
**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, 2007

OR

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

Commission File Number
001-32502

Warner Music Group Corp.

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

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

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

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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, 2007, the number of shares of the Registrant's common stock, par value \$0.001 per share, outstanding was 149,505,665,711.

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ITEM 1. FINANCIAL STATEMENTS

Warner Music Group Corp.
Consolidated Balance Sheets

	March 31, 2007 (unaudited)	September 30, 2006 (audited)
(in millions)		
Assets		
Current assets:		
Cash and equivalents	\$ 362	\$ 367
Short-term investments	—	18
Accounts receivable, less allowances of \$198 and \$207 million, respectively	513	585
Inventories	70	59
Royalty advances expected to be recouped within one year	194	191
Deferred tax assets	61	45
Other current assets	37	35
Total current assets	1,237	1,300
Royalty advances expected to be recouped after one year	238	207
Investments	26	25
Property, plant and equipment, net	135	146
Goodwill	984	929
Intangible assets subject to amortization, net	1,679	1,711
Intangible assets not subject to amortization	100	100
Other assets	93	102
Total assets	<u>\$ 4,492</u>	<u>\$ 4,520</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 200	\$ 209
Accrued royalties	1,178	1,142
Taxes and other withholdings	32	32
Current portion of long-term debt	17	17
Dividends payable	22	22
Other current liabilities	333	377
Total current liabilities	1,782	1,799
Long-term debt	2,249	2,239
Dividends payable	1	3
Deferred tax liabilities, net	205	197
Other noncurrent liabilities	251	224
Total liabilities	<u>4,488</u>	<u>4,462</u>
Commitments and Contingencies (See Note 12)		
Shareholders' equity:		
Common stock (\$0.001 par value; 500,000,000 shares authorized; 149,565,413 and 149,156,028 shares issued and outstanding, respectively)	—	—
Additional paid-in capital	574	567
Accumulated deficit	(564)	(516)
Accumulated other comprehensive income, net	(6)	7
Total shareholders' equity	4	58
Total liabilities and shareholders' equity	<u>\$ 4,492</u>	<u>\$ 4,520</u>

See accompanying notes.

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Warner Music Group Corp.
Consolidated Statements of Operations (Unaudited)
Three Months Ended March 31, 2007 and 2006

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
	(in millions, except per share amounts)	
Revenues (b)	\$ 784	\$ 796
Costs and expenses:		
Cost of revenues (a) (b)	(427)	(409)
Selling, general and administrative expenses (a) (b)	(275)	(294)
Restructuring costs	(12)	—
Amortization of intangible assets	(51)	(48)
Total costs and expenses	(765)	(751)
Operating income	19	45
Interest expense, net	(45)	(45)
Equity in the gains of equity-method investees, net	—	1
Other income, net	—	2
(Loss) income before income taxes	(26)	3
Income tax expense	(1)	(10)
Net loss	\$ (27)	\$ (7)
Net loss per common share:		
Basic	\$ (0.19)	\$ (0.05)
Diluted	\$ (0.19)	\$ (0.05)
Weighted average common shares:		
Basic	145.9	141.9
Diluted	145.9	141.9
(a) Includes depreciation expense of	\$ (10)	\$ (11)
(b) Includes the following expenses resulting from transactions with related companies:		
Revenues	\$ 2	\$ 4
Selling, general and administrative expenses	\$ —	\$ (3)

See accompanying notes.

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Warner Music Group Corp.
Consolidated Statements of Operations (Unaudited)
Six Months Ended March 31, 2007 and 2006

	Six Months Ended March 31, 2007	Six Months Ended March 31, 2006
	(in millions, except per share amounts)	
Revenues (b)	\$ 1,712	\$ 1,840
Costs and expenses:		
Cost of revenues (a) (b)	(935)	(939)
Selling, general and administrative expenses (a) (b)	(565)	(617)
Restructuring costs	(12)	—
Amortization of intangible assets	(101)	(95)
Total costs and expenses	<u>(1,613)</u>	<u>(1,651)</u>
Operating income	99	189
Interest expense, net	(92)	(90)
Equity in the gains of equity-method investees, net	—	1
Other income, net	<u>—</u>	<u>2</u>
Income before income taxes	7	102
Income tax expense	<u>(16)</u>	<u>(40)</u>
Net (loss) income	<u>\$ (9)</u>	<u>\$ 62</u>
Net (loss) income per common share:		
Basic	<u>\$ (0.06)</u>	<u>\$ 0.44</u>
Diluted	<u>\$ (0.06)</u>	<u>\$ 0.41</u>
Weighted average common shares:		
Basic	<u>145.4</u>	<u>141.7</u>
Diluted	<u>145.4</u>	<u>150.6</u>
(a) Includes depreciation expense of	<u>\$ (20)</u>	<u>\$ (22)</u>
(b) Includes the following expenses resulting from transactions with related companies:		
Revenues	\$ 3	\$ 4
Cost of revenues	\$ (1)	\$ —
Selling, general and administrative expenses	\$ (4)	\$ (8)

See accompanying notes.

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Warner Music Group Corp.
Consolidated Statements of Cash Flows (Unaudited)
Six Months Ended March 31, 2007 and 2006

	Six Months Ended March 31, 2007	Six Months Ended March 31, 2006
	(in millions)	
Cash flows from operating activities		
Net (loss) income	\$ (9)	\$ 62
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Depreciation and amortization	121	117
Deferred taxes	(22)	(2)
Non-cash interest expense	31	26
Non-cash, stock-based compensation expense	5	8
Equity in the gains of equity-method investees, including distributions	—	(1)
Changes in operating assets and liabilities:		
Accounts receivable	118	108
Inventories	(7)	8
Royalty advances	(28)	(29)
Accounts payable and accrued liabilities	(102)	(70)
Other balance sheet changes	—	(22)
Net cash provided by operating activities	<u>107</u>	<u>205</u>
Cash flows from investing activities		
Loan to third parties	(24)	—
Sales (purchases) in short-term investments	18	(61)
Investments and acquisitions	(57)	(18)
Proceeds from the sale of buildings	7	—
Capital expenditures	(13)	(12)
Net cash used in investing activities	<u>(69)</u>	<u>(91)</u>
Cash flows from financing activities		
Quarterly debt repayments	(8)	(8)
Proceeds from the exercise of stock options	2	—
Dividends paid	(40)	(37)
Net cash used in financing activities	(46)	(45)
Effect of foreign currency exchange rate changes on cash	3	2
Net (decrease) increase in cash and equivalents	(5)	71
Cash and equivalents at beginning of period	367	288
Cash and equivalents at end of period	<u>\$ 362</u>	<u>\$ 359</u>

See accompanying notes.

