquisition Corp. shareholder’s equity (deficit) | (97) | (81) |
| Noncontrolling interest | 55 | 59 |
| Total equity (deficit) | (42) | (22) |
| Total liabilities and deficit | $ 3,564 | $ 3,875 |

See accompanying notes.

**WMG Acquisition Corp.**

**Consolidated Statements of Operations (Unaudited)**

| | Three Months Ended March 31, | | Six Months Ended March 31, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (in millions, except per share data) | | | |
| Revenues | $ 662 | $ 671 | $ 1,580 | $ 1,558 |
| Costs and expenses: | | | | |
| Cost of revenues | (323) | (341) | (834) | (834) |
| Selling, general and administrative expenses (a) | (261) | (259) | (565) | (554) |
| Amortization of intangible assets | (54) | (56) | (110) | (114) |
| Total costs and expenses | (638) | (656) | (1,509) | (1,502) |
| Operating income | 24 | 15 | 71 | 56 |
| Interest expense, net | (40) | (35) | (85) | (74) |
| Gain on sale of equity-method investment | — | — | — | 36 |
| Gain on foreign exchange transaction | — | — | — | 9 |
| Impairment of cost-method investment | — | (29) | — | (29) |
| Impairment of equity-method investment | — | — | — | (10) |
| Other expense, net | (4) | (3) | (3) | (3) |
| Loss before income taxes | (20) | (52) | (17) | (15) |
| Income tax expense | (2) | (10) | (15) | (26) |
| Net loss | (22) | (62) | (32) | (41) |
| Less: loss attributable to noncontrolling interest | 3 | — | 2 | 7 |
| Net loss attributable to WMG Acquisition Corp. | $ (19) | $ (62) | $ (30) | $ (34) |
| (a) Includes depreciation expense of: | $ (9) | $ (9) | $ (18) | $ (17) |

See accompanying notes.

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**WMG Acquisition Corp.**

**Consolidated Statements of Cash Flows (Unaudited)**

| | Six Months Ended March 31, 2010 | Six Months Ended March 31, 2009 |
|---|---|---|
| | (in millions) | |
| **Cash flows from operating activities** | | |
| Net loss | $ (32) | $ (41) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation and amortization | 128 | 131 |
| Deferred taxes | (6) | (3) |
| Gain on sale of equity investment | — | (36) |
| Gain on foreign exchange transaction | — | (9) |
| Impairment of equity investment | — | 10 |
| Impairment of cost-method investment | 1 | 29 |
| Non-cash interest expense | 9 | 11 |
| Non-cash stock-based compensation expense | 5 | 5 |
| Other non-cash items | 1 | (1) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 136 | 166 |
| Inventories | 6 | 2 |
| Royalty advances | 4 | (18) |
| Accounts payable and accrued liabilities | (191) | (49) |
| Accrued interest | (5) | (2) |
| Other balance sheet changes | (5) | (8) |
| Net cash provided by operating activities | 51 | 187 |
| **Cash flows from investing activities** | | |
| Repayments of loans to third parties | — | 3 |
| Investments and acquisitions of businesses | (6) | (14) |
| Acquisition of publishing rights | (29) | (6) |
| Proceeds from the sale of investments | 9 | 124 |
| Capital expenditures | (15) | (9) |
| Net cash (used in) provided by investing activities | (41) | 98 |
| **Cash flows from financing activities** | | |
| Debt repayments | — | (8) |
| Distribution to noncontrolling interest holder | (2) | — |
| Net cash used in financing activities | (2) | (8) |
| Effect of foreign currency exchange rate changes on cash | (9) | (30) |
| Net (decrease) increase in cash and equivalents | (1) | 247 |
| Cash and equivalents at beginning of period | 196 | 313 |
| Cash and equivalents at end of period | $ 195 | $ 560 |

See accompanying notes.

**WMG Acquisition Corp.**

**Consolidated Statement of Equity (Deficit) (Unaudited)**

| | Additional Paid-in Capital | Accumulated Deficit | Accumulated Other Comprehensive Income | Total WMG Acquisition Corp. Shareholder's Deficit | Noncontrolling Interests | Total Equity (Deficit) |
|---|---|---|---|---|---|---|
| | (in millions) | | | | | |
| Balance at September 30, 2009 | $ 132 | $ (255) | $ 42 | $ (81) | $ 59 | $ (22) |
| Comprehensive loss: | | | | | | |
| Net loss | — | (30) | — | (30) | (2) | (32) |
| Foreign currency translation adjustment | — | — | 8 | 8 | — | 8 |
| Minimum pension liability | — | — | — | — | — | — |
| Deferred gains on derivative financial instruments | — | — | 1 | 1 | — | 1 |
| Other | — | — | — | — | (2) | (2) |
| Total comprehensive loss | — | — | — | (21) | (4) | (25) |
| Stock based compensation | 5 | — | — | 5 | — | 5 |
| Balance at March 31, 2010 | $ 137 | $ (285) | $ 51 | $ (97) | $ 55 | $ (42) |

See accompanying notes.

**WMG Acquisition Corp.**

**Notes to Consolidated Interim Financial Statements (Unaudited)**

**1. Description of Business**

WMG Acquisition Corp. (the “Company”) is a direct, wholly owned subsidiary of WMG Holdings Corp. (“Holdings”), which in turn, is a direct, wholly owned subsidiary of Warner Music Group Corp. (“Parent”). Parent, Holdings and the Company were formed by a private equity consortium of Investors (“Investor Group”), on November 21, 2003 to facilitate the acquisition. The Company is one of the world’s major music-based content companies and the successor to substantially all of the interests of the recorded music and music publishing businesses of Time Warner Inc (“Time Warner”). Effective March 1, 2004, the Company acquired such interests from Time Warner for approximately $2.6 billion (the “Acquisition”). The original Investor Group included affiliates of Thomas H. Lee Partners (“THL”), affiliates of Bain Capital Investors, LLC (“Bain”), affiliates of Providence Equity Partners, Inc. (“Providence”) and Music Capital Partners, L.P. (“Music Capital”). Music Capital’s partnership agreement required that the Music Capital partnership dissolve and commence winding up by the second anniversary of Parent’s May 2005 initial public offering. As a result, on May 7, 2007, Music Capital made a pro rata distribution of all shares of common stock of Parent held by it to its partners. The shares held by Music Capital had been subject to a stockholders agreement among Music Capital, THL, Bain and Providence and certain other parties. As a result of the distribution, the shares distributed by Music Capital ceased to be subject to the voting and other provisions of the stockholders agreement and Music Capital was no longer part of the Investor Group subject to the stockholders agreement.

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 is building 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 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.

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 countries, 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.

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

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. 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, HBO and Turner Music Publishing. In 2007, the Company entered the production music library business with the acquisition of Non-Stop Music and has more recently expanded its activities in this area through further acquisitions in both the U.S. and Europe. Production music is a complementary alternative to licensing standards and contemporary hits for television, film and advertising producers.

**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, 2010 are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2010.

The consolidated balance sheet at September 30, 2009 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, 2009 (File No. 333-121322).

**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 March 31, 2010 and 2009 relate to the three and six month periods ended March 26, 2010 and March 27, 2009, 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 deemed that no additional disclosures are necessary.

**New Accounting Pronouncements**

In December 2007, the Financial Accounting Standards Board ("FASB") revised the authoritative guidance for business combinations. The new guidance changes the accounting for business combinations in several areas including contingent consideration, acquisition-related costs, restructuring costs and deferred income taxes. Acquisition costs will generally be expensed as incurred. Restructuring costs associated with a business combination will generally be expensed subsequent to the acquisition date. Changes in deferred tax asset valuation allowances and uncertain tax positions after the acquisition date will generally impact income tax expense. The new guidance is effective for fiscal years beginning after December 15, 2008 on a prospective basis. The Company adopted the revised guidance as of October 1, 2009. The adoption of this guidance did not affect the Company's historical consolidated financial statements but it will change the Company's accounting treatment for business combinations on a prospective basis.

In December 2007, the FASB revised the authoritative guidance for accounting and reporting for the noncontrolling interest in a subsidiary (previously referred to as minority interest) and for the deconsolidation of a subsidiary. The new guidance requires the recognition of a noncontrolling interest as a component of equity in the consolidated financial statements as opposed to as a liability or mezzanine equity. The new guidance also changes the computation of net income of a consolidated group such that earnings attributed to the noncontrolling interest will no longer be deducted in determining net income. Instead, it must be separately presented on the face of the consolidated income statement. The carrying amount of the noncontrolling interest is adjusted to reflect the change in ownership interest, and any difference between the amount by which the noncontrolling interests are adjusted and the fair value of the consideration paid or received is recognized directly in equity attributable to the controlling interest (i.e., as additional paid in capital). Any transaction that results in the loss of control of a subsidiary is considered a remeasurement event with any retained interest remeasured at fair value. The gain or loss recognized in income includes both the realized gain or loss related to the portion of the ownership interest sold and the gain or loss on the remeasurement to fair value of the retained interest. FASB requires that the new guidance for noncontrolling interests and the new guidance on business combinations be adopted concurrently and thus, this guidance is also effective for fiscal years beginning after December 15, 2008. The Company adopted the provisions of this guidance effective October 1, 2009. This guidance changes the Company's accounting treatment of business combinations and dispositions with noncontrolling interests on a prospective basis, except for the presentation and disclosure requirements, which were applied on a retrospective basis. As of March 31, 2010 and September 30, 2009, noncontrolling interests of $55 million and $59 million have been classified as a component of equity in the consolidated balance sheet. Losses attributable to noncontrolling interests of $3 million and $2 million are included in net loss for the three and six months ended March 31, 2010. Losses attributable to noncontrolling interests of $7 million are included in net income for the six months ended March 31, 2009.

In June 2009, the FASB issued Statement No. 167, *Amendments to FASB Interpretation No. 46(R)* ("FAS 167"), 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. We have not completed our analysis of the impact of this new standard, if any, which will be adopted effective October 1, 2010.

**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 comprehensive loss, net of related taxes (in millions):

| | Three Months Ended March 31, 2010 | Three Months Ended March 31, 2009 | Six Months Ended March 31, 2010 | Six Months Ended March 31, 2009 |
|---|---|---|---|---|
| Net loss | $ (22) | $ (62) | $ (32) | $ (41) |
| Foreign currency translation adjustments (a) | 6 | (11) | 8 | 12 |
| Derivative financial instruments gains | 1 | 7 | 1 | 4 |
| Other | (1) | — | (2) | — |
| Comprehensive (loss) income | $ (16) | (66) | (25) | $ (25) |

(a) The foreign currency translation adjustments are not adjusted for income taxes as they relate to permanent investments in international subsidiaries.

**4. Investments**

The Company's investments consist of the following (in millions):

| | March 31, 2010 | September 30, 2009 |
|---|---|---|
| Cost-method investments | $ 3 | $ 13 |
| Equity-method investments | 6 | 5 |
| | $ 9 | $ 18 |

During the three months ended December 31, 2009, the Company sold its equity interest in lala media, inc. and terminated a memorandum of terms related to the formation of an international joint venture. The Company received cash consideration of approximately $9 million, which resulted in an immaterial gain.

**5. Inventories**

Inventories consist of the following (in millions):

| | March 31, 2010 | September 30, 2009 |
|---|---|---|
| Compact discs and other music-related products | $ 36 | $ 44 |
| Published sheet music and song books | 2 | 2 |
| | $ 38 | $ 46 |

## 6. Goodwill and Intangible Assets

### Goodwill

The following analysis details the changes in goodwill for each reportable segment during the six months ended March 31, 2010 (in millions):

| | Recorded Music | Music Publishing | Total |
|---|---|---|---|
| **Balance at September 30, 2009** | **$ 436** | **$ 591** | **$1,027** |
| Acquisitions | — | 7 | 7 |
| Dispositions | — | — | — |
| Other (a) | (8) | — | (8) |
| **Balance at March 31, 2010** | **$ 428** | **$ 598** | **$1,026** |

(a) Other represents foreign currency translation adjustments.

### Other Intangible Assets

Other intangible assets consist of the following (in millions):

| | September 30, 2009 | Acquisitions | Other (a) | March 31, 2010 |
|---|---|---|---|---|
| Intangible assets subject to amortization: | | | | |
| Recorded music catalog | $ 1,379 | — | (6) | $ 1,373 |
| Music publishing copyrights | 952 | 31 | (28) | 955 |
| Artist contracts | 80 | — | (1) | 79 |
| Trademarks | 31 | — | — | 31 |
| Other intangible assets | 8 | — | — | 8 |
| | 2,450 | 31 | (35) | 2,446 |
| Accumulated amortization | (1,133) | | | (1,243) |
| Total net intangible assets subject to amortization | 1,317 | | | 1,203 |
| Intangible assets not subject to amortization: | | | | |
| Trademarks and brands | 100 | | | 100 |
| Total net other intangible assets | $ 1,417 | | | $ 1,303 |

(a) Other represents foreign currency translation adjustments.

## 7. Restructuring Costs

### Acquisition-Related Restructuring Costs

In connection with the Acquisition that was effective as of March 1, 2004, 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 Acquisition. As of March 31, 2010, the Company had approximately $9 million of liabilities outstanding primarily related to long-term lease obligations for vacated facilities, which are expected to be settled by 2019 and $71 million of liabilities outstanding primarily related to revaluations of artist and other contracts.

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**8. Debt**

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

| | March 31, 2010 | September 30, 2009 |
|---|---|---|
| 9.5% Senior Secured Notes due 2016 (a) | $ 1,063 | $ 1,060 |
| 7.375% U.S. dollar-denominated Senior Subordinated Notes due 2014 | 465 | 465 |
| 8.125% Sterling-denominated Senior Subordinated Notes due 2014 (b) | 148 | 161 |
| Total debt | $ 1,676 | $ 1,686 |

(a) 9.5% Senior Secured Notes due 2016; face amount of $1.1 billion less unamortized discount of $37 million at March 31, 2010 and $40 million at September 30, 2009.

(b) Change represents the impact of foreign currency exchange rates on the carrying value of the £100 million Sterling-denominated notes.

**9. Stock-based Compensation**

The following table represents the expense recorded by the Company with respect to its stock-based awards for the three and six months ended March 31, 2010 and 2009 (in millions):

| | Three Months Ended March 31, 2010 | Three Months Ended March 31, 2009 | Six Months Ended March 31, 2010 | Six Months Ended March 31, 2009 |
|---|---|---|---|---|
| Recorded Music | $ 1 | $ 2 | $ 3 | $ 3 |
| Music Publishing | — | — | — | — |
| Corporate expenses | 1 | 1 | 2 | 2 |
| Total | $ 2 | $ 3 | $ 5 | $ 5 |

During the six months ended March 31, 2010, Parent awarded 35,309 shares of restricted stock and 185,000 stock options to its employees. During the six months ended March 31, 2009, the Company awarded 554,700 shares of restricted stock and 1,870,000 stock options to its employees.

**10. 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. The Company intends to defend against these lawsuits, including the appeal, 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.

**11. 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 14.

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.

**12. 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, 2009. The Company accounts for intersegment sales at fair value as if the sales were to third parties. While intercompany 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):

| Three Months Ended | Recorded music | Music publishing | Corporate expenses and eliminations | Total |
|---|---|---|---|---|
| **March 31, 2010** | | | | |
| Revenues | $ 534 | $ 134 | $ (6) | $ 662 |
| OIBDA | 49 | 61 | (23) | 87 |
| Depreciation of property, plant and equipment | (6) | (1) | (2) | (9) |
| Amortization of intangible assets | (37) | (17) | — | (54) |
| Operating income (loss) | $ 6 | $ 43 | $ (25) | $ 24 |
| **March 31, 2009** | | | | |
| Revenues | $ 539 | $ 136 | $ (4) | $ 671 |
| OIBDA | 45 | 55 | (20) | 80 |
| Depreciation of property, plant and equipment | (5) | (1) | (3) | (9) |
| Amortization of intangible assets | (38) | (17) | (1) | (56) |
| Operating income (loss) | $ 2 | $ 37 | $ (24) | $ 15 |

| Six Months Ended | Recorded music | Music publishing | Corporate expenses and eliminations | Total |
|---|---|---|---|---|
| **March 31, 2010** | | | | |
| Revenues | $ 1,317 | $ 275 | $ (12) | $1,580 |
| OIBDA | 162 | 83 | (46) | 199 |
| Depreciation of property, plant and equipment | (12) | (2) | (4) | (18) |
| Amortization of intangible assets | (76) | (34) | — | (110) |
| Operating income (loss) | $ 74 | $ 47 | $ (50) | $ 71 |
| **March 31, 2009** | | | | |
| Revenues | $ 1,296 | $ 271 | $ (9) | $1,558 |
| OIBDA | 152 | 77 | (42) | 187 |
| Depreciation of property, plant and equipment | (10) | (2) | (5) | (17) |
| Amortization of intangible assets | (81) | (32) | (1) | (114) |
| Operating income (loss) | $ 61 | $ 43 | $ (48) | $ 56 |

## 13. Additional Financial Information

### Cash Interest and Taxes

The Company made interest payments of approximately $81 million and $66 million during the six months ended March 31, 2010 and 2009, respectively. The Company previously made quarterly interest payments under its senior secured credit facility which was retired in May 2009. The Company now pays interest only semi-annually in the first and third quarters of the fiscal year. The Company paid approximately $21 million and $26 million of income and withholding taxes in the six months ended March 31, 2010 and 2009, respectively. The Company received $6 million and $9 million of income tax refunds in the six months ended March 31, 2010 and 2009, respectively.

## 14. 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, 2010. Derivatives not designated as hedging instruments primarily represent the balances below and the gains and losses on these financial instruments are included as other expenses of $14 million and royalty expense of $1 million in the statement of operations. Derivatives designated as hedging instruments are not material to the Company's financial statements.

| | Fair Value Measurements as of March 31, 2010 | | | |
|---|---|---|---|---|
| | (Level 1) | (Level 2) | (Level 3) | Total |
| | (in millions) | | | |
| *Other Current Assets:* | | | | |
| Foreign Currency Forward Exchange Contracts (a) | $ — | $ 20 | $ — | $ 20 |
| *Other Current Liabilities:* | | | | |
| Foreign Currency Forward Exchange Contracts (a) | $ — | $ (7) | $ — | $ (7) |
| *Other Non-Current Liabilities:* | | | | |
| Purchase Obligation (b) | $ — | $ — | $ (6) | $ (6) |

(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.

(b) The fair value of this purchase obligation is based on a discounted cash flow ("DCF") approach and it is adjusted to fair value on an annual basis. The assumptions used in preparing the DCF model were based on data available as of September 30, 2009 and includes estimates of timing of the payment obligation, amount of cash flows, and discount rate.

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 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 March 31, 2010, the fair value of the Company's fixed-rate debt exceeded the carrying value by approximately $99 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.

**WMG ACQUISITION CORP.**

**Supplementary Information**
**Consolidating Financial Statements**

The Company is one of the world's major music-based content companies and the successor to substantially all of the interests of the recorded music and music publishing businesses of Time Warner.