Warner Music Group Corp.
Consolidated Statement of Shareholders' Equity (Unaudited)
Six Months Ended March 31, 2007

	<u>Common Stock</u>		<u>Additional Paid-in Capital</u> <small>(in millions, except number of common shares)</small>	<u>Accumulated Deficit</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Shareholders' Equity</u>
	<u>Shares</u>	<u>Value</u>				
Balance at September 30, 2006	149,156,028	—	\$ 567	\$ (516)	\$ 7	\$ 58
Comprehensive loss:						
Net loss	—	—	—	(9)	—	(9)
Foreign currency translation adjustment	—	—	—	—	(6)	(6)
Deferred losses on derivative financial instruments	—	—	—	—	(7)	(7)
Total comprehensive loss	—	—	—	(9)	(13)	(22)
Dividends	—	—	—	(38)	—	(38)
Issuance of stock options and restricted shares of common stock	409,385	—	5	—	—	5
Exercises of stock options	—	—	2	—	—	2
Other	—	—	—	(1)	—	(1)
Balance at March 31, 2007	<u>149,565,413</u>	<u>—</u>	<u>\$ 574</u>	<u>\$ (564)</u>	<u>\$ (6)</u>	<u>\$ 4</u>

See accompanying notes.

Warner Music Group Corp.
Notes to Consolidated Interim Financial Statements (Unaudited)

1. Description of Business

Warner Music Group Corp. (the “Company” or “Parent”) was formed by a private equity consortium of Investors (the “Investor Group”) on November 21, 2003. The original Investor Group included Thomas H. Lee Partners, L.P. and its affiliates (“THL”), Bain Capital and its affiliates (“Bain”), Providence Equity Partners, Inc. and its affiliates (“Providence”) and Music Capital Partners, L.P. (“Music Capital”). The shares held by Music Capital had been subject to a stockholders agreement among Music Capital, THL, Bain and Providence and certain other parties. On May 7, 2007, Music Capital made a pro rata distribution of all shares of common stock of the Company held by it to its partners. Music Capital’s partnership agreement requires that the Music Capital partnership dissolve and commence winding up by the second anniversary of the Company’s May 2005 initial public offering. At such time, 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 is the direct parent of WMG Holdings Corp. (“Holdings”), which is the direct parent of WMG Acquisition Corp. (“Acquisition Corp.”). Acquisition Corp. is one of the world’s major music-based content companies 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, Acquisition Corp. acquired such interests from Time Warner for approximately \$2.6 billion (the “Acquisition”).

The Company’s business is seasonal. Therefore, operating results for the three and six months ended March 31, 2007 are not necessarily indicative of the results that may be expected for the fiscal year ended September 30, 2007.

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 consists of the discovery and development of artists and the related marketing, distribution and licensing of recorded music produced by such artists. In addition to the more traditional methods of discovering and developing artists, the Company established the Independent Label Group (“ILG”) to discover artists earlier in their careers and at lower cost by leveraging the Company’s independent distribution network.

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 Entertainment (“Rhino”), a division that specializes in marketing the Company’s music catalog through compilations and reissues of previously released music and video titles, as well as in the licensing of recordings to and from third parties for various uses, including film and television soundtracks. On May 31, 2006, the Company completed the acquisition of Ryko Corporation (“Ryko”), a leading independent, integrated music and entertainment company. See Note 5.

In January 2007, the Company acquired a majority interest in Roadrunner Music Group B.V. (“Roadrunner”), which includes Roadrunner Records, one of the leading hard rock and heavy metal labels. See Note 5.

Outside the U.S., Recorded Music activities are conducted in more than 50 countries 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 domestic record labels have international rights. In certain smaller countries, WMI licenses to unaffiliated third-party record labels the right to distribute its records.

Recorded Music distribution operations include Warner-Elektra-Atlantic Corporation (“WEA Corp.”), which markets and sells music products to retailers and wholesale distributors in the U.S.; Alternative Distribution Alliance (“ADA”), which distributes the products of independent labels to retail and wholesale distributors in the U.S.; Ryko Distribution, which distributes music and DVD releases from Rykodisc, Ryko’s record music label, and third-party record and video labels; various distribution centers and ventures operated

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internationally; an 80% interest in Word Entertainment, which specializes in the distribution of music products in the Christian retail marketplace; and ADA U.K., which provides ADA's distribution services to independent labels in the U.K.

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 rights holders, the Company's Music Publishing business gamers 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 Los Angeles, with operations in over 50 countries through various subsidiaries, affiliates and non-affiliated licensees. The Company owns or controls rights to more than one million musical compositions, including numerous pop hits, American standards, folk songs 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. and Hallmark Entertainment. In addition to the more traditional methods, the Company has implemented new initiatives to promote and develop emerging songwriters, such as its label, Perfect Game Recording Co., which similar to ILG seeks to identify and nurture songwriters earlier in the development process.

Publishing revenues are derived from four main sources:

- *Mechanical*: the licensor receives royalties with respect to compositions embodied in recordings sold in any format or configuration, including physical recordings (e.g., CDs, DVDs, video cassettes), online and wireless downloads and mobile phone ringtones.
- *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.
- *Other*: the licensor receives royalties from other uses such as in toys or novelty items and for use in sheet music.

2. Basis of Presentation

Interim Financial Statements

The accompanying consolidated financial statements are unaudited but, in the opinion of management, contain all the adjustments (consisting of those of a normal recurring nature) considered necessary to present fairly the Company's financial position and the results of operations and cash flows for the periods presented in conformity with accounting principles generally accepted in the U.S. ("U.S. GAAP") applicable to interim periods. The accompanying consolidated financial statements should be read in conjunction with the audited consolidated financial statements of the Company included in its Annual Report on Form 10-K for the fiscal year ended September 30, 2006 (Registration No. 001-32502).

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Basis of Consolidation

The consolidated accounts include 100% of the assets, liabilities, revenues, expenses, income, losses and cash flows of the Company and 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 in consolidation.

Stock-Based Compensation

In December 2004, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 123(R), "Share-Based Payment," ("FAS 123(R)") which revises FASB Statement No. 123, "Accounting for Stock-Based Compensation" ("FAS 123"). FAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized as compensation expense based on their fair value. Effective March 1, 2004, in connection with the Acquisition, the Company adopted the fair value recognition provisions of FAS 123 to account for all stock-based compensation plans adopted subsequent to the Acquisition. Under the fair value recognition provisions of FAS 123, 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. The Company expenses deferred stock-based compensation on an accelerated basis over the vesting period of the stock award. Effective October 1, 2005, the Company adopted FAS 123(R) using the modified prospective method. There was no impact to the Company's results of operations or financial position as a result of the adoption of FAS 123(R).

Accounting for Pension and Post-retirement Plans

In September 2006, the FASB issued FASB Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106 and 132(R)" ("FAS 158"). FAS 158 requires all companies to recognize the funded status of all sponsored plans on the balance sheet. Under FAS 158, all underfunded plans are aggregated and recorded as a liability, and all overfunded plans are aggregated and recorded as an asset. The Company is required to implement these provisions of FAS 158 in the fiscal year ended September 30, 2007. The Company recorded an adjustment to reflect the implementation of FAS 158, which resulted in an other pension asset of \$1 million, an additional pension liability of \$3 million and an other comprehensive loss of approximately \$2 million. The Company also recorded related tax adjustments of approximately \$2 million.

FAS 158 also eliminates the early measurement date option previously permitted under the related guidance. The Company will be required to implement this change in the fiscal year ended September 30, 2008.

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3. Comprehensive (Loss) Income

Comprehensive (loss) income consists of net (loss) income and other gains and losses affecting equity that, under U.S. GAAP, are excluded from net income. For the Company, the components of other comprehensive income primarily consist of foreign currency translation gains and losses and deferred gains and losses on financial instruments designated as hedges under FASB Statement No. 133, "Accounting for Derivative and Hedging Activities", which include interest-rate swaps and foreign exchange contracts, as well as adjustments to correctly state pension obligations. The following summary sets forth the components of comprehensive (loss) income, net of related taxes, for the three and six months ended March 31, 2007 and 2006 (in millions):

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006	Six Months Ended March 31, 2007	Six Months Ended March 31, 2006
Net (loss) income	\$ (27)	\$ (7)	\$ (9)	\$ 62
Foreign currency translation losses (a)	—	—	(6)	(2)
Derivative financial instruments (losses) gains	(6)	2	(7)	9
Comprehensive (loss) income	<u>\$ (33)</u>	<u>\$ (5)</u>	<u>\$ (22)</u>	<u>\$ 69</u>

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

4. Net (Loss) Income Per Common Share

The Company computes net (loss) income per common share in accordance with FASB Statement No. 128, "Earnings per Share" ("FAS 128"). Under the provisions of FAS 128, basic net (loss) income per common share is computed by dividing the net (loss) income applicable to common shares after preferred dividend requirements, if any, by the weighted average of common shares outstanding during the period. Diluted net (loss) income per common share adjusts basic net (loss) income per common share for the effects of stock options, warrants and other potentially dilutive financial instruments, only in the periods in which such effect is dilutive.

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

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006	Six Months Ended March 31, 2007	Six Months Ended March 31, 2006
Basic and diluted net (loss) income per common share:				
Numerator:				
Net (loss) income for basic calculation	<u>\$ (27)</u>	<u>\$ (7)</u>	<u>\$ (9)</u>	<u>\$ 62</u>
Net (loss) income for diluted calculation	<u>\$ (27)</u>	<u>\$ (7)</u>	<u>\$ (9)</u>	<u>\$ 62</u>
Denominator:				
Weighted average common shares outstanding for basic calculation (a)	<u>145.9</u>	<u>141.9</u>	<u>145.4</u>	<u>141.7</u>
Weighted average common outstanding shares for diluted calculation	<u>145.9</u>	<u>141.9</u>	<u>145.4</u>	<u>150.6</u>
Net (loss) income per common share—basic	<u>\$ (0.19)</u>	<u>\$ (0.05)</u>	<u>\$ (0.06)</u>	<u>\$ 0.44</u>
Net (loss) income per common share—diluted	<u>\$ (0.19)</u>	<u>\$ (0.05)</u>	<u>\$ (0.06)</u>	<u>\$ 0.41</u>

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

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The calculation of diluted net (loss) income per common share for each of the periods includes the effects of the assumed exercise of any outstanding stock options or warrants and the assumed vesting of shares of restricted stock where dilutive. The assumed exercise of outstanding stock options and warrants and the assumed vesting of restricted stock represent the following dilutive effect (in millions of shares):

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006	Six Months Ended March 31, 2007	Six Months Ended March 31, 2006
Stock options	2	3	2	3
Restricted stock	3	6	4	6
	<u>5</u>	<u>9</u>	<u>6</u>	<u>9</u>

5. Significant Acquisitions and Dispositions

Acquisition of Roadrunner Music Group

On January 29, 2007, the Company acquired 73.5% of Roadrunner, which includes Roadrunner Records, a leading hard rock and heavy metal label. The transaction was accounted for under the purchase method of accounting, and the results of operations of Roadrunner have been included in the Company's results of operations from the date of acquisition. The purchase price has been preliminarily allocated to the underlying net assets acquired in proportion to the estimated fair value, principally recorded music catalog, artist contracts and goodwill. The accompanying consolidated financial statements include the following allocation of the approximately \$83 million purchase price, consisting of a cash payment of \$59 million and estimated future payment obligations of \$24 million: recorded music catalog, \$15 million; artists' contracts, \$26 million; goodwill, \$27 million; tangible assets, \$47 million; and tangible liabilities, \$32 million.