The Company has issued $1.1 billion principal amount of 9.50% Senior Secured Notes due 2016, $465 million principal amount of 7.375% Senior Subordinated Notes due 2014 and £100 million sterling principal amount of 8.125% Senior Subordinated notes due 2014 (together, the "Notes"). The Notes are guaranteed by all of the Company's domestic wholly owned subsidiaries. The Senior Secured Notes are guaranteed on a senior secured basis and the Senior Subordinated Notes are guaranteed on an unsecured senior subordinated basis. These guarantees are full, unconditional, joint and several. The following condensed consolidating financial statements are presented for the information of the holders of the Notes and present the results of operations, financial position and cash flows of (i) the Company, which is the issuer of the Notes, (ii) the guarantor subsidiaries of the Company, (iii) the non-guarantor subsidiaries of the Company 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. There are no restrictions on the Company's ability to obtain funds from any of its wholly owned subsidiaries through dividends, loans or advances.

**WMG ACQUISITION CORP.**

**Supplementary Information**
**Condensed Consolidating Balance Sheet**
**For the Period Ended March 31, 2010**

| | WMG Acquisition Corp. | Guarantor Subsidiaries | Non-Guarantor Subsidiares | Eliminations | WMG Acquisition Corp. Consolidated |
|---|---|---|---|---|---|
| | | | (in millions) | | |
| **Assets:** | | | | | |
| Current assets: | | | | | |
| Cash and equivalents | — | 78 | 117 | — | 195 |
| Accounts receivable, net | | 204 | 202 | — | 406 |
| Due (to) from parent companies | (845) | 918 | (72) | (1) | — |
| Inventories | — | 13 | 25 | | 38 |
| Royalty advances expected to be recouped within one year | — | 95 | 62 | — | 157 |
| Deferred tax asset | — | — | 29 | — | 29 |
| Other current assets | 15 | 8 | 30 | — | 53 |
| Total current assets | (830) | 1,316 | 393 | (1) | 878 |
| Royalty advances expected to be recouped after one year | — | 116 | 76 | — | 192 |
| Investments in and advances to (from) consolidated subsidiaries | 2,530 | 833 | — | (3,363) | — |
| Investments | | 5 | 4 | | 9 |
| Property, plant, and equipment, net | — | 64 | 31 | — | 95 |
| Goodwill | — | 351 | 675 | — | 1,026 |
| Intangible assets subject to amortization, net | — | 676 | 527 | — | 1,203 |
| Intangible assets not subject to amortization | — | 90 | 10 | — | 100 |
| Other assets | 33 | 15 | 11 | 2 | 61 |
| Total assets | 1,733 | 3,466 | 1,727 | (3,362) | 3,564 |
| **Liabilities and (Deficit) Equity** | | | | | |
| Current liabilities: | | | | | |
| Accounts payable | — | 92 | 68 | — | 160 |
| Accrued royalties | — | 701 | 402 | — | 1,103 |
| Accrued liabilities | 7 | 81 | 128 | — | 216 |
| Accrued interest | 52 | — | — | — | 52 |
| Deferred revenue | — | 20 | 62 | — | 82 |
| Other current liabilities | — | — | 3 | — | 3 |
| Total current liabilities | 59 | 894 | 663 | — | 1,616 |
| Long-term debt | 1,676 | — | | — | 1,676 |
| Deferred tax liabilities, net | — | 51 | 108 | — | 159 |
| Other non-current liabilities | 6 | 103 | 45 | 1 | 155 |
| Total liabilities | 1,741 | 1,048 | 816 | 1 | 3,606 |
| Total WMG Acquisition Corp. shareholder's (deficit) equity | (8) | 2,418 | 856 | (3,363) | (97) |
| Non controlling interest | — | — | 55 | — | 55 |
| Total (deficit) equity | (8) | 2,418 | 911 | (3,363) | (42) |
| **Total liabilities and (deficit) equity** | 1,733 | 3,466 | 1,727 | (3,362) | 3,564 |

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**WMG ACQUISITION CORP.**

**Supplementary Information**
**Consolidating Balance Sheet (Unaudited)**
**September 30, 2009**

| | WMG Acquisition Corp. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | WMG Acquisition Corp. Consolidated |
|---|---|---|---|---|---|
| | | | (in millions) | | |
| **Assets:** | | | | | |
| Current assets: | | | | | |
| Cash and equivalents | $ — | $ 59 | $ 137 | $ — | $ 196 |
| Accounts receivable, net | — | 241 | 309 | — | 550 |
| Due (to) from parent companies | (761) | 819 | (56) | (2) | — |
| Inventories | — | 16 | 30 | — | 46 |
| Royalty advances expected to be recouped within one year | — | 101 | 70 | — | 171 |
| Deferred tax assets | — | — | 29 | — | 29 |
| Other current assets | — | 12 | 36 | — | 48 |
| Total current assets | (761) | 1,248 | 555 | (2) | 1,040 |
| Royalty advances expected to be recouped after one year | — | 124 | 85 | — | 209 |
| Investments in and advances to (from) consolidated subsidiaries | 2,527 | 861 | — | (3,388) | — |
| Investments | — | 15 | 3 | — | 18 |
| Property, plant and equipment, net | — | 68 | 32 | — | 100 |
| Goodwill | — | 351 | 676 | — | 1,027 |
| Intangible assets subject to amortization, net | — | 723 | 594 | — | 1,317 |
| Intangible assets not subject to amortization | — | 90 | 10 | — | 100 |
| Other assets | 35 | 17 | 12 | — | 64 |
| Total assets | $ 1,801 | $ 3,497 | $ 1,967 | $ (3,390) | $ 3,875 |
| **Liabilities and (Deficit) Equity** | | | | | |
| Current liabilities: | | | | | |
| Accounts payable | $ — | $ 126 | $ 93 | $ — | $ 219 |
| Accrued royalties | — | 716 | 469 | — | 1,185 |
| Accrued liabilities | 11 | 124 | 147 | — | 282 |
| Accrued interest | 57 | — | — | — | 57 |
| Deferred revenue | — | 14 | 99 | — | 113 |
| Other current liabilities | — | — | 14 | | 14 |
| Total current liabilities | 68 | 980 | 822 | — | 1,870 |
| Long-term debt | 1,686 | — | — | — | 1,686 |
| Deferred tax liabilities, net | — | 51 | 113 | — | 164 |
| Other noncurrent liabilities | — | 116 | 55 | 6 | 177 |
| Total liabilities | 1,754 | 1,147 | 990 | 6 | 3,897 |
| Total WMG Acquisition Corp. shareholder's equity (deficit) | 47 | 2,350 | 918 | (3,396) | (81) |
| Noncontrolling interest | — | — | 59 | — | 59 |
| Total equity (deficit) | 47 | 2,350 | 977 | (3,396) | (22) |
| Total liabilities and equity (deficit) | $ 1,801 | $ 3,497 | $ 1,967 | $ (3,390) | $ 3,875 |

**WMG ACQUISITION CORP.**

**Supplementary Information**
**Consolidating Statements of Operations (Unaudited)**
**For The Three Months Ended March 31, 2010 and 2009**

| | Three months ended March 31, 2010 | | | | |
|---|---|---|---|---|---|
| | WMG Acquisition Corp. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | WMG Acquisition Corp. Consolidated |
| | | | (in millions) | | |
| Revenue | — | 339 | 378 | (55) | 662 |
| Costs and expenses: | | | | | |
| Cost of revenues | — | (169) | (207) | 53 | (323) |
| Selling, general and administrative expenses | — | (95) | (166) | — | (261) |
| Amortization of intangible assets | — | (33) | (21) | — | (54) |
| Total costs and expenses | — | (297) | (394) | 53 | (638) |
| Operating income (loss) | — | 42 | (16) | (2) | 24 |
| Interest expense, net | (36) | (3) | (1) | — | (40) |
| Equity gains (losses) from consolidated subsidiaries | 17 | (14) | — | (3) | — |
| Other expense, net | — | (2) | (2) | — | (4) |
| (Loss) income before income taxes | (19) | 23 | (19) | (5) | (20) |
| Income tax expense | (2) | (2) | 1 | 1 | (2) |
| Net (loss) income | (21) | 21 | (18) | (4) | (22) |
| Less: loss attributable to noncontrolling interest | — | — | 3 | — | 3 |
| Net (loss) income attributable to WMG Acquisition Corp. | (21) | 21 | (15) | (4) | (19) |

| | Three months ended March 31, 2009 | | | | |
|---|---|---|---|---|---|
| | WMG Acquisition Corp. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | WMG Acquisition Corp. Consolidated |
| | | | (in millions) | | |
| Revenues | $ — | $ 343 | $ 379 | $ (51) | $ 671 |
| Costs and expenses: | | | | | |
| Cost of revenues | — | (203) | (188) | 50 | (341) |
| Selling, general and administrative expenses | — | (116) | (145) | 2 | (259) |
| Amortization of intangible assets | — | (35) | (21) | — | (56) |
| Total costs and expenses | — | (354) | (354) | 52 | (656) |
| Operating income | — | (11) | 25 | 1 | 15 |
| Interest expense, net | (29) | (5) | (1) | — | (35) |
| Equity (losses) gains from consolidated subsidiaries | (4) | 21 | — | (17) | — |
| Impairment of cost-method investment | — | (29) | — | — | (29) |
| Other (expense) income, net | (1) | — | (3) | 1 | (3) |
| (Loss) income before income taxes | (34) | (24) | 21 | (15) | (52) |
| Income tax expense | (10) | (10) | 3 | 7 | (10) |
| Net (loss) income | (44) | (34) | 24 | (8) | (62) |
| Less: loss attributable to noncontrolling interest | — | — | — | — | — |
| Net (loss) income attributable to WMG Acquisition Corp. | $ (44) | $ (34) | $ 24 | $ (8) | $ (62) |

**WMG ACQUISITION CORP.**

**Supplementary Information**
**Consolidating Statements of Operations (Unaudited)**
**For The Six Months Ended March 31, 2010 and 2009**

| | Six months ended March 31, 2010 | | | | |
|---|---|---|---|---|---|
| | WMG Acquisition Corp. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | WMG Acquisition Corp. Consolidated |
| Revenue | — | 693 | 1,000 | (113) | 1,580 |
| Costs and expenses: | | | | | |
| Cost of revenues | — | (350) | (588) | 104 | (834) |
| Selling, general and administrative expenses | — | (205) | (363) | 3 | (565) |
| Other income | — | | | | — |
| Amortization of intangible assets | — | (65) | (45) | — | (110) |
| Total costs and expenses | — | (620) | (996) | 107 | (1,509) |
| Operating income (loss) | — | 73 | 4 | (6) | 71 |
| Interest expense, net | (74) | (8) | (3) | — | (85) |
| Equity gains (losses) from consolidated subsidiaries | 62 | (6) | — | (56) | — |
| Other income (expense), net | 1 | (2) | (2) | — | (3) |
| (Loss) income before income taxes | (11) | 57 | (1) | (62) | (17) |
| Income tax expense | (15) | (16) | (7) | 23 | (15) |
| Net (loss) income | (26) | 41 | (8) | (39) | (32) |
| Less: loss attributable to noncontrolling interest | — | — | 2 | — | 2 |
| Net (loss) income attributable to WMG Acquisition Corp. | (26) | 41 | (6) | (39) | (30) |

| | Six months ended March 31, 2009 | | | | |
|---|---|---|---|---|---|
| | WMG Acquisition Corp. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries (in millions) | Eliminations | WMG Acquisition Corp. Consolidated |
| Revenues | $ — | $ 670 | $ 954 | $ (66) | $ 1,558 |
| Costs and expenses: | | | | | |
| Cost of revenues | — | (391) | (508) | 65 | (834) |
| Selling, general and administrative expenses | — | (217) | (337) | — | (554) |
| Amortization of intangible assets | — | (69) | (45) | — | (114) |
| Total costs and expenses | — | (677) | (890) | 65 | (1,502) |
| Operating (loss) income | — | (7) | 64 | (1) | 56 |
| Interest expense, net | (63) | (10) | (1) | — | (74) |
| Equity gains (losses) from consolidated subsidiaries | 59 | 114 | — | (173) | — |
| Gain on sale of equity-method investment | — | (3) | 39 | — | 36 |
| Gain on foreign exchange transaction | — | 9 | — | — | 9 |
| Impairment of equity-method investment | — | (10) | — | — | (10) |
| Impairment of cost-method investment | — | (29) | — | — | (29) |
| Other (expense) income, net | (1) | (1) | (1) | — | (3) |
| (Loss) income before income taxes | (5) | 63 | 101 | (174) | (15) |
| Income tax expense | (26) | (29) | (13) | 42 | (26) |
| Net (loss) income | (31) | 34 | 88 | (132) | (41) |
| Less: (income) loss attributable to noncontrolling interest | — | (1) | 8 | — | 7 |
| Net (loss) income attributable to WMG Acquisition Corp. | $ (31) | $ 33 | $ 96 | $ (132) | $ (34) |

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**WMG ACQUISITION CORP.**

**Supplementary Information**
**Consolidating Statement of Cash Flows (Unaudited)**
**For The Six Months Ended March 31, 2010**

| | WMG Acquisition Corp. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | WMG Acquisition Corp. Consolidated |
|---|---|---|---|---|---|
| | | | (in millions) | | |
| **Cash flows from operating activities:** | | | | | |
| Net (loss) income | (26) | 41 | (8) | (39) | (32) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | | | | |
| Impairment of cost-method investment | — | 1 | — | — | 1 |
| Depreciation and amortization | — | 78 | 50 | — | 128 |
| Deferred Taxes | — | — | (6) | | (6) |
| Non-cash interest expense | 5 | 4 | — | — | 9 |
| Non-cash, stock-based compensation expense | — | 5 | — | — | 5 |
| Other non-cash adjustments | — | 1 | — | — | 1 |
| Equity (income) loss from consolidated subsidiaries | (62) | 6 | — | 56 | — |
| Changes in operating assets and liabilities | | | | | |
| Accounts receivable | — | 38 | 98 | — | 136 |
| Inventories | — | 3 | 3 | — | 6 |
| Royalty advances | — | (1) | 5 | — | 4 |
| A/P and accrued liabilities | 102 | (142) | (134) | (17) | (191) |
| Accrued interest | (5) | — | — | — | (5) |
| Other balance sheet changes | (14) | 4 | 5 | — | (5) |
| Net cash used in operating activities | — | 38 | 13 | — | 51 |
| **Cash flows from investing activities:** | | | | | |
| Investments and acquisitions | — | — | (6) | — | (6) |
| Acquisition of publishing rights | — | (17) | (12) | — | (29) |
| Proceeds from sale of investments | — | 9 | — | | 9 |
| Capital Expenditures | — | (11) | (4) | — | (15) |
| Other | — | — | — | — | — |
| Net cash used in investing activities | — | (19) | (22) | — | (41) |
| **Cash flows from financing activities:** | | | | | |
| Distribution to noncontrolling interest holder | — | — | (2) | — | (2) |
| Net cash provided by financing activities | — | — | (2) | — | (2) |
| Effect of foreign exchange rates on cash | — | — | (9) | — | (9) |
| Net increase (decrease) in cash and equivalents | — | 19 | (20) | — | (1) |
| Cash and equivalents at beginning of period | — | 59 | 137 | — | 196 |
| Cash and equivalents at end of period | — | 78 | 117 | — | 195 |

**WMG ACQUISITION CORP.**

**Supplementary Information**
**Consolidating Statement of Cash Flows (Unaudited)**
**For The Six Months Ended March 31, 2009**

| | WMG Acquisition Corp. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | WMG Acquisition Corp. Consolidated |
|---|---|---|---|---|---|
| | | | (in millions) | | |
| **Cash flows from operating activities:** | | | | | |
| Net (loss) income | $ (31) | $ 34 | $ 88 | $ (132) | $ (41) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | | | | |
| Depreciation and amortization | — | 81 | 50 | — | 131 |
| Deferred taxes | — | — | (3) | — | (3) |
| Gain on sale of equity investment | — | 3 | (39) | — | (36) |
| Gain on foreign exchange transaction | — | (9) | — | — | (9) |
| Impairment of equity investment | — | 10 | — | — | 10 |
| Impairment of cost-method investment | — | 29 | — | — | 29 |
| Non-cash interest expense | 6 | 5 | — | — | 11 |
| Non-cash, stock-based compensation expense | — | 5 | — | — | 5 |
| Other non-cash items | (20) | (114) | 1 | 132 | (1) |
| Changes in operating assets and liabilities: | | | | | |
| Accounts receivable | — | 105 | 61 | — | 166 |
| Inventories | — | (1) | 3 | — | 2 |
| Royalty advances | — | (11) | (7) | — | (18) |
| Accounts payable and accrued liabilities | 54 | 62 | (165) | — | (49) |
| Accrued interest | (2) | — | — | — | (2) |
| Other balance sheet changes | 1 | 2 | (11) | — | (8) |
| Net cash provided by operating activities | 8 | 201 | (22) | — | 187 |
| **Cash flows from investing activities:** | | | | | |
| Repayment of loans by third parties | — | 3 | — | — | 3 |
| Investments and acquisitions of businesses | — | (8) | (6) | — | (14) |
| Acquisition of publishing rights | — | (3) | (3) | — | (6) |
| Proceeds from the sale of investments | — | 3 | 121 | — | 124 |
| Capital expenditures | — | (7) | (2) | — | (9) |
| Net cash provided by investing activities | — | (12) | 110 | — | 98 |
| **Cash flows from financing activities:** | | | | | |
| Debt repayments | (8) | — | — | — | (8) |
| (Decrease) increase in intercompany | — | — | — | — | — |
| Dividends paid | — | — | — | — | — |
| Net cash used in financing activities | (8) | — | — | — | (8) |
| Effect of foreign currency exchange rate changes on cash | — | — | (30) | — | (30) |
| Net increase in cash and equivalents | — | 189 | 58 | — | 247 |
| Cash and equivalents at beginning of period | — | 171 | 142 | — | 313 |
| Cash and equivalents at end of period | $ — | $ 360 | $ 200 | $ — | $ 560 |

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

You should read the following discussion of our results of operations and financial condition with the unaudited interim financial statements included elsewhere in this Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2010 (the "Quarterly Report").

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

### "SAFE HARBOR" STATEMENT UNDER PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

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

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

- the impact of our substantial leverage on our ability to raise additional capital to fund our operations, on our ability to react to changes in the economy or our industry and on our ability to meet our obligations under our indebtedness;
- the continued decline in the global recorded music industry and the rate of overall decline in the music industry;
- current uncertainty in global economic conditions could adversely affect our prospects and our results of operations;
- our ability to continue to identify, sign and retain desirable talent at manageable costs;
- the threat posed to our business by piracy of music by means of home CD-R activity, Internet peer-to-peer file-sharing and sideloading of unauthorized content;
- the significant threat posed to our business and the music industry by organized industrial piracy;
- the popular demand for particular recording artists and/or songwriters and albums and the timely completion of albums by major recording artists and/or songwriters;
- the diversity and quality of our portfolio of songwriters;
- the diversity and quality of our album releases;
- significant fluctuations in our results of operations and cash flows due to the nature of our business;
- our involvement in intellectual property litigation;
- the possible downward pressure on our pricing and profit margins;
- our ability to continue to enforce our intellectual property rights in digital environments;

- the ability to develop a successful business model applicable to a digital environment and to enter into expanded-rights deals with recording artists in order to broaden our revenue streams in growing segments of the music business;
- the impact of heightened and intensive competition in the recorded music and music publishing businesses and our inability to execute our business strategy;
- risks associated with our non-U.S. operations, including limited legal protections of our intellectual property rights and restrictions on the repatriation of capital;
- the impact of legitimate music distribution on the Internet or the introduction of other new music distribution formats;
- the reliance on a limited number of online music stores and their ability to significantly influence the pricing structure for online music stores;
- the impact of rate regulations on our Recorded Music and Music Publishing businesses;
- the impact of rates on other income streams that may be set by arbitration proceedings on our business;
- the impact an impairment in the carrying value of goodwill or other intangible and long-lived assets could have on our operating results and shareholder's deficit;
- risks associated with the fluctuations in foreign currency exchange rates;
- our ability and the ability of our joint venture partners to operate our existing joint ventures satisfactorily;
- the enactment of legislation limiting the terms by which an individual can be bound under a "personal services" contract;
- potential loss of catalog if it is determined that recording artists have a right to recapture recordings under the U.S. Copyright Act;
- changes in law and government regulations;
- trends that affect the end uses of our musical compositions (which include uses in broadcast radio and television, film and advertising businesses);
- the growth of other products that compete for the disposable income of consumers;
- risks inherent in relying on one supplier for manufacturing, packaging and distribution services in North America and Europe;
- risks inherent in our acquiring or investing in other businesses including our ability to successfully manage new businesses that we may acquire as we diversify revenue streams within the music industry;
- the fact that we have engaged in substantial restructuring activities in the past, and may need to implement further restructurings in the future and our restructuring efforts may not be successful;
- the fact that we are outsourcing certain back office functions, such as IT infrastructure and development and certain finance and accounting functions, which will make us more dependent upon third parties;
- that changes to our information technology infrastructure to harmonize our systems and processes may fail to operate as designed and intended;
- the possibility that our owners' interests will conflict with ours or yours;
- failure to attract and retain key personnel; and
- the effects associated with the formation of Live Nation Entertainment.

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

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

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## INTRODUCTION

WMG Acquisition Corp. (the “Company”) is one of the world’s major music-based content companies and the successor to substantially all of the interests of the recorded music and music publishing businesses of Time Warner Inc. (“Time Warner”). Effective March 1, 2004, the Company acquired such interests from Time Warner for approximately $2.6 billion (the “Acquisition”). The Company is a direct, wholly owned subsidiary of WMG Holdings Corp. (“Holdings”), which in turn, is a direct, wholly owned subsidiary of Warner Music Group Corp. (“Parent”). Parent, Holdings and the Company were formed by a private equity consortium of investors (the “Investor Group”) on November 21, 2003 to facilitate the Acquisition.

The terms “we,” “us,” “our,” “ours,” and the “Company” refer collectively to WMG Acquisition Corp. and its consolidated subsidiaries, except where otherwise indicated. Management’s discussion and analysis of results of operations and financial condition (“MD&A”) is provided as a supplement to the unaudited financial statements and footnotes included elsewhere herein to help provide an understanding of our financial condition, changes in financial condition and results of our operations. MD&A is organized as follows:

- *Overview.* This section provides a general description of our business, as well as recent developments that we believe are important in understanding our results of operations and financial condition and in anticipating future trends.
- *Results of operations.* This section provides an analysis of our results of operations for the three and six months ended March 31, 2010 and 2009. This analysis is presented on both a consolidated and segment basis.
- *Financial condition and liquidity.* This section provides an analysis of our cash flows for the six months ended March 31, 2010 and 2009, as well as a discussion of our financial condition and liquidity as of March 31, 2010. The discussion of our financial condition and liquidity includes (i) a summary of our debt agreements and (ii) a summary of our key debt compliance measures under our debt agreements.

### Use of OIBDA

We evaluate our operating performance based on several factors, including our primary financial measure of operating income (loss) before non-cash depreciation of tangible assets, non-cash amortization of intangible assets and non-cash impairment charges to reduce the carrying value of goodwill and intangible assets (which we refer to as “OIBDA”). We consider OIBDA to be an important indicator of the operational strengths and performance of our businesses, including the ability to provide cash flows to service debt. However, a limitation of the use of OIBDA as a performance measure is that it does not reflect the periodic costs of certain capitalized tangible and intangible assets used in generating revenues in our businesses. Accordingly, OIBDA should be considered in addition to, not as a substitute for, operating income, net income (loss) and other measures of financial performance reported in accordance with U.S. GAAP. In addition, our definition of OIBDA may differ from similarly titled measures used by other companies. A reconciliation of consolidated historical OIBDA to operating income and net income (loss) is provided in our “Results of Operations.”

### Use of Constant Currency

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

## OVERVIEW

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

*Recorded Music Operations*

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

We are also diversifying our revenues beyond our traditional businesses by entering into expanded-rights deals with recording artists in order to partner with artists in other areas of their careers. Under these agreements, we provide services to and participate in artists’ activities outside the traditional recorded music business. We are building artist services capabilities and platforms for

exploiting this broader set of music-related rights and participating more broadly in the monetization of the artist brands we help create. In developing our artist services business, we have both built and expanded in-house capabilities and expertise and have acquired a number of existing artist services companies involved in artist management, merchandising, strategic marketing and brand management, ticketing, concert promotion, fan club, original programming and video entertainment. We believe that entering into expanded-rights deals and enhancing our artist services capabilities will permit us to diversify revenue streams to better capitalize on the growth areas of the music industry and permit us to build stronger, long-term relationships with artists and more effectively connect artists and fans.

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

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

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

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

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

Recorded Music revenues are derived from three main sources:

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

- *Digital*: the rightsholder receives revenues with respect to online and mobile downloads, mobile ringtones and online and mobile streaming; and
- *Licensing:* the rightsholder receives royalties or fees for the right to use the sound recording in combination with visual images such as in films or television programs, television commercials and videogames.

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

- *Royalty costs and artist and repertoire costs*—the costs associated with (i) paying royalties to artists, producers, songwriters, other copyright holders and trade unions, (ii) signing and developing artists, (iii) creating master recordings in the studio and (iv) creating artwork for album covers and liner notes;
- *Product costs*—the costs to manufacture, package and distribute product to wholesale and retail distribution outlets as well as those principal costs related to expanded rights;
- *Selling and marketing costs*—the costs associated with the promotion and marketing of artists and recorded music products, including costs to produce music videos for promotional purposes and artist tour support; and
- *General and administrative costs*—the costs associated with general overhead and other administrative costs.

*Music Publishing Operations*

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

Our Music Publishing operations include Warner/Chappell, our global Music Publishing company headquartered in New York with operations in over 50 countries through various subsidiaries, affiliates and non-affiliated licensees. We own or control 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, our 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. 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, HBO and Turner Music Publishing. In 2007, we entered the production music library business with the acquisition of Non-Stop Music and have more recently expanded our activities in this area through further acquisitions in both the U.S. and Europe. Production music is a complementary alternative to licensing standards and contemporary hits for television, film and advertising producers.

Publishing revenues are derived from five main sources:

- *Mechanical:* the licensor receives royalties with respect to compositions embodied in recordings sold in any physical format or configuration (*e.g.*, CDs and DVDs);
- *Performance:* the licensor receives royalties if the composition is performed publicly through broadcast of music on television, radio, cable and satellite, live performance at a concert or other venue (*e.g.*, arena concerts, nightclubs), online and wireless streaming and performance of music in staged theatrical productions;
- *Synchronization:* the licensor receives royalties or fees for the right to use the composition in combination with visual images such as in films or television programs, television commercials and videogames as well as from other uses such as in toys or novelty items and merchandise;
- *Digital:* the licensor receives royalties or fees with respect to online and mobile downloads, mobile ringtones and online and mobile streaming; and
- *Other:* the licensor receives royalties for use in sheet music.

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

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

**Factors Affecting Results of Operations and Financial Condition**

*Market Factors*

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

*Current Economic Conditions*

Ongoing uncertainty in global economic conditions poses a risk to the overall economy, which could continue to negatively affect demand for our products and other related matters. While the music industry has been relatively resilient in prior financial downturns as its products are low priced relative to other entertainment goods, we have been negatively impacted by these global economic conditions, which have resulted in significant recessionary pressures and lower consumer confidence and lower retail sales in general. The current uncertainty in global economic conditions makes it particularly difficult to predict product demand and other related matters and makes it more likely that our actual results could differ materially from our expectations. Even in the midst of the global economic slowdown, we remain committed to executing on our strategic initiatives and plan to continue our transformation to adapt to the changing music industry in order to maximize cash flow and profitability. We expect to adapt to the impact of the economic slowdown with a particular focus on cash and liquidity. We will monitor current events closely and take advantage of our flexible cost structure to minimize any impact.

**Expanding Business Models to Offset Declines in Physical Sales**

*Digital Sales*

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

*Expanded-Rights Deals*

We have also been seeking to expand our relationships with recording artists as another means to offset declines in physical revenues in Recorded Music. For example, we have been signing recording artists to expanded-rights deals for the last several years. Under these expanded-rights deals, we participate in the recording artist’s revenue streams, other than from recorded music sales, such as live performances, merchandising and sponsorships. We believe that additional revenue from these revenue streams will help to offset declines in physical revenue over time. As we have generally signed newer artists to these deals, increased non-traditional revenue from these deals is expected to come several years after these deals have been signed as the artists become more successful and are able to generate revenue other than from recorded music sales. While non-traditional Recorded Music revenue, which includes revenue from expanded-rights deals as well as revenue from our artist services business, was less than 10% of our total revenue in fiscal 2009, we believe this revenue should continue to grow and represent a larger proportion of our revenue over time.

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

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## RESULTS OF OPERATIONS

### Three Months Ended March 31, 2010 Compared with Three Months Ended March 31, 2009

***Consolidated Historical Results***

***Revenues***

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

| | For the Three Months Ended March 31, | | 2010 vs 2009 | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| **Revenue by Type** | | | | |
| Physical and other | $ 293 | $ 311 | $ (18) | -6% |
| Digital | 189 | 166 | 23 | 14% |
| Licensing | 52 | 62 | (10) | -16% |
| **Total Recorded Music** | **534** | **539** | **(5)** | **-1%** |
| Mechanical | 40 | 41 | (1) | -2% |
| Performance | 55 | 59 | (4) | -7% |
| Synchronization | 24 | 25 | (1) | -4% |
| Digital | 13 | 7 | 6 | 86% |
| Other | 2 | 4 | (2) | -50% |
| **Total Music Publishing** | **134** | **136** | **(2)** | **-1%** |
| Intersegment elimination | (6) | (4) | (2) | 50% |
| **Total Revenue** | **$ 662** | **$ 671** | **$ (9)** | **-1%** |
| **Revenue by Geographical Location** | | | | |
| U.S. Recorded Music | $ 250 | $ 268 | $ (18) | -7% |
| U.S. Publishing | 53 | 58 | (5) | -9% |
| **Total U.S.** | **303** | **326** | **(23)** | **-7%** |
| International Recorded Music | 284 | 271 | 13 | 5% |
| International Publishing | 81 | 78 | 3 | 4% |
| **Total International** | **365** | **349** | **16** | **5%** |
| Intersegment eliminations | (6) | (4) | (2) | 50% |
| **Total Revenue** | **$ 662** | **$ 671** | **$ (9)** | **-1%** |

*Total Revenue*

Total revenues decreased by $9 million, or 1%, to $662 million for the three months ended March 31, 2010 from $671 million for the three months ended March 31, 2009. Excluding the favorable impact of foreign currency exchange rates, total revenues decreased $42 million, or 6%, period-to-period. Prior to intersegment eliminations, Recorded Music and Music Publishing revenues represented 80% and 20% of total revenues for the three months ended March 31, 2010 and 2009, respectively. Prior to intersegment eliminations, U.S. and international revenues represented 45% and 55% of total revenues for the three months ended March 31, 2010, respectively, compared to 48% and 52% for the three months ended March 31, 2009, respectively.

Total digital revenues after intersegment eliminations increased by $26 million, or 15%, to $199 million for the three months ended March 31, 2010 from $173 million for the three months ended March 31, 2009. Total digital revenues represented 30% and 26% of consolidated revenues for the three months ended March 31, 2010 and 2009, respectively. Prior to intersegment eliminations, total digital revenues for the three months ended March 31, 2010 were comprised of U.S. revenues of $127 million, or 63% of total digital revenues, and international revenues of $75 million, or 37% of total digital revenues. Total digital revenues for the three months ended March 31, 2009 were comprised of U.S. revenues of $113 million, or 65% of total digital revenues, and international revenues of $60 million, or 35% of total digital revenues. Excluding the favorable impact of foreign currency exchange rates, total digital revenues increased by $21 million, or 12%, for the three months ended March 31, 2010.

Recorded Music revenues decreased by $5 million, or 1%, to $534 million for the three months ended March 31, 2010 from $539 million for the three months ended March 31, 2009. Excluding the favorable impact of foreign currency exchange rates, total Recorded Music revenues decreased $31 million, or 5%, for the three months ended March 31, 2010. This performance reflected continued general economic pressures, the transition from physical sales to digital sales in the recorded music industry and a light release schedule. Economic pressures have resulted in decreased discretionary spending by consumers, and a reduction by retailers in the amount of floor and shelf space dedicated to music. Retailers still account for the majority of sales of our physical product; however, as the number of physical music retailers has declined significantly, there is increased competition for available display

space. This has led to a decrease in the amount and variety of product on display. In addition, increases in digital revenue have not yet fully offset the decline in physical revenue. We believe this is attributable to the ability of consumers in the digital space to purchase individual tracks from an album rather than purchase the entire album, the economic pressures described above and the ongoing issue of piracy.

Digital revenues increased by $26 million, or 15%, for the three months ended March 31, 2010, largely due to strong global download growth. Licensing revenues decreased $10 million, or 16%, to $52 million for the three months ended March 31, 2010, primarily as a result of the previously noted general economic pressures which continue to impact advertising spending.

Music Publishing revenues decreased by $2 million, or 1%, to $134 million for the three months ended March 31, 2010 from $136 million for the three months ended March 31, 2009. Excluding the favorable impact of foreign currency exchange rates, total Music Publishing revenues decreased by $9 million, or 6%, for the three months ended March 31, 2010. The increase in digital revenue, which was primarily driven by growth in revenues from streaming and Internet radio, was more than offset by a decrease in performance, mechanical, synchronization and other revenues. The decrease in performance revenues was driven by smaller contributions from the radio industry due to reductions in advertising spending. Mechanical revenue performance was impacted by the overall weakness in the physical recorded music business. Synchronization revenue decreases were driven by the impact of the previously mentioned economic pressures on the film, TV production and advertising markets, which have resulted in decreased spending on song licensing, primarily in the U.S.

*Revenue by Geographical Location*

U.S. revenues decreased by $23 million, or 7%, to $303 million for the three months ended March 31, 2010 from $326 million for the three months ended March 31, 2009. The overall decline in the U.S. Recorded Music business reflected the continued general economic pressures noted above, the transition from physical sales to digital sales in the recorded music industry and a light release schedule.

International revenues increased by $16 million, or 5%, to $365 million for the three months ended March 31, 2010 from $349 million for the three months ended March 31, 2009. Excluding the favorable impact of foreign currency exchange rates, total international revenues decreased $17 million, or 4%, for the three months ended March 31, 2010. An increase in digital revenue, primarily as a result of digital downloads, was more than offset by contracting demand for physical product. The contracting demand for physical product reflected the economic pressures noted above, the transition from physical sales to digital sales in the recorded music industry and the timing of our release schedule. Revenue growth in the U.K. was more than offset by weakness in certain Asia Pacific territories and parts of Europe.

*Cost of revenues*

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

| | For the Three Months Ended March 31, | | 2010 vs 2009 | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| Artist and repertoire costs | $ 205 | $ 214 | $ (9) | -4% |
| Product costs | 100 | 101 | (1) | -1% |
| Licensing costs | 18 | 26 | (8) | -31% |
| **Total cost of revenues** | **$ 323** | **$ 341** | **$ (18)** | **-5%** |

Our cost of revenues decreased by $18 million, or 5%, to $323 million for the three months ended March 31, 2010 from $341 million for the three months ended March 31, 2009. Expressed as a percentage of revenues, cost of revenues were 49% and 51% for the three months ended March 31, 2010 and 2009, respectively.

Artist and repertoire costs decreased as a percentage of revenues from 32% for the three months ended March 31, 2009 to 31% in the three months ended March 31, 2010 as a result of the timing of our artist and repertoire spending partially offset by higher royalty expense related to certain artist profit-sharing agreements and timing of artist and repertoire spend. In addition, we received a cost-recovery benefit related to an early termination of an artist contract in the current period.

Product costs remained relatively flat as a percentage of revenues at 15% for the three months ended March 31, 2010 and 2009.

Licensing costs decreased $8 million, or 31%, to $18 million for the three months ended March 31, 2010 from $26 million for the three months ended March 31, 2009. The decrease in licensing costs was driven primarily by the decrease in licensing revenue and changes in revenue mix. Licensing costs as a percentage of licensing revenues decreased from 42% for the three months ended March 31, 2009 to 35% for the three months ended March 31, 2010, primarily as a result of changes in revenue mix.

*Selling, general and administrative expenses*

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

| | For the Three Months Ended March 31, | | 2010 vs 2009 | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| General and administrative expense (1) | $ 138 | $ 143 | $ (5) | -3% |
| Selling and marketing expense | 107 | 101 | 6 | 6% |
| Distribution expense | 16 | 15 | 1 | 7% |
| **Total selling, general and administrative expense** | **$ 261** | **$ 259** | **$ 2** | **1%** |

(1) Includes depreciation expense of $9 for the three months ended March 31, 2010 and 2009.

Total selling, general and administrative expense increased by $2 million, or 1%, to $261 million for the three months ended March 31, 2010 from $259 million for the three months ended March 31, 2009. Expressed as a percentage of revenues, selling, general and administrative expenses remained flat at 39% for the three months ended March 31, 2010 and 2009.

General and administrative expenses decreased by $5 million, or 3%, to $138 million for the three months ended March 31, 2010 from $143 million for the three months ended March 31, 2009, primarily as a result of continued cost management efforts partially offset by severance charges taken in the current period. Expressed as a percentage of revenues, general and administrative expenses remained flat at 21% for the three months ended March 31, 2010 and 2009.

Selling and marketing expense increased by $6 million, or 6%, to $107 million for the three months ended March 31, 2010 from $101 million for the three months ended March 31, 2009, primarily as a result of marketing initiatives associated with upcoming new releases. Expressed as a percentage of revenues, selling and marketing expense increased slightly from 15% for the three months ended March 31, 2009 to 16% for the three months ended March 31, 2010.

Distribution expense increased by $1 million, or 7% to $16 million for the three months ended March 31, 2010 from $15 million for the three months ended March 31, 2009. Expressed as a percentage of revenues, distribution expense remained flat at 2% for the three months ended March 31, 2010 and 2009.