In connection with the signing of the initial agreement in December 2006, the Company had loaned Roadrunner approximately \$52 million in the form of a promissory note. The note was repaid in connection with the close of the acquisition on January 29, 2007. In addition, in connection with the closing, the Company loaned the minority owner approximately \$14.3 million in the form of a promissory note, which bears an annual simple rate of interest of 4.73% and matures in six years and can be utilized to satisfy the future payment obligations.

Acquisition of Ryko Corporation

On May 31, 2006, the Company completed the acquisition of Ryko, a leading independent, integrated music and entertainment company, for approximately \$67.5 million in cash. Ryko consists of a recorded music label, Rykodisc, which focuses on a range of contemporary music and comedy releases and numerous film and television soundtracks and Ryko Distribution, which distributes music and DVD releases from Rykodisc as well as from independent third-party record and video labels. Additionally, Ryko owns a catalog of more than 1,000 titles of rock, folk, jazz, world, blues and alternative albums including Restless Records' catalog of punk, new wave and soundtrack recordings. The catalog and roster includes artists such as Frank Zappa, Joe Jackson, Soul Asylum, The Flaming Lips and They Might Be Giants. The transaction was accounted for under the purchase method of accounting, and the results of operations of Ryko are included in the Company's results of operations from the acquisition date of Ryko. The purchase price was allocated to the underlying net assets acquired in proportion to the estimated fair value, principally recorded music catalog and goodwill. The accompanying consolidated financial statements include the following allocation of the approximately \$67.5 million purchase price: recorded music catalog, \$28 million; artists' contracts, \$1 million; tangible liabilities, \$13 million; and goodwill, \$52 million.

Acquisition of Maverick Recording Company

In November 2004, the Company acquired an additional 30% interest in Maverick Recording Company ("Maverick") from its existing partner for approximately \$17 million and certain amounts previously owed by such partner to the Company, bringing its total interest in Maverick to 80%. The transaction was accounted for

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under the purchase method of accounting and the purchase price was allocated to the underlying net assets of Maverick in proportion to the estimated fair value, principally artist contracts and recorded music catalog.

On July 14, 2006, the Company acquired the remaining 20% interest in Maverick from its existing partner. The additional purchase price was allocated to the underlying net assets of Maverick in proportion to the estimated fair value, principally goodwill.

6. Inventories

Inventories consist of the following (in millions):

	March 31, 2007 (unaudited)	September 30, 2006 (audited)
Compact discs, cassettes and other music-related products	\$ 117	\$ 100
Published sheet music and song books	2	2
	119	102
Less reserve for obsolescence	(49)	(43)
	<u>\$ 70</u>	<u>\$ 59</u>

7. Intangible Assets

Intangible assets consist of the following (in millions):

	September 30, 2006 (audited)	Acquisitions	Other (a)	March 31, 2007 (unaudited)
Intangible assets subject to amortization:				
Recorded music catalog (b)	\$ 1,288	\$ 15	\$ 4	\$ 1,307
Music publishing copyrights	852	4	16	872
Artist contracts (b)	39	27	—	66
Trademarks	10	—	—	10
Other intangible assets	4	2	—	6
	2,193	48	20	2,261
Accumulated amortization	(482)			(582)
Total net intangible assets subject to amortization	1,711			1,679
Intangible assets not subject to amortization:				
Trademarks and brands	100			100
Total net other intangible assets	<u>\$ 1,811</u>			<u>\$ 1,779</u>

(a) Other represents foreign currency translation adjustments.

(b) The acquisitions primarily relate to \$26 million of artist contracts and \$15 million of recorded music catalog acquired in connection with the acquisition of Roadrunner.

8. Restructuring Costs

Realignment Plan for Fiscal Year 2007

The Company announced plans to implement changes intended to better align the Company's workforce with the changing nature of the music industry. These changes are part of the Company's continued evolution from a traditional record and songs-based business to a music-based content company and its ongoing management of its cost structure. The changes include a continued redeployment of resources to focus on new

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business initiatives to help the Company diversify its revenue streams, including digital opportunities. The realignment plan is also designed to improve the operating effectiveness of our current businesses and to realign our management structure to, among other things, effectively address the continued development of digital distribution channels along with the decline of industry-wide CD sales.

The Company intends to enhance its effectiveness, flexibility, structure, and performance by reducing and realigning long-term costs. This will primarily consist of the reorganization of management structures to more adequately and carefully address regional needs and new business requirements, to reduce organizational complexity and to improve leadership channels. The Company also intends to continue to shift resources from our physical sales channels to efforts focused on digital distribution and emerging technologies and other new revenue streams. Part of the plan will also result in the outsourcing of some back-office functions as a cost-savings measure. In connection with these reductions, the Company expects to incur a charge ranging from \$55 million to \$65 million for severance and related benefits. In addition, the Company expects to incur implementation charges ranging from \$10 million to \$15 million related to consulting fees, costs of temporary workers and stay bonuses. All of these restructuring and implementation costs will be paid in cash. To implement such changes, the Company expects to reduce headcount by approximately 400 employees. The Company expects the majority of any cost savings to be offset by new hirings and ongoing investment focused on new business initiatives such as digital distribution and video.