***Reconciliation of Consolidated Historical OIBDA to Operating Income and Net Loss Attributable to WMG Acquisition Corp.***

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

| | For the Three Months Ended March 31, | | 2010 vs 2009 | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| OIBDA | $ 87 | $ 80 | $ 7 | 9% |
| Depreciation expense | (9) | (9) | — | — |
| Amortization expense | (54) | (56) | 2 | 4% |
| **Operating income** | **24** | **15** | **9** | **60%** |
| Interest expense, net | (40) | (35) | (5) | -14% |
| Impairment of cost-method investment | — | (29) | 29 | — |
| Other expense, net | (4) | (3) | (1) | -33% |
| **Loss before income taxes** | **(20)** | **(52)** | **32** | **62%** |
| Income tax expense | (2) | (10) | 8 | 80% |
| **Net loss** | **(22)** | **(62)** | **40** | **65%** |
| Less: loss attributable to noncontrolling interest | 3 | — | 3 | — |
| **Net loss attributable to WMG Acquisition Corp.** | **$ (19)** | **$ (62)** | **$ 43** | **69%** |

*OIBDA*

Our OIBDA increased by $7 million to $87 million for the three months ended March 31, 2010 as compared to $80 million for the three months ended March 31, 2009. Expressed as a percentage of revenues, total OIBDA margin increased from 12%, for the three months ended March 31, 2009, to 13%, for the three months ended March 31, 2010. Our OIBDA increase was primarily driven by the realization of cost savings from management initiatives taken in prior periods and our ability to leverage our highly variable cost structure.

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

*Depreciation expense*

Our depreciation expense remained flat at $9 million for three months ended March 31, 2010 and 2009.

*Amortization expense*

Amortization expense decreased by $2 million, or 4%, to $54 million for the three months ended March 31, 2010. The decrease was primarily related to certain intangibles assets being fully amortized during the current period.

*Operating income*

Our operating income increased $9 million, or 60%, to $24 million for the three months ended March 31, 2010 as compared to $15 million for the prior period. The increase in operating income was primarily due to the growth in OIBDA noted above.

*Interest expense, net*

Our interest expense, net, increased $5 million, or 14%, to $40 million for the three months ended March 31, 2010 as compared to $35 million for the three months ended March 31, 2009. This was primarily a result of the change in interest terms related to our refinancing in May 2009.

See "—Financial Condition and Liquidity" for more information.

*Impairment of cost-method investments*

During the three months ended March 31, 2009, we determined that our cost-method investments in digital venture capital companies, including imeem and lala, were impaired largely due to the current economic environment and changing business conditions from the time of the initial investments. As a result, we recorded one-time charges of $29 million, including $16 million to write off our investment in imeem and $11 million to write down our investment in lala.

*Other expense, net*

Other expense, net for the three months ended March 31, 2010 and 2009 include net hedging gains on foreign exchange contracts, which represent currency exchange movements associated with inter-company receivables and payables that are short term in nature.

*Income tax expense*

We provided income tax expense of $2 million for the three months ended March 31, 2010 as compared to $10 million for the three months ended March 31, 2009. The decrease in income tax expense primarily relates to lower pre-tax income in our foreign jurisdictions and the inclusion of a $4 million tax expense attributable to additional goodwill tax amortization in the three months ended March 31, 2009 that resulted from the settlement of the IRS tax audit for the periods ended September 30, 2004, 2005 and 2006.

We are currently under examination by the Internal Revenue Service for the fiscal years ended September 30, 2007 through September 30, 2008. We expect that $5 million of the total accrual for uncertain tax positions, which was $7 million as of March 31, 2010, will be paid during the next twelve months.

*Net loss*

Our net loss decreased by $40 million, to a net loss of $22 million for the three months ended March 31, 2010 as compared to net loss of $62 million for the three months ended March 31, 2009. The decrease was primarily a result of the impairment of cost-method investments recognized in the prior year quarter, the current year quarter increase in OIBDA described above and lower income tax expense, partially offset by increased interest expense.

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*Noncontrolling interest*

Net loss attributable to noncontrolling interests was $3 million for the three months ended March 31, 2010.

**Business Segment Results**

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

| | For the Three Months Ended March 31, | | 2010 vs 2009 | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| **Recorded Music** | | | | |
| Revenue | $ 534 | $ 539 | $ (5) | -1% |
| OIBDA | 49 | 45 | 4 | 9% |
| Operating income | $ 6 | $ 2 | 4 | — |
| **Music Publishing** | | | | |
| Revenue | $ 134 | $ 136 | $ (2) | -1% |
| OIBDA | 61 | 55 | 6 | 11% |
| Operating income | $ 43 | $ 37 | $ 6 | 16% |
| **Corporate expenses and eliminations** | | | | |
| Revenue | $ (6) | $ (4) | $ (2) | -50% |
| OIBDA | (23) | (20) | (3) | -15% |
| Operating loss | $ (25) | $ (24) | $ (1) | -4% |
| **Total** | | | | |
| Revenue | $ 662 | $ 671 | $ (9) | -1% |
| OIBDA | 87 | 80 | 7 | 9% |
| Operating income | $ 24 | $ 15 | $ 9 | 60% |

*Recorded Music*

*Revenues*

Recorded Music revenues decreased by $5 million, or 1%, to $534 million for the three months ended March 31, 2010 from $539 million for the three months ended March 31, 2009. Excluding the favorable impact of foreign currency exchange rates, total Recorded Music revenues decreased $31 million, or 5%, for the three months ended March 31, 2010. Prior to intersegment eliminations, Recorded Music revenues represented 80% of total revenues for the three months ended March 31, 2010 and 2009. U.S. Recorded Music revenues were $250 million and $268 million, or 47% and 50% of Recorded Music revenues for the three months ended March 31, 2010 and 2009, respectively. International Recorded Music revenues were $284 million and $271 million, or 53% and 50% of consolidated Recorded Music revenues for the three months ended March 31, 2010 and 2009, respectively.

The decrease in Recorded Music revenues reflected the continued general economic pressures described above, the transition from physical sales to digital sales in the recorded music industry and a light release schedule. Economic pressures have resulted in decreased discretionary spending by consumers and a reduction by retailers in the amount of floor and shelf space dedicated to music. Retailers still account for the majority of sales of our physical product; however, as the number of physical music retailers has declined significantly, there is increased competition for available display space. This has led to a decrease in the amount and variety of product on display. In addition, increases in digital revenue have not yet fully offset the decline in physical revenue. We believe this is attributable to the ability of consumers in the digital space to purchase individual tracks from an album rather than purchase the entire album, the economic pressures described above and the ongoing issue of piracy.

*OIBDA and Operating Income*

Recorded Music OIBDA was $49 million for the three months ended March 31, 2010 as compared to $45 million for the three months ended March 31, 2009. Recorded Music operating income included the following (in millions):

| | For the Three Months Ended March 31, | | 2010 vs 2009 | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| OIBDA | $ 49 | $ 45 | $ 4 | 9% |
| Depreciation and amortization | (43) | (43) | — | — |
| **Operating income** | **$ 6** | **$ 2** | **$ 4** | **—** |

Recorded Music OIBDA increased by $4 million, or 9%, to $49 million for the three months ended March 31, 2010 compared to $45 million for the three months ended March 31, 2009. Expressed as a percentage of Recorded Music revenues, Recorded Music OIBDA margin increased to 9% for the three months ended March 31, 2010 from 8% for the three months ended March 31, 2009. Our OIBDA increase was primarily driven by the realization of cost savings from management initiatives taken in prior periods and our ability to leverage our highly variable cost structure.

Recorded Music operating income increased by $4 million, due to the increase in OIBDA described noted above.

*Cost of revenues*

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

| | For the Three Months Ended March 31, | | 2010 vs 2009 | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| Artist and repertoire costs | $ 154 | $ 153 | $ 1 | 1% |
| Product costs | 100 | 101 | (1) | -1% |
| Licensing costs | 18 | 25 | (7) | -28% |
| **Total cost of revenues** | **$ 272** | **$ 279** | **$ (7)** | **-3%** |

Recorded Music cost of revenues decreased $7 million, or 3%, for the three months ended March 31, 2010. The decrease was comprised of decreases in licensing costs of $7 million and product costs of $1 million partially offset by an increase of $1 million in artist and repertoire costs. The decrease in licensing costs was driven primarily by the decrease in licensing revenue and changes in revenue mix. Artist and repertoire costs as a percentage of Recorded Music revenues increased to 29% during the three months ended March 31, 2010 from 28% in the three months ended March 31, 2009 as a result of higher royalty expense related to certain artist profit-sharing agreements, offset by the benefit received related to an early termination of an artist contract in the current period.

*Selling, general and administrative expense*

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

| | For the Three Months Ended March 31, | | 2010 vs 2009 | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| General and administrative expense (1) | $ 98 | $ 107 | $ (9) | -8% |
| Selling and marketing expense | 105 | 99 | 6 | 6% |
| Distribution expense | 16 | 14 | 2 | 14% |
| **Total selling, general and administrative expense** | **$ 219** | **$ 220** | **$ (1)** | **—** |

(1) Includes depreciation expense of $6 million and $5 million for the three months ended March 31, 2010 and 2009, respectively.

Recorded Music selling, general and administrative expense decreased $1 million, for the three months ended March 31, 2010. Expressed as a percentage of Recorded Music revenues, selling, general and administrative expense remained flat at 41% for the three months ended March 31, 2010 and 2009. The decrease in general and administrative expense was primarily the result of the realization of cost savings from management initiatives taken in prior periods partially offset by severance charges taken in the current period. The increase in selling and marketing expense was primarily the result of marketing initiatives associated with upcoming new releases.

*Music Publishing*

*Revenues*

Music Publishing revenues decreased by $2 million, or 1%, to $134 million for the three months ended March 31, 2010 compared to $136 million for the three months ended March 31, 2009. Excluding the favorable impact of foreign currency exchange rates, total Music Publishing revenues decreased $9 million, or 6% for the three months ended March 31, 2010. Music Publishing revenues represented 20% of consolidated revenue, for the three months ended March 31, 2010 and 2009. An increase in digital revenue, which was driven primarily by growth in revenues from streaming and Internet radio, was more than offset by a decrease in performance, mechanical, synchronization and other revenues. A decrease in performance revenues was driven by smaller contributions from the radio industry due to reductions in advertising spending. Mechanical revenue performance was impacted by the overall weakness in the physical recorded music business. Synchronization revenue decreases were driven by the impact of the previously mentioned economic pressures on the film, TV production and advertising markets, which have resulted in decreased spending on song licensing, primarily in the U.S.

*OIBDA and Operating Income*

Music Publishing operating income increased to $43 million for the three months ended March 31, 2010 as compared to $37 million for the three months ended March 31, 2009. Music Publishing operating income includes the following (in millions):

| | For the Three Months Ended March 31, | | 2010 vs 2009 | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| OIBDA | $ 61 | $ 55 | $ 6 | 11% |
| Depreciation and amortization | (18) | (18) | — | — |
| **Operating income** | **$ 43** | **$ 37** | **$ 6** | **16%** |

Music Publishing OIBDA increased $6 million to $61 million, for the three months ended March 31, 2010, from $55 million, for the three months ended March 31, 2009. Expressed as a percentage of Music Publishing revenues, Music Publishing OIBDA was 46% and 40% for the three months ended March 31, 2010 and 2009, respectively. The increase in OIBDA margin was driven by an adjustment in royalty reserves and our continued focus on maximizing the profitability of our publishing investments.

Music Publishing operating income increased by $6 million due to the increase in OIBDA described noted above.

*Cost of revenues*

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

| | For the Three Months Ended March 31, | | 2010 vs 2009 | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| Artist and repertoire costs | $ 58 | $ 65 | $ (7) | -11% |
| **Total cost of revenues** | **$ 58** | **$ 65** | **$ (7)** | **-11%** |

Music Publishing cost of revenues decreased by $7 million for the three months ended March 31, 2010, driven primarily by an adjustment in royalty reserves and our continued focus on maximizing the profitability of our publishing investments. Expressed as a percentage of Music Publishing revenues, Music Publishing cost of revenues were 43% and 48% for the three months ended March 31, 2010 and 2009, respectively.

*Selling, general and administrative expense*

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

| | For the Three Months Ended March 31, | | 2010 vs 2009 | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| General and administrative expense (1) | $ 16 | $ 17 | $ (1) | -6% |
| **Total selling, general and administrative expense** | **$ 16** | **$ 17** | **$ (1)** | **-6%** |

(1) Includes depreciation expense of $1 million for the three months ended March 31, 2010 and 2009.

Music Publishing selling, general and administrative expense decreased to $16 million for the three months ended March 31, 2010 as compared with $17 million for the three months ended March 31, 2009. Expressed as a percentage of Music Publishing revenues, Music Publishing selling, general and administrative expense increased to 12% for the three months ended March 31, 2010 from 13% for the three months ended March 31, 2009.

*Corporate Expenses and Eliminations*

Our OIBDA loss from corporate expenses and eliminations increased from $20 million for the three months ended March 31, 2009 to $23 million for the three months ended March 31, 2010.

Our operating loss from corporate expenses and eliminations increased from $24 million for the three months ended March 31, 2009 to $25 million for the three months ended March 31, 2010.

**Six Months Ended March 31, 2010 Compared with Six Months Ended March 31, 2010**

***Consolidated Historical Results***

***Revenues***

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

| | For the Six Months Ended March 31, | | *2010 vs 2009* | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| **Revenue by Type** | | | | |
| Physical and other | $ 841 | $ 856 | $ (15) | -2% |
| Digital | 361 | 322 | 39 | 12% |
| Licensing | 115 | 118 | (3) | -3% |
| **Total Recorded Music** | **1,317** | **1,296** | **21** | **2%** |
| Mechanical | 87 | 87 | — | — |
| Performance | 105 | 108 | (3) | -3% |
| Synchronization | 49 | 47 | 2 | 4% |
| Digital | 28 | 22 | 6 | 27% |
| Other | 6 | 7 | (1) | -14% |
| **Total Music Publishing** | **275** | **271** | **4** | **1%** |
| Intersegment elimination | (12) | (9) | (3) | -33% |
| **Total Revenue** | **$ 1,580** | **$ 1,558** | **$ 22** | **1%** |
| Revenue by Geographical Location | | | | |
| U.S. Recorded Music | $ 535 | $ 583 | $ (48) | -8% |
| U.S. Publishing | 99 | 106 | (7) | -7% |
| **Total U.S.** | **634** | **689** | **(55)** | **-8%** |
| International Recorded Music | 782 | 713 | 69 | 10% |
| International Publishing | 176 | 165 | 11 | 7% |
| **Total International** | **958** | **878** | **80** | **9%** |
| Intersegment eliminations | (12) | (9) | (3) | -33% |
| **Total Revenue** | **$ 1,580** | **$ 1,558** | **$ 22** | **1%** |

*Total Revenue*

Total revenues increased by $22 million, or 1%, to $1,580 million for the six months ended March 31, 2010 from $1,558 million for the six months ended March 31, 2009. Excluding the favorable impact of foreign currency exchange rates, total revenues decreased $61 million, or 4%, period-to-period. Prior to intersegment eliminations, Recorded Music and Music Publishing revenues represented 83% and 17% of total revenues for the six months ended March 31, 2010 and 2009, respectively. Prior to intersegment eliminations, U.S. and international revenues represented 40% and 60% of total revenues for the six months ended March 31, 2010, respectively, compared to 44% and 56% for the six months ended March 31, 2009, respectively.

Total digital revenues after intersegment eliminations increased by $39 million, or 11%, to $383 million for the six months ended March 31, 2010 from $344 million for the six months ended March 31, 2009. Total digital revenues represented 24% and 22% of consolidated revenues for the six months ended March 31, 2010 and 2009, respectively. Prior to intersegment eliminations, total digital revenues for the six months ended March 31, 2010 were comprised of U.S. revenues of $235 million, or 60% of total digital revenues, and international revenues of $154 million, or 40% of total digital revenues. Total digital revenues for the six months ended March 31, 2009 were comprised of U.S. revenues of $225 million, or 65% of total digital revenues, and international revenues of $119 million, or 35% of total digital revenues. Excluding the favorable impact of foreign currency exchange rates, total digital revenues increased by $30 million, or 8%, for the six months ended March 31, 2010.

Recorded Music revenues increased by $21 million, or 2%, to $1,317 million for the six months ended March 31, 2010 from $1,296 million for the six months ended March 31, 2009. Excluding the favorable impact of foreign currency exchange rates, total Recorded Music revenues decreased $49 million, or 4%, for the six months ended March 31, 2010. This performance reflected continued general economic pressures, the transition from physical sales to digital sales in the recorded music industry and a light release schedule. Economic pressures have resulted in decreased discretionary spending by consumers and a reduction by retailers in the amount of floor and shelf space dedicated to music. Retailers still account for the majority of sales of our physical product; however, as the number of physical music retailers has declined significantly, there is increased competition for available display space. This has led to a decrease in the amount and variety of product on display. In addition, increases in digital revenue have not yet fully offset the decline in physical revenue. We believe this is attributable to the ability of consumers in the digital space to purchase individual tracks from an album rather than purchase the entire album, the economic pressures described above and the ongoing issue of piracy.

Digital revenues increased by $39 million, or 12%, for the six months ended March 31, 2010, largely due to strong international download growth and moderate domestic download growth. Licensing revenues decreased $3 million, or 3%, to $115 million for the six months ended March 31, 2010 from $118 million for the six months ended March 31, 2009, primarily as a result of the previously noted general economic pressures, which continue to impact advertising spending.

Music Publishing revenues increased by $4 million, or 1%, to $275 million for the six months ended March 31, 2010 from $271 million for the six months ended March 31, 2009. Excluding the favorable impact of foreign currency exchange rates, total Music Publishing revenues decreased by $9 million for the six months ended March 31, 2010. On a constant currency basis, the increase in digital revenue, which was driven primarily by growth in revenues from streaming and Internet radio, was more than offset by a decrease in performance and mechanical revenues. The decrease in performance revenues was driven by smaller contributions from the radio industry due to reductions in lower advertising spending. Mechanical revenue performance was impacted by the overall weakness in the physical recorded music business.

*Revenue by Geographical Location*

U.S. revenues decreased by $55 million, or 8%, to $634 million for the six months ended March 31, 2010 from $689 million for the six months ended March 31, 2009. The overall decline in the U.S. Recorded Music business reflected the continued general economic pressures noted above, the transition from physical sales to digital sales in the recorded music industry and a light release schedule.

International revenues increased by $80 million, or 9%, to $958 million for the six months ended March 31, 2010 from $878 million for the six months ended March 31, 2009. Excluding the favorable impact of foreign currency exchange rates, total international revenues decreased $3 million for the six months ended March 31, 2010. An increase in digital revenue, primarily as a result of growth in digital downloads, and growth in our European concert promotion business, mostly in France and Italy, was more than offset by contracting demand for physical product. The contracting demand for physical product reflected the continued economic pressures noted above, the transition from physical sales to digital sales in the recorded music industry and a light release schedule. Revenue growth in the U.K. was more than offset by weakness in Japan and parts of Europe.

*Cost of revenues*

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

| | For the Six Months Ended March 31, | | 2010 vs 2009 | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| Artist and repertoire costs | $ 496 | $ 527 | $ (31) | -6% |
| Product costs | 300 | 265 | 35 | 13% |
| Licensing costs | 38 | 42 | (4) | -10% |
| **Total cost of revenues** | **$ 834** | **$ 834** | **$ —** | **—** |

Our cost of revenues were $834 million for the six months ended March 31, 2010 and 2009. Expressed as a percentage of revenues, cost of revenues were 53% to 54% for the six months ended March 31, 2010 and 2009, respectively.

Artist and repertoire costs as a percentage of revenues decreased from 34% for the six months ended March 31, 2009 to 31% in the six months ended March 31, 2010 as a result of the timing of our artist and repertoire spending partially offset by higher royalty expense related to certain artist profit-sharing agreements and timing of artist and repertoire spend. In addition, we received a cost-recovery benefit related to the early termination of certain artist contracts in the current period.

Product costs increased as a percentage of revenues to 19% for the six months ended March 31, 2010 from 17% of revenues in the six months ended March 31, 2009. The increase in product costs was due primarily to increased costs associated with our European concert promotion business.

Licensing costs decreased $4 million, or 10%, to $38 million for the six months ended March 31, 2010 from $42 million for the six months ended March 31, 2009. The decrease was driven primarily by the decrease in licensing revenue. Expressed as a percentage of licensing revenues, licensing costs decreased from 36% for the six months ended March 31, 2009 to 33% for the six months ended March 31, 2010 primarily as a result of changes in revenue mix.

*Selling, general and administrative expenses*

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

| | For the Six Months Ended March 31, | | 2010 vs 2009 | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| General and administrative expense (1) | $ 285 | $ 283 | $ 2 | 1% |
| Selling and marketing expense | 245 | 238 | 7 | 3% |
| Distribution expense | 35 | 33 | 2 | 6% |
| **Total selling, general and administrative expense** | **$ 565** | **$ 554** | **$ 11** | **2%** |

(1) Includes depreciation expense of $18 million and $17 million for the six months ended March 31, 2010, and 2009, respectively.

Total selling, general and administrative expense increased by $11 million, or 2%, to $565 million for the six months ended March 31, 2010 from $554 million for the six months ended March 31, 2009. Expressed as a percentage of revenues, selling, general and administrative expenses remained flat at 36% for the six months ended March 31, 2010 and 2009.

General and administrative expenses increased by $2 million, or 1%, to $285 million for the six months ended March 31, 2010 from $283 million for the six months ended March 31, 2009, primarily as a result of severance charges taken in current period offset by continued cost-management efforts. Expressed as a percentage of revenues, general and administrative expenses remained flat at 18% for the six months ended March 31, 2010 and 2009.

Selling and marketing expense increased by $7 million, or 3%, to $245 million for the six months ended March 31, 2010 from $238 million for the six months ended March 31, 2009, primarily as a result of marketing initiatives associated with upcoming new releases. Expressed as a percentage of revenues, selling and marketing expense increased to 16% for the six months ended March 31, 2010, from 15% for the six months ended March 31, 2009.

Distribution expense increased by $2 million, or 6% to $35 million for the six months ended March 31, 2010 from $33 million for the six months ended March 31, 2009. Expressed as a percentage of revenues, distribution expense remained flat at 2% for the six months ended March 31, 2010 and 2009.

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***Reconciliation of Consolidated Historical OIBDA to Operating Income and Net Loss Attributable to WMG Acquisition Corp.***

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

| | For the Six Months Ended March 31, | | *2010 vs 2009* | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| OIBDA | $ 199 | $ 187 | $ 12 | 6% |
| Depreciation expense | (18) | (17) | (1) | -6% |
| Amortization expense | (110) | (114) | 4 | 4% |
| **Operating income** | **71** | **56** | **15** | **27%** |
| Interest expense, net | (85) | (74) | (11) | -15% |
| Gain on sale of equity-method investment | — | 36 | (36) | — |
| Gain on foreign exchange transaction | — | 9 | (9) | — |
| Impairment of cost-method investment | — | (29) | 29 | — |
| Impairment of equity-method investment | — | (10) | 10 | — |
| Other expense, net | (3) | (3) | — | — |
| **Loss before income taxes** | **(17)** | **(15)** | **(2)** | **-13%** |
| Income tax expense | (15) | (26) | 11 | 42% |
| Net loss | (32) | (41) | 9 | 22% |
| Less: loss attributable to noncontrolling interest | 2 | 7 | (5) | -71% |
| **Net loss attributable to WMG Acquisition Corp.** | **$ (30)** | **$ (34)** | **$ 4** | **12%** |

*OIBDA*

Our OIBDA increased by $12 million to $199 million for the six months ended March 31, 2010 as compared to $187 million for the six months ended March 31, 2009. Expressed as a percentage of revenues, total OIBDA margin increased to 13% for the six months ended March 31, 2010, from 12% for the three months ended March 31, 2009. Our OIBDA increase was primarily driven by the realization of cost savings from management initiatives taken in prior periods and the decreases in artist and repertoire costs noted above.

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

*Depreciation expense*

Our depreciation expense increased by $1 million, or 6%, to $18 million for six months ended March 31, 2010. The increase was primarily related to additional depreciation related to acquisitions and investments in IT infrastructure.

*Amortization expense*

Amortization expense decreased by $4 million, or 4%, to $110 million for the six months ended March 31, 2010. The decrease was primarily related to certain intangibles assets being fully amortized during the current period.

*Operating income*

Our operating income increased $15 million, or 27%, to $71 million for the six months ended March 31, 2010 as compared to $56 million for the prior period. The increase in operating income was primarily due to the growth in OIBDA and decrease in amortization expense noted above.

*Interest expense, net*

Our interest expense, net, increased $11 million, or 15%, to $85 million for the six months ended March 31, 2010 as compared to $74 million for the six months ended March 31, 2009. This was primarily a result of the change in interest terms related to our refinancing in May 2009.

See “—Financial Condition and Liquidity” for more information.

*Gain on sale of equity-method investment*

During the six months ended March 31, 2009, we sold our remaining equity stake in Front Line Management to Ticketmaster for $123 million in cash. As a result of the transaction, we recorded a gain on sale of equity-method investment of $36 million.

*Gain on foreign exchange transaction*

During the six months ended March 31, 2009, we recorded a $9 million non-cash gain on a foreign exchange transaction as a result of a settlement of a short-term foreign-denominated loan related to the Front Line Management sale.

*Impairment of equity-method investment*

During the six months ended March 31, 2009, we chose not to continue our participation in Equatrax, L.P. (formerly known as Royalty Services, L.P.) and Equatrax, LLC (formerly known as Royalty Services, LLC), which were formed in 2004 to develop an outsourced royalty platform. As a result, we wrote off the remaining $10 million related to our investment in the joint venture.

*Impairment of cost-method investments*

During the six months ended March 31, 2009, we determined that our cost-method investments in digital venture capital companies, including imeem and lala, were impaired largely due to the current economic environment and changing business conditions from the time of the initial investments. As a result, we recorded one-time charges of $29 million, including $16 million to write off our investment in imeem and $11 million to write down our investment in lala.

*Other expense, net*

Other expense, net for the six months ended March 31, 2010 and 2009 include net hedging gains on foreign exchange contracts, which represent currency exchange movements associated with inter-company receivables and payables that are short term in nature, offset by equity in earnings on our share of net income on investments recorded in accordance with the equity method of accounting for an unconsolidated investee.

*Income tax expense*

We provided income tax expense of $15 million for the six months ended March 31, 2010 as compared to $26 million for the six months ended March 31, 2009. The decrease in income tax expense primarily relates to lower pre-tax income in our foreign jurisdictions and the inclusion of a $4 million tax expense attributable to additional goodwill tax amortization in the six months ended March 31, 2009 that resulted from the settlement of the IRS tax audit for the periods ended September 30, 2004, 2005 and 2006.

We are currently under examination by the Internal Revenue Service for the fiscal years ended September 30, 2007 through September 30, 2008. We expect that $5 million of the total accrual for uncertain tax positions, which was $7 million as of March 31, 2010, will be paid during the next twelve months.

*Net loss*

Our net loss decreased by $9 million, to a net loss of $32 million for the six months ended March 31, 2010 as compared to net loss of $41 million for the six months ended March 31, 2009. The decrease in net loss was driven primarily by our increase in OIBDA and decreases in amortization and income tax expense. In addition, during the six months ended March 31, 2009, we recorded impairments of equity and cost-method investments. These impairments were offset by an increase in interest expense in the current period, a prior period gain on the sale of our remaining stake in Front Line Management and a prior period gain on a foreign exchange transaction, all which are more fully discussed above.

*Noncontrolling interest*

Net loss attributable to noncontrolling interests for the six months ended March 31, 2010 and 2009 was of $2 million and $7 million, respectively.

**Business Segment Results**

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

| | For the Six Months Ended March 31, | | 2010 vs 2009 | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| **Recorded Music** | | | | |
| Revenue | $ 1,317 | $ 1,296 | $ 21 | 2% |
| OIBDA | 162 | 152 | 10 | 7% |
| Operating income | $ 74 | $ 61 | 13 | 21% |
| **Music Publishing** | | | | |
| Revenue | $ 275 | $ 271 | $ 4 | 1% |
| OIBDA | 83 | 77 | 6 | 8% |
| Operating income | $ 47 | $ 43 | $ 4 | 9% |
| **Corporate expenses and eliminations** | | | | |
| Revenue | $ (12) | $ (9) | $ (3) | -33% |
| OIBDA | (46) | (42) | (4) | -10% |
| Operating loss | $ (50) | $ (48) | $ (2) | -4% |
| **Total** | | | | |
| Revenue | $ 1,580 | $ 1,558 | $ 22 | 1% |
| OIBDA | 199 | 187 | 12 | 6% |
| Operating income | $ 71 | $ 56 | $ 15 | 27% |

*Recorded Music*

*Revenues*

Recorded Music revenues increased by $21 million, or 2%, to $1,317 million for the six months ended March 31, 2010 from $1,296 million for the six months ended March 31, 2009. Excluding the favorable impact of foreign currency exchange rates, total Recorded Music revenues decreased $49 million, or 4%, for the six months ended March 31, 2010. Prior to intersegment eliminations, Recorded Music revenues represented 83% of total revenues for the six months ended March 31, 2010 and 2009. U.S. Recorded Music revenues were $535 million and $583 million, or 41% and 45% of Recorded Music revenues for the six months ended March 31, 2010 and 2009, respectively. International Recorded Music revenues were $782 million and $713 million, or 59% and 55% of consolidated Recorded Music revenues for the six months ended March 31, 2010 and 2009, respectively.

This Recorded Music performance reflected the continued general economic pressures described above, the transition from physical sales to digital sales in the recorded music industry and the timing of our release schedule. Economic pressures have resulted in decreased discretionary spending by consumers and a reduction by retailers in the amount of floor and shelf space dedicated to music. Retailers still account for the majority of sales of our physical product; however, as the number of physical music retailers has declined significantly, there is increased competition for available display space. This has led to a decrease in the amount and variety of product on display. In addition, increases in digital revenue have not yet fully offset the decline in physical revenue. We believe this is attributable to the ability of consumers in the digital space to purchase individual tracks from an album rather than purchase the entire album, the economic pressures described above and the ongoing issue of piracy.

*OIBDA and Operating Income*

Recorded Music OIBDA was $162 million for the six months ended March 31, 2010 as compared to $152 million for the six months ended March 31, 2009. Recorded Music operating income included the following (in millions):

| | For the Six Months Ended March 31, | | 2010 vs 2009 | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| OIBDA | $ 162 | $ 152 | $ 10 | 7% |
| Depreciation and amortization | (88) | (91) | 3 | 3% |
| **Operating income** | **$ 74** | **$ 61** | **$ 13** | **21%** |

Recorded Music OIBDA increased by $10 million, or 7%, to $162 million for the six months ended March 31, 2010 compared to $152 million for the six months ended March 31, 2009. Our OIBDA increase was primarily driven by the realization of cost savings from management initiatives taken in prior periods and our ability to leverage our highly variable cost structure. Expressed as a percentage of Recorded Music revenues, Recorded Music OIBDA remained flat at 12% for the six months ended March 31, 2010 and 2009.

Recorded Music operating income increased by $13 million, or 21% due to the increase in OIBDA described noted above as well a decrease in depreciation and amortization expense.

*Cost of revenues*

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

| | For the Six Months Ended March 31, | | 2010 vs 2009 | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| Artist and repertoire costs | $ 348 | $ 375 | $ (27) | -7% |
| Product costs | 300 | 263 | 37 | 14% |
| Licensing costs | 38 | 42 | (4) | -10% |
| **Total cost of revenues** | **$ 686** | **$ 680** | **$ 6** | **1%** |

Recorded Music cost of revenues increased $6 million, or 1%, for the six months ended March 31, 2010. The increase was comprised of increases in product costs of $37 million partially offset by decreases of $27 million in artist and repertoire costs and licensing costs of $4 million. The increase in product costs was driven by international production costs associated with our European concert promotion business. Artist and repertoire costs decreased as a percentage of Recorded Music revenues to 26% in the six months ended March 31, 2010 from 29% in the six months ended March 31, 2009 as a result of the timing of our artist and repertoire spending and a cost-recovery benefit related to the early termination of certain artist contracts in the current period, partially offset by higher royalty expense related to certain artist profit-sharing agreements.

*Selling, general and administrative expense*

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

| | For the Six Months Ended March 31, | | 2010 vs 2009 | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| General and administrative expense (1) | $ 205 | $ 206 | $ (1) | — |
| Selling and marketing expense | 241 | 235 | 6 | 3% |
| Distribution expense | 35 | 33 | 2 | 6% |
| **Total selling, general and administrative expense** | **$ 481** | **$ 474** | **$ 7** | **1%** |

(1) Includes depreciation expense of $12 million and $10 million for the six months ended March 31, 2010 and 2009, respectively.

Recorded Music selling, general and administrative expense increased $7 million, or 1%, for the six months ended March 31, 2010. Expressed as a percentage of Recorded Music revenues, selling, general and administrative expense remained flat at 37% for the six months ended March 31, 2010 and 2009, respectively, primarily as a result of marketing initiatives associated with upcoming new releases and severance charges taken in current period, partially offset by continued cost-management efforts.

*Music Publishing*

*Revenues*

Music Publishing revenues increased by $4 million, or 1%, to $275 million for the six months ended March 31, 2010 compared to $271 million for the six months ended March 31, 2009. Excluding the favorable impact of foreign currency exchange rates, total Music Publishing revenues decreased $9 million, or 3% for the six months ended March 31, 2010. Music Publishing revenues represented 17% of consolidated revenue, for both the six months ended March 31, 2010 and 2009. International Music Publishing revenues were $176 million and $165 million, or 64% and 61% of consolidated Music Publishing revenues for the six months ended March 31, 2010 and 2009, respectively. U.S. Music Publishing revenues were $99 million and $106 million, or 36% and 39% of consolidated Music Publishing revenues for the six months ended March 31, 2010 and 2009, respectively.

On a constant currency basis, the increase in digital revenue, which was driven primarily by growth in revenues from streaming and Internet radio, was more than offset by a decrease in performance and mechanical revenues. The decrease in performance revenues was driven by smaller contributions from the radio industry due to reductions in advertising spending. Mechanical revenue performance was impacted by the overall weakness in the physical recorded music business.

*OIBDA and Operating Income*

Music Publishing operating income increased to $47 million for the six months ended March 31, 2010, from $43 million for the six months ended March 31, 2009. Music Publishing operating income includes the following (in millions):

| | For the Six Months Ended March 31, | | *2010 vs 2009* | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| OIBDA | $ 83 | $ 77 | 6 | 8% |
| Depreciation and amortization | (36) | (34) | (2) | -6% |
| **Operating income** | **$ 47** | **$ 43** | **$ 4** | **9%** |

Music Publishing OIBDA increased by $6 million, or 8%, to $83 million for the six months ended March 31, 2010 from $77 million for the six months ended March 31, 2009. Expressed as a percentage of Music Publishing revenues, Music Publishing OIBDA was 30% and 28% for the six months ended March 31, 2010 and 2009, respectively. The increase in OIBDA margin was driven by an adjustment in royalty reserves and our continued focus to direct current and future spending on publishing deals that maximize profitability.

Music Publishing operating income increased by $4 million due to the increase in OIBDA noted above, offset by increased amortization on music publishing rights.

*Cost of revenues*

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

| | For the Six Months Ended March 31, | | *2010 vs 2009* | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| Artist and repertoire costs | $ 161 | $ 164 | $ (3) | -2% |
| **Total cost of revenues** | **$ 161** | **$ 164** | **$ (3)** | **-2%** |

Music Publishing cost of revenues decreased by $3 million for the six months ended March 31, 2010, driven primarily by an adjustment in royalty reserves and our continued focus to direct current and future spending on publishing deals that maximize profitability. Expressed as a percentage of Music Publishing revenues, Music Publishing cost of revenues were 59% and 61% for the six months ended March 31, 2010 and 2009, respectively.

*Selling, general and administrative expense*

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

| | For the Six Months Ended March 31, | | *2010 vs 2009* | |
|---|---|---|---|---|
| | 2010 | 2009 | $ Change | % Change |
| General and administrative expense (1) | $ 33 | $ 32 | $ 1 | 3% |
| **Total selling, general and administrative expense** | **$ 33** | **$ 32** | **$ 1** | **3%** |

(1) Includes depreciation expense of $2 million for the six months ended March 31, 2010 and 2009.

Music Publishing selling, general and administrative expense increased to $33 million for the six months ended March 31, 2010 as compared with $32 million for the six months ended March 31, 2009. Expressed as a percentage of Music Publishing revenues, Music Publishing selling, general and administrative expense remained flat at 12% for the six months ended March 31, 2010 and 2009.

*Corporate Expenses and Eliminations*

Our OIBDA loss from corporate expenses and eliminations increased to $46 million for the six months ended March 31, 2010 from $42 million for the six months ended March 31, 2009.

Our operating loss from corporate expenses and eliminations increased from $48 million for the six months ended March 31, 2009 to $50 million for the six months ended March 31, 2010.

## FINANCIAL CONDITION AND LIQUIDITY

### Financial Condition

At March 31, 2010, we had $1.676 billion of debt, $195 million of cash and equivalents (net debt of $1.481 billion, defined as total debt less cash and equivalents and short-term investments) and a $97 million WMG Acquisition Corp.'s shareholder's deficit. This compares to $1.686 billion of debt, $196 million of cash and equivalents (net debt of $1.490 billion, defined as total debt less cash and equivalents and short-term investments) and a $81 million shareholder's deficit at September 30, 2009. Net debt decreased by $9 million as a result of (i) a $13 million decrease related to the impact of foreign exchange rates on our Sterling-denominated Senior Subordinated Notes offset by (ii) a $3 million increase related to the accretion on our Senior Secured Notes and (iii) a $1 million decrease in cash and equivalents as more fully described below.

The $16 million increase in shareholder's deficit during the six months ended March 31, 2010 consisted of $30 million of net loss for the six months ended March 31, 2010, offset by foreign currency exchange movements of $8 million, $5 million of stock compensation and $1 million related to deferred gains on derivative financial instruments.