We anticipate that the changes described above will be implemented by the end of the fiscal year 2007. The Company also expects to incur substantially all of the costs associated with the realignment plan by the end of the current fiscal year. Approximately \$12 million of restructuring costs were incurred in the Company's fiscal second quarter of 2007, consisting primarily of the elimination of duplicative positions and redirecting of resources to growth areas of the Company's businesses in Europe.

	<u>Employee Terminations</u>	<u>Other Exit Costs</u> (in millions)	<u>Total</u>
Liability as of September 30, 2006	\$ —	\$ —	\$ —
Additions in 2007	12	—	12
Cash paid during the six months ended March 31, 2007	(2)	—	(2)
Liability as of March 31, 2007	<u>\$ 10</u>	<u>\$ —</u>	<u>\$ 10</u>

Acquisition-Related Restructuring Costs

As of March 31, 2007, the Company had approximately \$26 million of liabilities for acquisition-related restructuring costs that were recognized as part of the cost of the Acquisition. These liabilities represent estimates of future cash obligations for all restructuring activities that have been implemented, as well as for all restructuring activities that have been committed to by management but have yet to occur. The outstanding balance of these liabilities primarily relates to extended payment terms for severance obligations and long-term lease obligations for vacated facilities. These remaining lease obligations are expected to be settled by 2019. The Company expects to pay the majority of the remaining employee termination costs by the end of fiscal year 2007.

	<u>Employee Terminations</u>	<u>Other Exit Costs</u> (in millions)	<u>Total</u>
Liability as of September 30, 2006	\$ 4	\$ 28	\$ 32
Cash paid during the six months ended March 31, 2007	(1)	(4)	(5)
Non-cash reductions during the six months ended March 31, 2007 (a)	—	(1)	(1)
Liability as of March 31, 2007	<u>\$ 3</u>	<u>\$ 23</u>	<u>\$ 26</u>

- (a) Principally relates to changes in foreign currency exchange rates and the non-cash write-off of the carrying value of advances relating to terminating certain artist, songwriter and co-publisher contracts.

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

	<u>March 31,</u> <u>2007</u> <u>(unaudited)</u>	<u>September 30,</u> <u>2006</u> <u>(audited)</u>
Senior secured credit facility:		
Revolving credit facility	\$ —	\$ —
Term loan	<u>1,405</u>	<u>1,413</u>
	1,405	1,413
7.375% U.S. dollar-denominated Senior Subordinated Notes due 2014—Acquisition Corp.	465	465
8.125% Sterling-denominated Senior Subordinated Notes due 2014—Acquisition Corp.	196	187
9.5% Senior Discount Notes due 2014—Holdings	<u>200</u>	<u>191</u>
Total debt	2,266	2,256
Less current portion	<u>(17)</u>	<u>(17)</u>
Total long-term debt	<u>\$ 2,249</u>	<u>\$ 2,239</u>

Restricted Net Assets

The Company is a holding company that conducts substantially all its business operations through the Company's subsidiary, Acquisition Corp. and its subsidiaries. Accordingly, the ability of the Company to obtain funds from its subsidiaries is restricted by the senior secured credit facility of Acquisition Corp., the indenture for the 7.375% U.S. dollar-denominated Senior Subordinated Notes due 2014 and 8.125% Sterling-denominated Senior Subordinated Notes due 2014 (collectively, the "Acquisition Corp. Senior Subordinated Notes") and the indenture for the 9.5% Senior Discount Notes due 2014 issued by Holdings ("Holdings Discount Notes").

10. 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, 2007 and 2006 by segment and on a consolidated basis (in millions):

	<u>Three Months</u> <u>Ended</u> <u>March 31, 2007</u>	<u>Three Months</u> <u>Ended</u> <u>March 31, 2006</u>	<u>Six Months</u> <u>Ended</u> <u>March 31, 2007</u>	<u>Six Months</u> <u>Ended</u> <u>March 31, 2006</u>
Recorded Music	\$ 2	\$ 1	\$ 4	\$ 4
Music Publishing	(1)	—	(1)	1
Corporate expenses	<u>1</u>	<u>1</u>	<u>2</u>	<u>3</u>
Total	<u>\$ 2</u>	<u>\$ 2</u>	<u>\$ 5</u>	<u>\$ 8</u>

During the three and six months ended March 31, 2007, employees of the Company exercised 13,790 and 434,759 stock options, respectively. The Company received cash payments in respect of those exercises in the amount of approximately \$0.1 million and \$2 million, respectively.

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11. Shareholders' Equity

Return of Capital and Dividends Paid

On March 8, 2007, the Company declared a dividend on its outstanding stock at a rate of \$0.13 per share, or approximately \$19 million in the aggregate, which was paid on April 27, 2007 to the Company's shareholders, except for the portion of the dividends with respect to the unvested restricted stock, which will be paid at such time as such shares become vested.

On December 29, 2006, the Company declared a dividend on its outstanding common stock at a rate of \$0.13 per share, or approximately \$19 million in the aggregate, which was paid to the Company's shareholders on February 16, 2007, except for the portion of the dividends with respect to the unvested restricted stock, which will be paid at such time as such shares become vested.

On August 31, 2006, the Company declared a dividend on its outstanding common stock at a rate of \$0.13 per share, or approximately \$19 million in the aggregate, which was paid to the Company's shareholders on October 20, 2006, except for the portion of the dividends with respect to unvested restricted stock, which will be paid at such time as such shares become vested.

During the six months ended March 31, 2007, 1,817,902 shares of restricted stock purchased by or awarded to certain employees vested.