### Cash Flows

The following table summarizes our historical cash flows. The financial data for the six months ended March 31, 2010 and 2009 are unaudited and are derived from our interim financial statements included elsewhere herein. The cash flow is comprised of the following in millions:

| | Six Months Ended March 31, 2010 | Six Months Ended March 31, 2009 |
|---|---|---|
| Cash provided by (used in): | | |
| Operating activities | $ 51 | $ 187 |
| Investing activities | (41) | 98 |
| Financing activities | (2) | (8) |

*Operating Activities*

Cash provided by operations was $51 million for the six months ended March 31, 2010 compared to cash provided by operations of $187 million for the six months ended March 31, 2009. The $136 million decrease primarily related to the variable timing of our working capital requirements related to timing of sales and collections in the period, which included a decrease in cash associated with our European concert promotion business and an expected increase in cash paid for interest as a result of our May 2009 refinancing. Cash paid for interest amounted to $81 million in the current period, compared to $66 million in the prior period.

*Investing Activities*

Cash used in investing activities was $41 million for the six months ended March 31, 2010 as compared to cash provided by investing activities of $98 million for the six months ended March 31, 2009. The $41 million of cash used in investing consisted of cash used to acquire music publishing rights of $29 million, cash used for acquisitions totaling $6 million, net of cash acquired and capital expenditures of $15 million, offset by $9 million of cash proceeds received in connection with the sale of our equity investment in lala media, inc. The $98 million of cash provided by investing activities in the six months ended March 31, 2009 consisted primarily of proceeds received from the sale of our remaining stake in Front Line Management to Ticketmaster for $123 million, a repayment of a loan to a third party of $3 million, offset by cash used for acquisitions totaling $14 million, net of cash acquired, capital expenditures of $9 million and $6 million to acquire music publishing rights.

*Financing Activities*

Cash used in financing activities was $2 million and $8 million for the six months ended March 31, 2010 and 2009, respectively. The $2 million of cash used in financing activities in the six months ended March 31, 2010 consisted of distributions to our noncontrolling interest holders. The $8 million of cash used in financing activities in the six months ended March 31, 2009 consisted of our quarterly repayments on our senior secured credit facility, which was retired in May 2009.

**Liquidity**

Our primary sources of liquidity are the cash flows generated from our subsidiaries' operations and available cash and equivalents and short-term investments. These sources of liquidity are needed to fund our debt service requirements, working capital requirements, capital expenditure requirements and any dividends we may elect to pay in the future. We believe that our existing sources of cash will be sufficient to support our existing operations over the next fiscal year.

As of March 31, 2010, our long-term debt consisted of $1.1 billion aggregate principal amount of Senior Secured Notes less unamortized discount of $37 million and $613 million of Senior Subordinated Notes.

*Senior Secured Notes*

On May 28, 2009, Acquisition Corp. issued $1.1 billion aggregate principal amount of 9.50% Senior Secured Notes due 2016 pursuant to an indenture, dated as of May 28, 2009, among Acquisition Corp., the guarantors party thereto and Wells Fargo Bank, National Association, as trustee. The Senior Secured Notes were issued at 96.289% of their face value for total net proceeds of $1.059 billion, with an effective interest rate of 10.25%. The original issue discount (OID) was $41 million. The OID is equal to the difference between the stated principal amount and the issue price. The OID will be amortized over the term of the Senior Secured Notes using the effective interest rate method and reported as non-cash interest expense. Deferred financing fees of $25 million were incurred related to the Senior Secured Notes and are being amortized over the term of the Senior Secured Notes.

The Senior Secured Notes mature on June 15, 2016. Interest on the Senior Secured Notes accrues at a rate of 9.50% per annum and is payable, commencing on December 15, 2009, semi-annually in arrears on June 15 and December 15 of each year to the holders of record on the immediately preceding June 1 and December 1. Interest on the Senior Secured Notes is computed on the basis of a 360-day year comprised of twelve 30-day months.

The Senior Secured Notes are senior secured obligations of Acquisition Corp. that rank senior in right of payment to Acquisition Corp.'s subordinated indebtedness, including its existing senior subordinated notes. The obligations under the Senior 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 Senior Secured Notes are not guaranteed by Holdings. All obligations under the Senior Secured Notes and the guarantees of those obligations are secured by first-priority liens, subject to permitted liens, in the assets of Holdings, Acquisition Corp., and the subsidiary guarantors that previously secured our senior secured credit facility, which consist of the shares of Acquisition Corp., Acquisition Corp.'s assets and the assets of the subsidiary guarantors, except for certain excluded assets.

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

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

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

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

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

*Senior Subordinated Notes*

Acquisition Corp. has outstanding two tranches of senior subordinated notes due in 2014: $465 million principal amount of U.S. dollar-denominated notes and £100 million principal amount of Sterling-denominated notes (collectively, the “Acquisition Corp. Senior Subordinated Notes”). The Acquisition Corp. Senior Subordinated Notes mature on April 15, 2014 and bear interest at a fixed rate of 7.375% per annum on the $465 million dollar notes and 8.125% per annum on the £100 million Sterling-denominated notes.

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

*Holdings Discount Notes*

Our immediate parent company, Holdings, issued debt in December of 2004. As of March 31, 2010, Holdings had $258 million of debt represented by the Holdings Discount Notes. The Holdings Discount Notes were issued at a discount and had an initial accreted value of $630.02 per $1,000 principal amount at maturity. Prior to December 15, 2009, no cash interest payments accrued. However, interest accrued on the Holdings Discount Notes in the form of an increase in the accreted value of such notes such that the accreted value of the Holdings Discount Notes equaled the principal amount at maturity of $258 million on December 15, 2009. Thereafter, cash interest on the Holdings Discount Notes is payable semi-annually at a fixed rate of 9.5% per annum with the initial cash interest payment payable on June 15, 2010. The Holdings Discount Notes mature on December 15, 2014. While Holdings is the issuer of such debt, it is a holding company that conducts substantially all of its business operations through us, its only asset and wholly-owned subsidiary. As such, Holdings will be relying on us to make any payments of principal and interest as they become due.

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

*Dividends*

Parent discontinued its previous policy of paying a regular quarterly dividend during the second quarter of fiscal year 2008. Any future determination to pay dividends will be at the discretion of its Board of Directors and will depend on, among other things, the results of its operations, cash requirements, financial condition, contractual restrictions and other factors its Board of Directors may deem relevant.

**Covenant Compliance**

The indentures governing the Holdings Discount Notes, the Acquisition Corp. Senior Subordinated Notes and the Senior Secured Notes contain certain financial covenants, which limit the ability of our restricted subsidiaries as defined in the indentures governing the notes to, among other things, incur additional indebtedness, issue certain preferred shares, pay dividends, make certain investments, sell certain assets, create liens on certain debt, and consolidate, merge, sell or otherwise dispose of all, or some of, our assets. In order for Acquisition Corp. and Holdings to incur additional debt or make certain restricted payments using certain

exceptions provided for in the indentures governing the Acquisition Corp. Senior Subordinated Notes, the Senior Secured Notes and Holdings Discount Notes, the Fixed Charge Coverage Ratio, as defined in such indentures, must exceed a 2.0 to 1.0 ratio. Fixed Charges are defined in such indentures as consolidated interest expense excluding certain non-cash interest expense.

The terms of the indentures governing the Acquisition Corp. Senior Subordinated Notes, the Senior Secured Notes and Holdings Discount Notes significantly restrict Acquisition Corp., Holdings and other subsidiaries from paying dividends and otherwise transferring assets to us. For example, the ability of Acquisition Corp. and Holdings to make such payments is governed by a formula based on 50% of each of their consolidated net income (which, as defined in the indentures governing such notes, excludes goodwill impairment charges and any after-tax extraordinary, unusual or nonrecurring gains and losses) accruing from July 1, 2004 under the indentures governing the Acquisition Corp. Senior Subordinated Notes, the Holdings Discount Notes, and July 1, 2009 under the Senior Secured Notes, plus in each case proceeds from equity offerings and capital contributions, among other items. In addition, as a condition to making such payments to us based on such formula, Acquisition Corp. and Holdings must each have an adjusted EBITDA, as defined in the indenture, to interest expense ratio of at least 2.0 to 1.0 after giving effect to any such payments. Notwithstanding such restrictions, the indentures governing the Acquisition Corp. Senior Subordinated Notes, the Holdings Discount Notes and the Senior Secured Notes permit an aggregate of $45 million, $75 million and $50 million, respectively, of such payments to be made by Acquisition Corp. and Holdings pursuant to the indentures, whether or not there is availability under the formula or the conditions to its use are met. The indenture governing the Senior Secured Notes also permits Acquisition Corp. to make restricted payments not to exceed $90 million in any fiscal year.

Acquisition Corp. and Holdings may make additional restricted payments using certain other exceptions provided for in the indentures governing the Acquisition Corp. Senior Subordinated Notes, the Senior Secured Notes and Holdings Discount Notes

**Summary**

Management believes that funds generated from our operations will be sufficient to fund our debt service requirements, working capital requirements and capital expenditure requirements for the foreseeable future. We also have additional borrowing capacity under our indentures. However, our ability to continue to fund these items and to reduce debt may be affected by general economic, financial, competitive, legislative and regulatory factors, as well as other industry-specific factors such as the ability to control music piracy and the continued industry-wide decline of CD sales. We or any of our affiliates may also, from time to time depending on market conditions and prices, contractual restrictions, our financial liquidity and other factors, seek to repurchase the Holdings Discount Notes, our Acquisition Corp. Senior Subordinated Notes or our Senior Secured Notes and/or Parent common stock in open market purchases, privately negotiated purchases or otherwise. The amounts involved in any such transactions, individually or in the aggregate, may be material and may be funded from available cash or from additional borrowings. In addition, we may from time to time, depending on market conditions and prices, contractual restrictions, our financial liquidity and other factors, seek to refinance the Holdings Discount Notes, Acquisition Corp. Senior Subordinated Notes and/or our Senior Secured Notes with existing cash and/or with funds provided from additional borrowings.

## CRITICAL ACCOUNTING POLICIES

The SEC's Financial Reporting Release No. 60, "Cautionary Advice Regarding Disclosure About Critical Accounting Policies" ("FRR 60"), suggests companies provide additional disclosure and commentary on those accounting policies considered most critical. FRR 60 considers an accounting policy to be critical if it is important to our financial condition and results, and requires significant judgment and estimates on the part of management in our application. We believe the following list represents the critical accounting policies of us as contemplated by FRR 60. For a summary of all of our significant accounting policies, see Note 3 to our audited consolidated financial statements contained in our annual report on Form 10-K for the fiscal year ended September 30, 2009.

**Purchase Accounting**

We account for our business acquisitions under the Financial Accounting Standards Board ("FASB") authoritative guidance for business combinations. The total cost of acquisitions is allocated to the underlying identifiable net assets based on their respective estimated fair values. The excess of the purchase price over the estimated fair values of the net assets acquired is recorded as goodwill. Determining the fair value of assets acquired and liabilities assumed requires management's judgment and often 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. In addition, reserves have been established on our balance sheet related to acquired liabilities and qualifying restructuring costs based on assumptions made at the time of acquisition. We evaluate these reserves on a regular basis to determine the adequacy or accuracy of the amounts estimated.

**Accounting for Goodwill and Other Intangible Assets**

We account for our goodwill and other indefinite-lived intangible assets as required by FASB Accounting Standards Codification ("ASC") Topic 350, Intangibles—Goodwill and other ("ASC 350"). Under ASC 350, we no longer amortize goodwill, including the goodwill included in the carrying value of investments accounted for using the equity method of accounting, and certain other intangible assets deemed to have an indefinite useful life. ASC 350 requires that goodwill and certain intangible assets be

assessed for impairment using fair value measurement techniques on an annual basis and when events occur that may suggest that the fair value of such assets cannot support the carrying value. Goodwill impairment is tested using a two-step process. The first step of the goodwill impairment test is used to identify potential impairment by comparing the fair value of a reporting unit with its net book value (or carrying amount), including goodwill.

In performing the first step, management determines the fair value of its reporting units using a combination of a discounted cash flow ("DCF") analysis and a market-based approach. Determining fair value requires significant judgment concerning the assumptions used in the valuation model, including discount rates, the amount and timing of expected future cash flows and, growth rates, as well as relevant comparable company earnings multiples for the market-based approach including the determination of whether a premium or discount should be applied to those comparables. The cash flows employed in the DCF analyses are based on management's most recent budgets and business plans and when applicable, various growth rates have been assumed for years beyond the current business plan periods. Any forecast contains a degree of uncertainty and modifications to these cash flows could significantly increase or decrease the fair value of a reporting unit. For example, if revenue from sales of physical products continues to decline and the revenue from sales of digital products does not continue to grow as expected and we are unable to adjust costs accordingly, it could have a negative impact on future impairment tests. In determining which discount rate to utilize, management determines the appropriate weighted average cost of capital ("WACC") for each reporting unit. Management considers many factors in selecting a WACC, including the market view of risk for each individual reporting unit, the appropriate capital structure and the appropriate borrowing rates for each reporting unit. The selection of a WACC is subjective and modification to this rate could significantly increase or decrease the fair value of a reporting unit.

If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired and the second step of the impairment test is unnecessary. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit.

As of September 30, 2009, we had recorded goodwill in the amount of $1.03 billion, primarily related to the Acquisition (as defined). We test our goodwill and other indefinite-lived intangible assets for impairment on an annual basis in the fourth quarter of each fiscal year. The performance of our fiscal 2009 impairment analyses did not result in any impairments of the Company's goodwill. The discount rates utilized in the fiscal 2009 analysis ranged from 9% to 10% while the terminal growth rates used in the DCF analysis ranged from 2% to 3%. To illustrate the magnitude of a potential impairment relative to future changes in estimated fair values, had the fair values of each of the reporting units been hypothetically lower by 50% at September 30, 2009, no reporting unit's book value would have exceeded its fair value. The percentage by which the fair value of each reporting unit exceeded the respective carrying value was as follows:

| Reporting Unit | Percentage by which Fair Value Exceeded Carrying Value |
|---|---|
| U.S. Recorded Music | 50% |
| International Recorded Music | 205% |
| Publishing | 78% |

The impairment test for other intangible assets not subject to amortization involves a comparison of the estimated fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. The estimates of fair value of intangible assets not subject to amortization are determined using a DCF valuation analysis. Common among such approaches is the "relief from royalty" methodology, which is used in estimating the fair value of the Company's trademarks. Discount rate assumptions are based on an assessment of the risk inherent in the projected future cash flows generated by the respective intangible assets. Also subject to judgment are assumptions about royalty rates, which are based on the estimated rates at which similar trademarks are being licensed in the marketplace.

See Note 8 to our audited consolidated financial statements contained in our annual report on Form 10-K for the fiscal year ended September 30, 2009 for a further discussion of our goodwill and other intangible assets.

**Equity Method and Cost Method Investments**

For non-publicly traded investments, management's assessment of fair value is based on valuation methodologies including discounted cash flows, estimates of sales proceeds and external appraisals, as appropriate. The ability to accurately predict future cash flows, especially in developing and unstable markets, may impact the determination of fair value.

In the event a decline in fair value of an investment occurs, management may be required to determine if the decline in market value is other than temporary. Management's assessments as to the nature of a decline in fair value are based on the valuation methodologies discussed above and our ability and intent to hold the investment. We consider our equity method investees to be strategic long-term investments; therefore, we generally complete our assessments with a long-term viewpoint. If the fair value of any of our equity method or cost method investments is less than the carrying value and the decline in value is considered to be other than temporary, an impairment charge is recorded to write down the carrying value of the investment to its fair value. Management's assessments of fair value in accordance with these valuation methodologies represent our best estimates as of the time of the impairment review and are consistent with our internal planning. If different fair values were estimated, this could have a material impact on the financial statements.

**Revenue and Cost Recognition**

***Sales Returns and Uncollectible Accounts***

In accordance with practice in the recorded music industry and as customary in many territories, certain products (such as CDs and DVDs) are sold to customers with the right to return unsold items. Under FASB ASC Topic 605, Revenue Recognition, revenues from such sales are recognized when the products are shipped based on gross sales less a provision for future estimated returns.

In determining the estimate of product sales that will be returned, management analyzes historical returns, current economic trends, changes in customer demand and commercial acceptance of our products. Based on this information, management reserves a percentage of each dollar of product sales to provide for the estimated customer returns.

Similarly, management evaluates accounts receivables to determine if they will ultimately be collected. In performing this evaluation, significant judgments and estimates are involved, including an analysis of specific risks on a customer-by-customer basis for larger accounts and customers, and a receivables aging analysis that determines the percent that has historically been uncollected by aged category. Based on this information, management provides a reserve for the estimated amounts believed to be uncollectible.

Based on management's analysis of sales returns and uncollectible accounts, reserves totaling $107 million and $135 million have been established at March 31, 2010 and September 30, 2009, respectively. The ratio of our receivable allowances to gross accounts receivables were approximately 21% and 20% at March 31, 2010 and September 30, 2009, respectively.

***Gross Versus Net Revenue Classification***

In the normal course of business, we act as an intermediary or agent with respect to certain payments received from third parties. For example, we distribute music product on behalf of third-party record labels.

The accounting issue encountered in these arrangements is whether we should report revenue based on the "gross" amount billed to the ultimate customer or on the "net" amount received from the customer after participation and other royalties paid to third parties. To the extent revenues are recorded gross (in the full amount billed), any participations and royalties paid to third parties are recorded as expenses so that the net amount (gross revenues, less expenses) flows through operating income. Accordingly, the impact on operating income is the same, whether we record the revenue on a gross basis or net basis (less related participations and royalties).

Determining whether revenue should be reported gross or net is based on an assessment of whether we are acting as the "principal" in a transaction or acting as an "agent" in the transaction. To the extent we are acting as a principal in a transaction, we report as revenue the payments received on a gross basis. To the extent we are acting as an agent in a transaction, we report as revenue the payments received less participations and royalties paid to third parties, i.e., on a net basis. The determination of whether we are serving as principal or agent in a transaction is judgmental in nature and based on an evaluation of the terms of an arrangement.

In determining whether we serve as principal or agent in these arrangements, we follow the guidance in FASB ASC Subtopic 605-45, Principal Agent Considerations ("ASC 605-45"). Pursuant to such guidance, we serve as the principal in transactions where we have the substantial risks and rewards of ownership. The indicators that we have substantial risks and rewards of ownership are as follows:

- we are the supplier of the products or services to the customer;
- we have latitude in establishing prices;
- we have the contractual relationship with the ultimate customer;

- we modify and service the product purchased to meet the ultimate customer specifications;
- we have discretion in supplier selection; and
- we have credit risk.

Conversely, pursuant to ASC 605-45, we serve as agent in arrangements where we do not have substantial risks and rewards of ownership. The indicators that we do not have substantial risks and rewards of ownership are as follows:

- the supplier (not WMG Acquisition) is responsible for providing the product or service to the customer;
- the supplier (not WMG Acquisition) has latitude in establishing prices;
- the amount we earn is fixed;
- the supplier (not WMG Acquisition) has credit risk; and
- the supplier (not WMG Acquisition) has general inventory risk for a product before it is sold.

Based on the above criteria and for the more significant transactions that we have evaluated, we record the distribution of product on behalf of third-party record labels on a gross basis, subject to the terms of the contract. However, recorded music compilations distributed by other record companies where we have a right to participate in the profits are recorded on a net basis.

**Accounting for Royalty Advances**

We regularly commit to and pay royalty advances to our recording artists and songwriters in respect of future sales. We account for these advances under the related guidance in FASB ASC Topic 928, Entertainment—Music (“ASC 928”). Under ASC 928, we capitalize as assets certain advances that we believe are recoverable from future royalties to be earned by the recording artist or songwriter. Advances vary in both amount and expected life based on the underlying recording artist or songwriter. Advances to recording artists or songwriters with a history of successful commercial acceptability will typically be larger than advances to a newer or unproven recording artist or songwriter. In addition, in most cases these advances represent a multi-album release or multi-song obligation and the number of albums releases and songs will vary by recording artist or songwriter.

Management’s decision to capitalize an advance to a recording artist or songwriter as an asset requires significant judgment as to the recoverability of the advance. The recoverability is assessed upon initial commitment of the advance based upon management’s forecast of anticipated revenue from the sale of future and existing albums or songs. In determining whether the advance is recoverable, management evaluates the current and past popularity of the recording artist or songwriter, the sales history of the recording artist or songwriter, the initial or expected commercial acceptability of the product, the current and past popularity of the genre of music that the product is designed to appeal to, and other relevant factors. Based upon this information, management expenses the portion of any advance that it believes is not recoverable. In most cases, advances to recording artists or songwriters without a history of success and evidence of current or past popularity will be expensed immediately. Advances are individually assessed for recoverability continuously and at minimum on a quarterly basis. As part of the ongoing assessment of recoverability, we monitor the projection of future sales based on the current environment, the recording artist’s or songwriter’s ability to meet their contractual obligations as well as our intent to support future album releases or songs from the recording artist or songwriter. To the extent that a portion of an outstanding advance is no longer deemed recoverable, that amount will be expensed in the period the determination is made.

We had $349 million and $380 million of advances in our balance sheet at March 31, 2010 and September 30, 2009, respectively. We believe such advances are recoverable through future royalties to be earned by the applicable recording artists and songwriters.

**Stock-Based Compensation**

We account for share-based payments in accordance with FASB ASC Topic 718, Compensation—Stock Compensation (“ASC 718”). ASC 718 requires all share-based payments to employees, including grants of employee stock options, to be recognized as compensation expense based on their fair value. Under this fair value recognition provision of ASC 718, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the vesting period. We have applied the modified prospective method and expenses deferred stock-based compensation on an accelerated basis over the vesting period of the stock award.

We estimate the fair value of our grants made using the binomial method, which includes assumptions related to volatility, expected life, dividend yield and risk-free interest rate. We also award or sell restricted shares to our employees. For restricted shares awarded or sold below market value, the accounting charge is measured at the grant date and amortized ratably as non-cash compensation over the vesting term.

**Accounting for Income Taxes**

As part of the process of preparing the consolidated financial statements, we are required to estimate income taxes payable in each of the jurisdictions in which we operate. This process involves estimating the actual current tax expense together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheets. FASB ASC Topic 740, Income Taxes ("ASC 740"), requires a valuation allowance be established when it is more likely than not that all or a portion of deferred tax assets will not be realized. In circumstances where there is sufficient negative evidence, establishment of a valuation allowance must be considered. We believe that cumulative losses in the most recent three-year period generally represent sufficient negative evidence to consider a valuation allowance under the provisions of ASC 740. As a result, we determined that certain of our deferred tax assets required the establishment of a valuation allowance.

The realization of the remaining deferred tax assets is primarily dependent on forecasted future taxable income. Any reduction in estimated forecasted future taxable income may require that we record additional valuation allowances against our deferred tax assets on which a valuation allowance has not previously been established. The valuation allowance that has been established will be maintained until there is sufficient positive evidence to conclude that it is more likely than not that such assets will be realized. An ongoing pattern of profitability will generally be considered as sufficient positive evidence. Our income tax expense recorded in the future may be reduced to the extent of offsetting decreases in our valuation allowance. The establishment and reversal of valuation allowances could have a significant negative or positive impact on our future earnings.

Tax assessments may arise several years after tax returns have been filed. Predicting the outcome of such tax assessments involves uncertainty; however, we believe that recorded tax liabilities adequately account for our analysis of more likely than not outcomes.

**New Accounting Principles**

In addition to the critical accounting policies discussed above, we adopted several new accounting policies during the past two years. None of these new accounting principles had a material effect on our audited financial statements. See Note 3 to our audited consolidated financial statements contained in our annual report on Form 10-K for the fiscal year ended September 30, 2009 for a complete summary.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

As discussed in Note 18 to our audited consolidated financial statements for the fiscal year ended September 30, 2009, we are exposed to market risk arising from changes in market rates and prices, including movements in foreign currency exchange rates. As of March 31, 2010, other than as described below, there have been no material changes to the Company's exposure to market risk since September 30, 2009.

We have transactional exposure to changes in foreign currency exchange rates relative to the U.S. dollar due to the global scope of our operations. We use foreign exchange contracts, primarily to hedge the risk that unremitted or future royalties and license fees owed to our U.S. companies for the sale, or anticipated sale, of U.S.-copyrighted products abroad may be adversely affected by changes in foreign currency exchange rates. We focus on managing the level of exposure to the risk of foreign currency exchange rate fluctuations on our major currencies, which include the Euro, British pound sterling, Japanese yen, Canadian dollar, Swedish krona, and Australian dollar. During the three months ended March 31, 2010, we entered into additional foreign exchange hedge contracts and, as of March 31, 2010, we had outstanding hedge contracts for the sale of $399 million and the purchase of $87 million of foreign currencies at fixed rates. During the current-year quarter, certain of our foreign exchange contracts expired and new foreign exchange contracts were renewed with similar features.

The fair value of foreign exchange contracts is subject to changes in foreign currency exchange rates. For the purpose of assessing the specific risks, we use a sensitivity analysis to determine the effects that market risk exposures may have on the fair value of our financial instruments. For foreign exchange forward contracts outstanding at March 31. 2010, assuming a hypothetical 10% depreciation of the U.S dollar against foreign currencies from prevailing foreign currency exchange rates and assuming no change in interest rates, the fair value of the foreign exchange forward contracts would have decreased by $31 million. Because our foreign exchange contracts are entered into for hedging purposes, these losses would be largely offset by gains on the underlying transactions.

We are exposed to foreign currency exchange rate risk with respect to our £100 million principal amount of Sterling-denominated notes that were issued in April 2004. These sterling notes mature on April 15, 2014. As of March 31, 2010, these sterling notes had a carrying value of approximately $148 million. Based on the principal amount of Sterling-denominated notes outstanding

as of March 31, 2010 and assuming that all other market variables are held constant (including the level of interest rates), a 10% weakening or strengthening of the U.S. dollar compared to the British pound sterling would not have an impact on the fair value of these sterling notes, since these notes are completely hedged as of March 31, 2010.

## ITEM 4. CONTROLS AND PROCEDURES

*Certification*

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

*Introduction*

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

The Securities and Exchange Commission's rules define "internal control over financial reporting" as a process designed by, or under the supervision of, a public company's principal executive and principal financial officers, or persons performing similar functions, and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles, or U.S. GAAP, including those policies and procedures that: (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company, (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

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

*Evaluation of Disclosure Controls and Procedures*

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

*Changes in Internal Control over Financial Reporting*

There have been no changes, other than as noted below, in our Internal Controls over financial reporting or other factors during the period ended March 31, 2010 that have materially affected, or are reasonably likely to materially affect, our Internal Controls.

In an effort to make our information technology, or IT, more efficient and increase our IT capabilities and reduce potential disruptions, as well as generate cost savings, we signed a contract during the first quarter of fiscal 2009 with a third-party service provider to outsource a significant portion of our IT functions. We began transitioning work to the service provider in December 2008, and the transition will continue through the following 18 months. In addition, in an effort to make our finance and accounting functions more efficient, as well as generate cost savings, we signed a contract during the third quarter of fiscal 2009 with a third-party service provider to outsource certain accounting and finance functions. We began transitioning work to the service provider in April 2009, and the transition was substantially completed by April 2010. The outsourcing arrangements are expected to enhance the cost

efficiency of these administrative functions. The outsourcing of these functions will have an immediate effect with regard to the responsibilities for the performance of certain processes and internal controls over financial reporting. We anticipate that internal controls over financial reporting could be further impacted in the future as these outsourced functions benefit from expected innovations and improvements from our service providers.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

*Pricing of Digital Music Downloads*

On December 20, 2005 and February 3, 2006, the Attorney General of the State of New York served the Company with requests for information in connection with an industry-wide investigation as to whether the practices of industry participants concerning the pricing of digital music downloads violate Section 1 of the Sherman Act, New York State General Business Law §§ 340 et seq., New York Executive Law §63(12), and related statutes. On February 28, 2006, the Antitrust Division of the U.S. Department of Justice served the Company with a request for information in the form of a Civil Investigative Demand as to whether its activities relating to the pricing of digitally downloaded music violate Section 1 of the Sherman Act. We have provided documents and other information in response to these requests and intend to continue to fully cooperate with the New York Attorney General's and Department of Justice's industry-wide inquiries. 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. On August 15, 2006, the Judicial Panel on Multidistrict Litigation consolidated these actions 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 us, 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 us. 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. The Company intends to continue to defend against these lawsuits, including the appeal, vigorously, but is unable to predict the outcome of these suits. Any litigation the Company may become involved in as a result of the inquiries of the Attorney General and Department of Justice, regardless of the merits of the claim, could be costly and divert the time and resources of management.

*Other Matters*

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

### ITEM 1A. RISK FACTORS

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

#### Risks Related to our Business

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

The industry began experiencing negative growth rates in 1999 on a global basis and the worldwide recorded music market has contracted considerably. Illegal downloading of music, CD-R piracy, industrial piracy, economic recession, bankruptcies of record wholesalers and retailers, and growing competition for consumer discretionary spending and retail shelf space may all be contributing to a declining recorded music industry. Additionally, the period of growth in recorded music sales driven by the introduction and penetration of the CD format has ended. While CD sales still generate most of the recorded music revenues, CD sales continue to decline industry-wide and we expect that trend to continue. However, new formats for selling recorded music product have been

created, including the legal downloading of digital music and the distribution of music on mobile devices and revenue streams from these new channels have emerged. These new digital revenue streams are important as they are beginning to offset declines in physical sales and represent the fastest growing area of our recorded music business. In addition, we are also taking steps to broaden our revenue mix into growing areas of the music business, including sponsorship, fan clubs, artist websites, merchandising, touring, ticketing and artist management. As our expansion into these new areas is recent, we cannot determine how our expansion into these new areas will impact our business. Despite the increase in digital sales and expanded-rights revenues, revenues from these sources have yet to fully offset declining physical sales on a worldwide industry basis and it is too soon to determine the impact that sales of music through new channels might have on the industry or when the decline in physical sales might be offset by the increase in digital sales and other expanded-rights revenues. Accordingly, the recorded music industry performance may continue to negatively impact our operating results. While it is believed within the recorded music industry that growth in digital sales will re-establish a growth pattern for recorded music sales, the timing of the recovery cannot be established with accuracy nor can it be determined how these changes will affect individual markets. A declining recorded music industry is likely to lead to reduced levels of revenue and operating income generated by our Recorded Music business. Additionally, a declining recorded music industry is also likely to have a negative impact on our Music Publishing business, which generates a significant portion of its revenues from mechanical royalties attributable to the sale of music in CD and other physical recorded music formats.

**Current uncertainty in global economic conditions could adversely affect our prospects and our results of operations.**

Current uncertainty in global economic conditions poses a risk to the overall economy as consumers and businesses may defer purchases in response to tighter credit and negative financial news, which could negatively affect product demand and other related matters. The current volatility and disruption to the capital and credit markets have reached unprecedented levels and have adversely impacted global economic conditions, resulting in significant recessionary pressures and lower consumer confidence and lower retail sales in general, which has negatively impacted our business. In addition, although we believe our cash provided by operations will provide us with sufficient liquidity through the current credit crisis, the impact of this crisis on our major customers and suppliers, including those who provide our manufacturing, packaging and physical distribution requirements, cannot be predicted and may be quite severe. The inability of major manufacturers to ship our products could impair our ability to meet delivery date requirements of our customers. A disruption of the ability of our significant customers to access liquidity could cause disruptions or an overall deterioration of their businesses which could lead to reductions in their future orders of our products or the failure on their part to meet their payment obligations to us. Consequently, demand could be different from our expectations due to factors including changes in business and economic conditions, including conditions in the credit market that could affect consumer confidence, customer acceptance of our and competitors' products, changes in the level of inventory at retailers and changes in the global advertising business, any of which could have a material adverse effect on our results.

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

There are a variety of factors that could cause us to reduce our prices and reduce our profit margins. They are, among others, price competition from the sale of motion pictures in Blu-Ray/DVD-Video format and videogames, the negotiating leverage of mass merchandisers, big-box retailers and distributors of digital music, the increased costs of doing business with mass merchandisers and big-box retailers as a result of complying with operating procedures that are unique to their needs and any changes in costs associated with new digital formats. In addition, we are currently dependent on a small number of leading online music stores, which allows them to significantly influence the prices we can charge in connection with the distribution of digital music. Over the course of the last decade, U.S. mass-market and other stores' share of U.S physical music sales has continued to grow. While we cannot predict how future competition will impact music retailers, as the music industry continues to transform it is possible that the share of music sales by mass-market retailers such as Wal-Mart and Target and online music stores such as Apple's iTunes will continue to grow as a result of the decline of specialty music retailers, which could further increase their negotiating leverage. Several large specialty music retailers, including Tower Records and Musicland, have filed for bankruptcy protection. The declining number of specialty music retailers may not only put pressure on profit margins, but could also impact catalog sales as mass-market retailers generally sell top chart albums only, with a limited range of back catalog. Recently, global economic conditions have led to a continued challenging retailer landscape which was most pronounced in the U.K., where EUK, Pinnacle and Zavvi have each gone into administration, which is similar to bankruptcy in the U.S. See "Risk Factors—We are substantially dependent on a limited number of online music stores, in particular Apple's iTunes Music Store, for the online sale of our music recordings and they are able to significantly influence the pricing structure for online music stores."

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

We are dependent on identifying, signing and retaining recording artists with long-term potential, whose debut albums are well received on release, whose subsequent albums are anticipated by consumers and whose music will continue to generate sales as part of our catalog for years to come. The competition among record companies for such talent is intense. Competition among record companies to sell records is also intense and the marketing expenditures necessary to compete have increased as well. We are also dependent on signing and retaining songwriters who will write the hit songs of today and the classics of tomorrow. Our competitive

position is dependent on our continuing ability to attract and develop artists whose work can achieve a high degree of public acceptance. Our financial results may be adversely affected if we are unable to identify, sign and retain such artists under terms that are economically attractive to us. Our financial results may also be affected by the existence or absence of superstar artist releases during a particular period. Some music industry observers believe that the number of superstar acts with long-term appeal, both in terms of catalog sales and future releases, has declined in recent years. Additionally, our financial results are generally affected by the worldwide economic and retail environment, as well as the appeal of our Recorded Music catalog and our Music Publishing library.

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

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

**Organized industrial piracy may lead to decreased sales.**

The global organized commercial pirate trade is a significant threat to the music industry. The International Intellectual Property Alliance, ("IIPA"), estimates that trade losses due to physical piracy of records and music in 39 key countries/territories around the world with copyright protection and/or enforcement deficiencies totaled $1.5 billion in 2009. Unauthorized copies and piracy have contributed to the decrease in the volume of legitimate sales and put pressure on the price of legitimate sales. They have had, and may continue to have, an adverse effect on our business.

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

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

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

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

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

The industry in which we operate is highly competitive, is based on consumer preferences and is rapidly changing. Additionally, the music industry requires substantial human and capital resources. We compete with other recorded music companies and music publishers to identify and sign new recording artists and songwriters who subsequently achieve long-term success and to renew agreements with established artists and songwriters. In addition, our competitors may from time to time reduce their prices in an effort to expand market share and introduce new services, or improve the quality of their products or services. We may lose business if we are unable to sign successful recording artists or songwriters or to match the prices or the quality of products and services, offered by our competitors. Our Recorded Music business competes not only with other recorded music companies, but also with the recorded music efforts of live events companies and artists who may chose to distribute their own works. Our Music Publishing business

competes not only with other music publishing companies, but also with songwriters who publish their own works. Our Recorded Music business is to a large extent dependent on technological developments, including access to and selection and viability of new technologies, and is subject to potential pressure from competitors as a result of their technological developments. For example, our Recorded Music business may be further adversely affected by technological developments that facilitate the piracy of music, such as Internet peer-to-peer file-sharing and CD-R activity, by an inability to enforce our intellectual property rights in digital environments and by a failure to develop successful business models applicable to a digital environment. The Recorded Music business also faces competition from other forms of entertainment and leisure activities, such as cable and satellite television, pre-recorded films on videocassettes and DVD, the Internet and computer and videogames.

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

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

- limited legal protection and enforcement of intellectual property rights;
- restrictions on the repatriation of capital;
- fluctuations in interest and foreign exchange rates;
- differences and unexpected changes in regulatory environment, including environmental, health and safety, local planning, zoning and labor laws, rules and regulations;
- varying tax regimes which could adversely affect our results of operations or cash flows, including regulations relating to transfer pricing and withholding taxes on remittances and other payments by subsidiaries and joint ventures;
- exposure to different legal standards and enforcement mechanisms and the associated cost of compliance;
- difficulties in attracting and retaining qualified management and employees or rationalizing our workforce;
- tariffs, duties, export controls and other trade barriers;
- longer accounts receivable settlement cycles and difficulties in collecting accounts receivable;
- recessionary trends, inflation and instability of the financial markets;
- higher interest rates; and
- political instability.

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

In addition, our results can be affected by trends, developments and other events in individual countries. There can be no assurance that in the future other country-specific trends, developments or other events will not have such a significant adverse effect on our business, results of operations or financial condition. Unfavorable conditions can depress sales in any given market and prompt promotional or other actions that affect our margins.

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

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

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

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

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

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

We have positioned ourselves to take advantage of online and mobile technology as a sales distribution channel and believe that the development of legitimate channels for digital music distribution holds promise for us in the future. Digital revenue streams of all kinds are important to offset continued declining revenue from physical CD sales industry-wide over time. However, legitimate channels for digital distribution are a recent development and we cannot predict their impact on our business. In digital formats, certain costs associated with physical products such as manufacturing, distribution, inventory and return costs do not apply. Partially eroding that benefit are increases in mechanical copyright royalties payable to music publishers that only apply in the digital space. While there are some digital-specific variable costs and infrastructure investments necessary to produce, market and sell music in digital formats, we believe it is reasonable to expect that we will generally derive a higher contribution margin from digital sales than physical sales. However, we cannot be sure that we will generally continue to achieve higher margins from digital sales. Any legitimate digital distribution channel that does develop may result in lower or less profitable sales for us than comparable physical sales. In addition, the transition to greater sales through digital channels introduces uncertainty regarding the potential impact of the “unbundling” of the album on our business. It remains unclear how consumer behavior will continue to change when customers are faced with more opportunities to purchase only favorite tracks from a given album rather than the entire album. In addition, if piracy continues unabated and legitimate digital distribution channels fail to gain consumer acceptance, our results of operations could be harmed. Furthermore, as new distribution channels continue to develop, we may have to implement systems to process royalties on new revenue streams for potential future distribution channels that are not currently known. These new distribution channels could also result in increases in the number of transactions that we need to process. If we are not able to successfully expand our processing capability or introduce technology to allow us to determine and pay royalty amounts due on these new types of transactions in a timely manner, we may experience processing delays or reduced accuracy as we increase the volume of our digital sales, which could have a negative effect on our relationships with artists and brand identity.