12. Commitments and Contingencies

Radio Promotion Activities

Two independent labels have filed antitrust suits against the Company alleging that its radio promotion activities are anticompetitive. *Radikal Records, Inc. v. Warner Music Group, et al.* was filed on March 21, 2006 in U.S. District Court in the Central District of California, Western Division. *TSR Records, Inc. v. Warner Music Group, et al.* was filed on March 28, 2006 in U.S. District Court in the Central District of California, Western Division. The Company filed a Notice of Related Case and was successful in having both of these cases consolidated. On May 16, 2006, the Company filed a Motion to Dismiss in both cases. On October 11, 2006, the court denied the Company's Motion to Dismiss as to the antitrust claims but granted the motion, with leave to amend, as to the state tort claim for interference with prospective economic advantage. On October 24, 2006, Plaintiffs filed amended complaints, attempting to cure the defects in their tort claim. The Company again moved to dismiss the state court claims and on January 31, 2007, the court granted the Company's motion, but allowed plaintiffs to replead. The Company intends to defend against these lawsuits vigorously, but is unable to predict the outcome of these suits.

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. The Company has provided documents and other information in response to these requests and intends 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 have been filed. On August 15, 2006, the Judicial Panel on Multidistrict Litigation consolidated these actions for pre-trial proceedings in the Southern

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

Statement of Objections

On March 30, 2007, the European Commission (“EC”) issued a Statement of Objections to Apple Inc., iTunes S.a.r.l. and one of our subsidiaries, WEA International Inc. (“WEA”). The Company believes that similar Statements of Objections were also issued to Apple Inc. and each of the other major recorded music companies. The Statement of Objections targets Apple Inc.’s practice of applying certain territorial restrictions in relation to its iTunes stores in the European Economic Area (“EEA”). The EC alleges that these restrictions arise, among other ways, as a result of the agreement between Apple Inc. and WEA for the sale of downloaded music in the EEA. In the EC’s preliminary view, these restrictions may lead to a distortion of competition, infringing Article 81 of the EC Treaty. In particular, the EC asserts that (i) consumers resident in a particular EEA country in which iTunes does not operate a dedicated online store are prevented from acquiring downloaded music from iTunes and (ii) consumers resident in a particular EEA country may be required to pay a higher price for the same download than consumers resident in another EEA country or may not have access to the same downloads as are available to consumers resident in another EEA country. The EC, if it finds an infringement, may require that the alleged restriction be eliminated and also has the authority to impose fines on the parties to any infringement. The Company intends to cooperate with the EC but believes that its practices have not infringed Article 81 of the EC Treaty.

Other Matters

In addition to the matters 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.

13. Derivative Financial Instruments

During the six months ended March 31, 2007, the Company did not enter into additional interest rate swap agreements to hedge the variability of its expected future cash interest payments. However, the Company entered into additional foreign exchange contracts to hedge its foreign currency royalty payments for the first quarter of fiscal year 2008. As of March 31, 2007, the Company had interest rate swap agreements to hedge a total notional debt amount of \$897 million and recorded deferred gains in comprehensive income of \$1 million. Additionally, as of March 31, 2007, the Company had \$1 million of deferred net losses in comprehensive income related to foreign currency hedging.

14. 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 before non-cash depreciation of tangible assets and non-cash amortization of intangible assets (“OIBDA”). The Company has supplemented its analysis of OIBDA results by segment with an analysis of operating income by segment.

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The Company accounts for inter-segment 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 and, therefore, do not themselves impact consolidated results.

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006	Six Months Ended March 31, 2007	Six Months Ended March 31, 2006
	(in millions)			
Revenues				
Recorded music	\$ 648	\$ 676	\$ 1,448	\$ 1,596
Music publishing	143	129	276	260
Corporate expenses and eliminations	(7)	(9)	(12)	(16)
Total revenues	<u>\$ 784</u>	<u>\$ 796</u>	<u>\$ 1,712</u>	<u>\$ 1,840</u>

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006	Six Months Ended March 31, 2007	Six Months Ended March 31, 2006
	(in millions)			
OIBDA				
Recorded music	\$ 55	\$ 81	\$ 196	\$ 287
Music publishing	53	47	72	68
Corporate expenses and eliminations	(28)	(24)	(48)	(49)
Total OIBDA	<u>\$ 80</u>	<u>\$ 104</u>	<u>\$ 220</u>	<u>\$ 306</u>

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006	Six Months Ended March 31, 2007	Six Months Ended March 31, 2006
	(in millions)			
Depreciation of Property, Plant and Equipment				
Recorded music	\$ 6	\$ 7	\$ 12	\$ 14
Music publishing	1	1	2	2
Corporate expenses and eliminations	3	3	6	6
Total depreciation	<u>\$ 10</u>	<u>\$ 11</u>	<u>\$ 20</u>	<u>\$ 22</u>

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006	Six Months Ended March 31, 2007	Six Months Ended March 31, 2006
	(in millions)			
Amortization of Intangibles Assets				
Recorded music	\$ 36	\$ 34	\$ 72	\$ 67
Music publishing	14	14	29	28
Corporate expenses and eliminations	1	—	—	—
Total amortization	<u>\$ 51</u>	<u>\$ 48</u>	<u>\$ 101</u>	<u>\$ 95</u>

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	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006	Six Months Ended March 31, 2007	Six Months Ended March 31, 2006
(in millions)				
Operating Income				
Recorded music	\$ 13	\$ 40	\$ 112	\$ 206
Music publishing	38	32	41	38
Corporate expenses and eliminations	(32)	(27)	(54)	(55)
Total operating income	<u>\$ 19</u>	<u>\$ 45</u>	<u>\$ 99</u>	<u>\$ 189</u>

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006	Six Months Ended March 31, 2007	Six Months Ended March 31, 2006
(in millions)				
Reconciliation of OIBDA to Operating Income				
OIBDA	\$ 80	\$ 104	\$ 220	\$ 306
Depreciation expense	(10)	(11)	(20)	(22)
Amortization expense	(51)	(48)	(101)	(95)
Operating income	<u>\$ 19</u>	<u>\$ 45</u>	<u>\$ 99</u>	<u>\$ 189</u>

15. Additional Financial Information

Cash Interest and Taxes

The Company made interest payments of approximately \$73 million and \$71 million during the six months ended March 31, 2007 and 2006, respectively. The Company paid approximately \$37 million and \$26 million of income and withholding taxes in the six months ended March 31, 2007 and 2006, respectively. The Company received \$6 million and \$4 million of income tax refunds in the six months ended March 31, 2007 and 2006, respectively.

16. Subsequent Events

Napster Settlement

On April 24, 2007, the Company and Bertelsmann AG (“Bertelsmann”) jointly announced a settlement of contingent claims held by the Company relating to Bertelsmann’s relationship with Napster in 2000-2001. The settlement covers the resolution of the related legal claims against Bertelsmann by the Company’s recorded music and music publishing businesses. As part of the settlement, the Company has received \$110 million which the Company will be sharing with its artists and songwriters. Bertelsmann admits no liability in making this settlement.

Warner Music Group Corp.
Supplementary Information
Consolidating Financial Statements

The Company is the direct parent of Holdings, which is the direct parent of Acquisition Corp.

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

The Company and Holdings are holding companies that conduct substantially all their business operations through Acquisition Corp. Accordingly, the ability of the Company to obtain funds from its subsidiaries is restricted by the senior secured credit facility of Acquisition Corp., the indenture for the Acquisition Corp. Senior Subordinated Notes and the indenture for the Holdings Discount Notes.

Warner Music Group Corp.
Supplementary Information
Consolidating Balance Sheet (unaudited)
March 31, 2007

	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	Warner Music Group Corp. Consolidated
Assets:					
Current assets:					
Cash and equivalents	\$ 101	\$ —	\$ 261	\$ —	\$ 362
Short-term investments	—	—	—	—	—
Due (to) from affiliates	(3)	—	3	—	—
Accounts receivable, net	—	—	513	—	513
Inventories	—	—	70	—	70
Royalty advances expected to be recouped within one year	—	—	194	—	194
Deferred tax assets	—	—	61	—	61
Other current assets	—	—	37	—	37
Total current assets	98	—	1,139	—	1,237
Royalty advances expected to be recouped after one year	—	—	238	—	238
Investments in and advances (from) to consolidated subsidiaries	(70)	126	—	(56)	—
Investments	—	—	26	—	26
Property, plant and equipment, net	—	—	135	—	135
Goodwill	—	—	984	—	984
Intangible assets subject to amortization, net	—	—	1,679	—	1,679
Intangible assets not subject to amortization	—	—	100	—	100
Other assets	—	4	89	—	93
Total assets	\$ 28	\$ 130	\$ 4,390	\$ (56)	\$ 4,492
Liabilities and shareholders' equity:					
Current liabilities:					
Accounts payable	\$ —	\$ —	\$ 200	\$ —	\$ 200
Accrued royalties	—	—	1,178	—	1,178
Taxes and other withholdings	2	—	30	—	32
Current portion of long-term debt	—	—	17	—	17
Dividends payable	22	—	—	—	22
Other current liabilities	(1)	—	334	—	333
Total current liabilities	23	—	1,759	—	1,782
Long-term debt	—	200	2,049	—	2,249
Deferred tax liabilities, net	—	—	205	—	205
Dividends payable	1	—	—	—	1
Other noncurrent liabilities	—	—	251	—	251
Total liabilities	24	200	4,264	—	4,488
Shareholders' equity	4	(70)	126	(56)	4
Total liabilities and shareholders' equity	\$ 28	\$ 130	\$ 4,390	\$ (56)	\$ 4,492

Warner Music Group Corp.
Supplementary Information
Consolidating Balance Sheet (audited)
September 30, 2006

	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. <small>(in millions)</small>	Eliminations	Warner Music Group Corp. Consolidated
Assets:					
Current assets:					
Cash and equivalents	\$ 41	\$ —	\$ 326	\$ —	\$ 367
Short-term investments	18	—	—	—	18
Due (to) from affiliates	(4)	—	4	—	—
Accounts receivable, net	—	—	585	—	585
Inventories	—	—	59	—	59
Royalty advances expected to be recouped within one year	—	—	191	—	191
Deferred tax assets	—	—	45	—	45
Other current assets	—	—	35	—	35
Total current assets	55	—	1,245	—	1,300
Royalty advances expected to be recouped after one year	—	—	207	—	207
Investments in and advances to (from) consolidated subsidiaries	28	215	—	(243)	—
Investments	—	—	25	—	25
Property, plant and equipment, net	—	—	146	—	146
Goodwill	—	—	929	—	929
Intangible assets subject to amortization, net	—	—	1,711	—	1,711
Intangible assets not subject to amortization	—	—	100	—	100
Other assets	—	4	98	—	102
Total assets	\$ 83	\$ 219	\$ 4,461	\$ (243)	\$ 4,520
Liabilities and shareholders' equity:					
Current liabilities:					
Accounts payable	\$ —	\$ —	\$ 209	\$ —	\$ 209
Accrued royalties	—	—	1,142	—	1,142
Taxes and other withholdings	—	—	32	—	32
Current portion of long-term debt	—	—	17	—	17
Dividends payable	22	—	—	—	22
Other current liabilities	—	—	377	—	377
Total current liabilities	22	—	1,777	—	1,799
Long-term debt	—	191	2,048	—	2,239
Deferred tax liabilities, net	—	—	197	—	197
Dividends payable	3	—	—	—	3
Other noncurrent liabilities	—	—	224	—	224
Total liabilities	25	191	4,246	—	4,462
Shareholders' equity	58	28	215	(243)	58
Total liabilities and shareholders' equity	\$ 83	\$ 219	\$ 4,461	\$ (243)	\$ 4,520

Warner Music Group Corp.
Supplementary Information
Consolidating Statements of Operations (unaudited)
For The Three Months Ended March 31, 2007 and 2006