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

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

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

Mechanical royalties and performance royalties are the two largest sources of income to our Music Publishing business and mechanical royalties are a significant expense to our Recorded Music business. In the U.S., mechanical rates are set pursuant to an arbitration process under the U.S. Copyright Act unless rates are determined through voluntary industry negotiations and performance rates are set by performing rights societies and subject to challenge by performing rights licensees. Outside the U.S., mechanical and performance rates are typically negotiated on an industry-wide basis. The mechanical and performance rates set pursuant to such processes may adversely affect us by limiting our ability to increase the profitability of our Music Publishing business. If the mechanical rates are set too high it may also adversely affect us by limiting our ability to increase the profitability of our Recorded Music business. In addition, rates our Recorded Music business receives in the U.S. for, among other sources of income and potential income, webcasting and satellite radio are set by an arbitration process under the U.S. Copyright Act unless rates are determined

through voluntary industry negotiations. It is important as sales shift from physical to diversified distribution channels that we receive fair value for all of the uses of our intellectual property as our business model now depends upon multiple revenue streams from multiple sources. If the rates for Recorded Music income sources that are established through legally prescribed rate-setting processes are set too low, it could have a material adverse impact on our Recorded Music business or our business prospects.

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

On March 31, 2010, we had $1.026 billion of goodwill and $100 million of indefinite-lived intangible assets. Financial Accounting Standards Codification ("ASC") Topic 350, Intangibles—Goodwill and other ("ASC 350") requires that we test these assets for impairment annually (or more frequently should indications of impairment arise) by estimating the fair value of each of our reporting units (calculated using a discounted cash flow method) and comparing that value to the reporting units' carrying value. If the carrying value exceeds the fair value, there is a potential impairment and additional testing must be performed. In performing our annual tests and determining whether indications of impairment exist, we consider numerous factors including actual and projected operating results of each reporting unit, external market factors such as market prices for similar assets, the market capitalization of our stock, and trends in the music industry. We tested our goodwill and other indefinite-lived intangible assets for impairment in the fourth quarter of fiscal 2009 and concluded that such assets were not impaired. We continue to believe that conclusion is appropriate. However, future events may occur that could adversely affect the estimated fair value of our reporting units. Such events may include, but are not limited to, strategic decisions made in response to changes in economic and competitive conditions and the impact of the economic environment on our operating results. Failure to achieve sufficient levels of cash flow at our reporting units could also result in impairment charges on goodwill and indefinite-lived intangible assets. If the value of the acquired goodwill or acquired indefinite-lived intangible assets is impaired, our operating results and shareholder's deficit could be adversely affected.

We also had $1.203 billion of definite-lived intangible assets at March 31, 2010. FASB ASC Topic 360-10-35, ("ASC 360-10-35") requires companies to review these assets for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. If similar events occur as enumerated above such that we believe indicators of impairment are present, we would test for recoverability by comparing the carrying value of the asset to the net undiscounted cash flows expected to be generated from the asset. If those net undiscounted cash flows do not exceed the carrying amount, we would perform the next step, which is to determine the fair value of the asset, which could result in an impairment charge. Any impairment charge recorded would negatively affect our operating results and shareholder's deficit.

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

The reporting currency for our financial statements is the U.S. dollar. We have substantial assets, liabilities, revenues and costs denominated in currencies other than U.S. dollars. To prepare our consolidated financial statements, we must translate those assets, liabilities, revenues and expenses into U.S. dollars at then-applicable exchange rates. Consequently, increases and decreases in the value of the U.S. dollar versus other currencies will affect the amount of these items in our consolidated financial statements, even if their value has not changed in their original currency. These translations could result in significant changes to our results of operations from period to period. Prior to intersegment eliminations, approximately 55% and 60% of our revenues related to operations in foreign territories for the three and six months ended March 31, 2010. From time to time, we enter into foreign exchange contracts to hedge the risk of unfavorable foreign currency exchange rate movements. As of March 31, 2010, we have hedged a portion of our material foreign currency exposures related to royalty payments remitted between our foreign affiliates and our U.S. affiliates for the next fiscal year.

**We may not have full control and ability to direct the operations we conduct through joint ventures and we do not control minority (equity and cost-method) investments.**

We currently have interests in a number of joint ventures and may in the future enter into further joint ventures as a means of conducting our business. In addition, we structure certain of our relationships with recording artists and songwriters as joint ventures. We may not be able to fully control the operations and the assets of our joint ventures, and we may not be able to make major decisions or may not be able to take timely actions with respect to our joint ventures unless our joint venture partners agree.

We also have several equity and cost-method investments. We have invested in privately held companies, some of which are in the startup or development stages. These investments are inherently risky because the markets for the technologies or products these companies are developing are typically in the early stages and may never materialize. We do not control these investments and could lose some or all of our investment in these entities. Our evaluation of investments in private companies is based on the fundamentals of the business, including, among other factors, the nature of their technologies and potential for financial returns.

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

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

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

The U.S. Copyright Act provides authors (or their heirs) a right to terminate U.S. licenses or assignments of rights in their copyrighted works. This right does not apply to works that are "works made for hire." Since the effective date of U.S. copyright liability for sound recordings (February 15, 1972), virtually all of our agreements with recording artists provide that such recording artists render services under an employment-for-hire relationship. A termination right exists under the U.S. Copyright Act for U.S. rights in musical compositions that are not "works made for hire." If any of our commercially available sound recordings were determined not to be "works made for hire," then the recording artists (or their heirs) could have the right to terminate the U.S. rights they granted to us, generally during a five-year period starting at the end of 35 years from the date of a post-1977 license or assignment (or, in the case of a pre-1978 grant in a pre-1978 recording, generally during a five-year period starting either at the end of 56 years from the date of copyright or on January 1, 1978, whichever is later). A termination of U.S. rights could have an adverse effect on our Recorded Music business. From time to time, authors (or their heirs) can terminate our U.S. rights in musical compositions. However, we believe the effect of those terminations is already reflected in the financial results of our Music Publishing business.

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

We may acquire, make investments in, or enter into strategic alliances or joint ventures with, companies engaged in businesses that are similar or complementary to ours. If we make such acquisitions or investments or enter into strategic alliances, we will face certain risks inherent in such transactions. For example, gaining regulatory approval for significant acquisitions or investments could be a lengthy process and there can be no assurance of a successful outcome and we could increase our leverage in connection with acquisitions or investments. We could face difficulties in managing and integrating newly acquired operations. Additionally, such transactions would divert management resources and may result in the loss of recording artists or songwriters from our rosters. If we invest in companies involved in new businesses or develop our own new business opportunities, we will need to integrate and effectively manage these new businesses before any new line of business can become successful, and as such the progress and success of any new business is uncertain. In addition, investments in new business may result in an increase in capital expenditures to build infrastructure to support our new initiatives. We cannot assure you that if we make any future acquisitions, investments, strategic alliances or joint ventures that they will be completed in a timely manner, that they will be structured or financed in a way that will enhance our credit-worthiness or that they will meet our strategic objectives or otherwise be successful. We also may not be successful in implementing appropriate operational, financial and management systems and controls to achieve the benefits expected to result from these transactions. Failure to effectively manage any of these transactions could result in material increases in costs or reductions in expected revenues, or both. In addition, if any new business in which we invest or which we attempt to develop does not progress as planned, we may not recover the funds and resources we have expended and this could have a negative impact on our businesses or our company as a whole.

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

The recorded music industry continues to undergo substantial change. These changes continue to have a substantial impact on our business. See "The recorded music industry has been declining and may continue to decline, which may adversely affect our prospects and our results of operations." Following the Acquisition, we implemented a broad restructuring plan in order to adapt our cost structure to the changing economics of the music industry. We continue to shift resources from our physical sales channels to efforts focused on digital distribution, emerging technologies and other new revenue streams.

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

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

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

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

We regularly implement business process improvement initiatives to harmonize our systems and processes and to optimize our performance. Our current business process initiatives include, but are not limited to, the delivery of a SAP enterprise resource planning application in the U.S. for fiscal 2011. While we will experience changes in internal controls over financial reporting in fiscal 2011 as the implementation occurs, we expect to be able to transition to the new processes and controls with no negative impact to our internal control environment. If we fail to effectively implement the SAP application or if the SAP application fails to operate as designed and intended, it may impact our ability to process transactions accurately and efficiently.

**We are controlled by entities that may have conflicts of interest with us.**

THL, Bain Capital and Providence Equity (collectively, the “Current Investor Group”) control a majority of Parent’s common stock on a fully diluted basis. In addition, representatives of the Current Investor Group occupy substantially all of our seats on our Board of Directors and pursuant to a stockholders agreement, have the right to appoint all of the independent directors to our board. As a result, the Current Investor Group has the ability to control our policies and operations, including the appointment of management, the entering into of mergers, acquisitions, sales of assets, divestitures and other extraordinary transactions, future issuances of Parent’s common stock or other securities, the payments of dividends, if any, on Parent’s common stock, the incurrence of debt by us and the amendment of our certificate of incorporation and Bylaws. The Current Investor Group has the ability to prevent any transaction that requires the approval of our Board of Directors or the stockholders regardless of whether or not other members of our Board of Directors or stockholders believe that any such transaction is in their own best interests. For example, the Current Investor Group could cause us to make acquisitions that increase our indebtedness or to sell revenue-generating assets. Additionally, the Current Investor Group is in the business of making investments in companies and may from time to time acquire and hold interests in businesses that compete directly or indirectly with us. The Current Investor Group may also pursue acquisition opportunities that may be complementary to our business, and, as a result, those acquisition opportunities may not be available to us. So long as the Current Investor Group continues to hold a majority of our outstanding common stock, they will be entitled to nominate a majority of our Board of Directors, and will have the ability to effectively control the vote in any election of directors. In addition, so long as the Current Investor Group continues to own a significant amount of our equity, even if such amount is less than 50%, they will continue to be able to strongly influence or effectively control our decisions.

**Our reliance on one company for the manufacturing, packaging and physical distribution of our products in North America and Europe could have an adverse impact on our ability to meet our manufacturing, packaging and physical distribution requirements.**

Cinram is currently our exclusive supplier of manufacturing, packaging and physical distribution services in North America and most of Europe (with the exception of certain artwork production and packaging provided by Ivy Hill, which was sold by Cinram to Multi Packaging Solutions in 2009). Accordingly, our continued ability to meet our manufacturing, packaging and physical distribution requirements in those territories depends largely on Cinram’s continued successful operation in accordance with the service level requirements mandated by us in our service agreements. If, for any reason, Cinram were to fail to meet contractually required service levels, or was unable to otherwise continue to provide services, we would have difficulty satisfying our commitments

to our wholesale and retail customers, which could have an adverse impact on our revenues. In February 2010, Moody's Investor Service downgraded Cinram's debt ratings and Standard & Poor's put them on "credit watch" due to Cinram's announcement that it had received notice from a significant customer that the customer exercised its option to terminate its service agreements in July 2010. Cinram will have to refinance its credit facility when it comes due in May 2011. In May 2010, Standard & Poor's lowered its debt ratings on Cinram, basing this again on the upcoming loss of the significant customer in July 2010 and refinancing risk with its upcoming bank loan maturity in May 2011. Any inability of Cinram to continue to provide services due to financial distress, refinancing issues or otherwise could also require us to switch to substitute suppliers of these services. Even though our agreements with Cinram give us a right to terminate based upon failure to meet mandated service levels, and there are several capable substitute suppliers, it might be difficult for us to switch to substitute suppliers for any such services, particularly in the short term, and the delay and transition time associated with finding substitute suppliers could also have an adverse impact on our revenues.

On March 13, 2007, we entered into amendments to our existing manufacturing, packaging and physical distribution arrangements with Cinram for our physical products in North America and most of Europe. Cinram will remain our exclusive supplier of manufacturing, packaging and physical distribution services in North America and most of Europe. The terms of the Cinram agreements remain substantially the same as the terms of the original agreements. We believe that the terms of these agreements, as amended, continue to reflect market rates. The agreements, as amended, now expire on December 31, 2010.

**We may be materially and adversely affected by the formation of Live Nation Entertainment.**

On February 10, 2009, Live Nation and Ticketmaster Entertainment announced a proposed merger to form Live Nation Entertainment. The Live Nation-Ticketmaster merger attracted intense scrutiny and was reviewed by the U.S. Department of Justice, several State Attorneys General (including New York, California, Illinois, Florida and Massachusetts) and the U.K., where it was referred to the Monopolies and Mergers Commission for a more detailed investigation. The merger would combine the world's largest online ticketing, concert promotion and management companies including Front Line Management. The combined entity would control venues, ticketing and ancillary revenues derived from concerts, and in some cases would act as a record label as part of the expanded-rights deals Live Nation has signed with several artists. On January 25, 2010, the U.S. Department of Justice cleared the merger but required the companies to make several concessions as a condition of their approval. We cannot predict what impact Live Nation Entertainment might have on us.

## Risks Related to our Leverage

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

We are highly leveraged. As of March 31, 2010, our total consolidated indebtedness was $1.676 billion.

Our high degree of leverage could have important consequences for our investors, including:

- making it more difficult for us and our subsidiaries to make payments on indebtedness;
- increasing our vulnerability to general economic and industry conditions;
- requiring a substantial portion of cash flow from operations to be dedicated to the payment of principal and interest on indebtedness, therefore reducing our ability to use our cash flow to fund our operations, capital expenditures and future business opportunities;
- limiting our ability and the ability of our subsidiaries to obtain additional financing for working capital, capital expenditures, product development, debt service requirements, acquisitions and general corporate or other purposes; and
- limiting our ability to adjust to changing market conditions and placing us at a competitive disadvantage compared to our competitors who are less highly leveraged.

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

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

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

While Parent currently has sufficient cash to make scheduled interest payments on behalf of Holdings, in the future Holdings, our immediate parent company, also may rely on us and our subsidiaries to make payments on its borrowings. If we do not dividend funds to Holdings in an amount sufficient to make such payments, Holdings may default under the indenture governing its borrowings, which would result in all such notes becoming due and payable. Because our debt agreements have covenants that limit our ability to make payments to Holdings, Holdings may not have access to funds in an amount sufficient to service its indebtedness.

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

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

- incur additional indebtedness or issue certain preferred shares;
- pay dividends on or make distributions in respect of Parent's common stock or make other restricted payments;
- make certain investments;
- sell certain assets;
- create liens on certain indebtedness without in certain cases securing the applicable indebtedness;
- consolidate, merge, sell or otherwise dispose of all or substantially all of our assets;
- enter into certain transactions with our affiliates; and
- designate our subsidiaries as unrestricted subsidiaries.

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

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

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

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

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

Item 2 is not applicable and has been omitted.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Item 3 is not applicable and has been omitted.

## ITEM 4. (REMOVED AND RESERVED)

## ITEM 5. OTHER INFORMATION

*French Legal Proceedings*

As previously disclosed, APPAC, a minority shareholder group of Vivendi Universal, initiated an inquiry in the Paris Court of Appeal into various issues relating to Vivendi, including Vivendi's financial disclosures, the appropriateness of executive compensation, and trading in Vivendi stock by certain individuals previously associated with Vivendi. The inquiry has encompassed certain trading by Mr. Bronfman in Vivendi stock. Several individuals, including Mr. Bronfman (the former Vice Chairman of Vivendi) and the former CEO, CFO and COO of Vivendi, had been given the status of "mis en examen" in connection with the inquiry. Although there is no equivalent to "mis en examen" in the U.S. system of jurisprudence, it is a preliminary stage of proceedings that does not entail any filing of charges.

In January 2009, the Paris public prosecutor formally recommended that no charges be filed and that Mr. Bronfman not be referred for trial. On October 22, 2009, the investigating magistrate rejected the prosecutor's recommendation and released an order referring for trial Mr. Bronfman and six other individuals, including the former CEO, CFO and COO of Vivendi. While the inquiry encompassed various issues, Mr. Bronfman has been referred for trial solely with respect to certain trading in Vivendi stock. The trial is currently scheduled to take place during June 2010. The outcome of the trial and any subsequent proceedings with respect to Mr. Bronfman is uncertain at this time. Mr. Bronfman believes that his trading in Vivendi stock was at all times proper.

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## ITEM 6. EXHIBITS

| | |
|---|---|
| 3.1 | Amended and Restated Certificate of Incorporation of WMG Acquisition Corp. (1) |
| 3.2 | Amended and Restated Bylaws of WMG Acquisition Corp. (2) |
| 31.1 | Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended* |
| 31.2 | Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-15(a) of the Securities Exchange Act of 1934, as amended* |
| 32.1 | Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002** |
| 32.2 | Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002** |

* Filed herewith.

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

(1) Incorporated by reference to exhibit 3.196 to WMG Acquisition Corp’s Amendment No. 1 to the Registration Statement on Form S-4 (File No. 333-12122).

(2) Incorporated by reference to exhibit 3.197 to WMG Acquisition Corp’s Amendment No. 1 to the Registration Statement on Form S-4 (File No. 333-12122).

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## SIGNATURES

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

May 6, 2010

WMG ACQUISITION CORP.

| | |
|---|---|
| By: | /s/ EDGAR BRONFMAN, JR. |
| **Name:** | **Edgar Bronfman, Jr.** |
| **Title:** | **Chief Executive Officer and Chairman of the Board of Directors (Principal Executive Officer)** |
| By: | /s/ STEVEN MACRI |
| **Name:** | **Steven Macri** |
| **Title:** | **Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)** |

**Exhibit 31.1**

**CHIEF EXECUTIVE OFFICER CERTIFICATION**

I, Edgar Bronfman, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q for the period ended March 31, 2010 of WMG Acquisition Corp. (the "Registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Dated: May 6, 2010

/s/ EDGAR BRONFMAN, JR.

**Chief Executive Officer and Chairman of the Board of Directors (Principal Executive Officer)**

**Exhibit 31.2**

**CHIEF FINANCIAL OFFICER CERTIFICATION**

I, Steven Macri, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the period ended March 31, 2010 of WMG Acquisition Corp. (the "Registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Dated: May 6, 2010

/s/ STEVEN MACRI

**Chief Financial Officer (Principal Financial and Accounting Officer)**

**Exhibit 32.1**

**Certification of the Chief Executive Officer**
**Pursuant to 18 U.S.C. Section 1350,**
**As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report of WMG Acquisition Corp. (the "Company") on Form 10-Q for the period ended March 31, 2010 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Edgar Bronfman, Jr., Chief Executive Officer of the Company certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: May 6, 2010

/s/ EDGAR BRONFMAN, JR.

**Edgar Bronfman, Jr.**
**Chief Executive Officer**

**Exhibit 32.2**

**Certification of the Chief Financial Officer**
**Pursuant to 18 U.S.C. Section 1350,**
**As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report of WMG Acquisition Corp. (the "Company") on Form 10-Q for the period ended March 31, 2010 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Steven Macri, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: May 6, 2010

/s/ STEVEN MACRI

**Steven Macri**
**Chief Financial Officer**