	Three months ended March 31, 2007				Warner Music Group Corp. Consolidated
	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	
Revenues	\$ —	\$ —	\$ 784	\$ —	\$ 784
Costs and expenses:					
Cost of revenues	—	—	(427)	—	(427)
Selling, general and administrative expenses	—	—	(275)	—	(275)
Restructuring costs	—	—	(12)	—	(12)
Amortization of intangible assets	—	—	(51)	—	(51)
Total costs and expenses	—	—	(765)	—	(765)
Operating income	—	—	19	—	19
Interest expense, net	1	(4)	(42)	—	(45)
Equity in the (losses) gains of consolidated subsidiaries	(28)	(24)	—	52	—
(Loss) income before income taxes	(27)	(28)	(23)	52	(26)
Income tax expense	—	—	(1)	—	(1)
Net (loss) income	<u>\$ (27)</u>	<u>\$ (28)</u>	<u>\$ (24)</u>	<u>\$ 52</u>	<u>\$ (27)</u>
	Three months ended March 31, 2006				
	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	Warner Music Group Corp. Consolidated
Revenues	\$ —	\$ —	\$ 796	\$ —	\$ 796
Costs and expenses:					
Cost of revenues	—	—	(409)	—	(409)
Selling, general and administrative expenses	—	—	(294)	—	(294)
Amortization of intangible assets	—	—	(48)	—	(48)
Total costs and expenses	—	—	(751)	—	(751)
Operating income	—	—	45	—	45
Interest expense, net	—	(4)	(41)	—	(45)
Equity in the gains of equity-method investees, net	—	—	1	—	1
Equity in the (losses) gains of consolidated subsidiaries	(7)	(3)	—	10	—
Other income, net	—	—	2	—	2
(Loss) income before income taxes	(7)	(7)	7	10	3
Income tax expense	—	—	(10)	—	(10)
Net (loss) income	<u>\$ (7)</u>	<u>\$ (7)</u>	<u>\$ (3)</u>	<u>\$ 10</u>	<u>\$ (7)</u>

Warner Music Group Corp.
Supplementary Information
Consolidating Statements of Operations (unaudited)
For The Six Months Ended March 31, 2007 and 2006

	Six months ended March 31, 2007				Warner Music Group Corp. Consolidated
	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	
Revenues	\$ —	\$ —	\$ 1,712	\$ —	\$ 1,712
Costs and expenses:					
Cost of revenues	—	—	(935)	—	(935)
Selling, general and administrative expenses	—	—	(565)	—	(565)
Restructuring costs	—	—	(12)	—	(12)
Amortization of intangible assets	—	—	(101)	—	(101)
Total costs and expenses	—	—	(1,613)	—	(1,613)
Operating income	—	—	99	—	99
Interest expense, net	1	(9)	(84)	—	(92)
Equity in the (losses) gains of consolidated subsidiaries	(10)	(1)	—	11	—
Income (loss) before income taxes	(9)	(10)	15	11	7
Income tax expense	—	—	(16)	—	(16)
Net (loss) income	<u>\$ (9)</u>	<u>\$ (10)</u>	<u>\$ (1)</u>	<u>\$ 11</u>	<u>\$ (9)</u>
	Six months ended March 31, 2006				
	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	Warner Music Group Corp. Consolidated
Revenues	\$ —	\$ —	\$ 1,840	\$ —	\$ 1,840
Costs and expenses:					
Cost of revenues	—	—	(939)	—	(939)
Selling, general and administrative expenses	—	—	(617)	—	(617)
Amortization of intangible assets	—	—	(95)	—	(95)
Total costs and expenses	—	—	(1,651)	—	(1,651)
Operating income	—	—	189	—	189
Interest expense, net	—	(8)	(82)	—	(90)
Equity in the gains of equity-method investees, net	—	—	1	—	1
Equity in the gains (losses) of consolidated subsidiaries	62	70	—	(132)	—
Other income, net	—	—	2	—	2
Income (loss) before income taxes	62	62	110	(132)	102
Income tax expense	—	—	(40)	—	(40)
Net income (loss)	<u>\$ 62</u>	<u>\$ 62</u>	<u>\$ 70</u>	<u>\$ (132)</u>	<u>\$ 62</u>

Warner Music Group Corp.
Supplementary Information
Consolidating Statement of Cash Flows (unaudited)
For The Six Months Ended March 31, 2007

	<u>Warner Music Group Corp.</u>	<u>WMG Holdings Corp. (issuer)</u>	<u>WMG Acquisition Corp.</u> (in millions)	<u>Eliminations</u>	<u>Consolidated</u>
Cash flows from operating activities:					
Net (loss) income	\$ (9)	\$ (10)	\$ (1)	\$ 11	\$ (9)
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:					
Depreciation and amortization	—	—	121	—	121
Deferred taxes	—	—	(22)	—	(22)
Non-cash interest expense	—	9	22	—	31
Non-cash stock compensation expense	—	—	5	—	5
Equity in the (gains) losses of equity-method investees, including distributions	10	1	—	(11)	—
Changes in operating assets and liabilities:					
Accounts receivable	—	—	118	—	118
Inventories	—	—	(7)	—	(7)
Royalty advances	—	—	(28)	—	(28)
Accounts payable and accrued liabilities	—	—	(102)	—	(102)
Other balance sheet changes	—	—	—	—	—
Net cash provided by operating activities	<u>1</u>	<u>—</u>	<u>106</u>	<u>—</u>	<u>107</u>
Cash flows from investing activities:					
Loan to third parties	—	—	(24)	—	(24)
Purchases in short term investments	18	—	—	—	18
Investments and acquisitions	—	—	(57)	—	(57)
Proceeds from the sale of buildings	—	—	7	—	7
Capital expenditures	—	—	(13)	—	(13)
Net cash provided by (used in) investing activities	<u>18</u>	<u>—</u>	<u>(87)</u>	<u>—</u>	<u>(69)</u>
Cash flows from financing activities:					
Quarterly debt repayments	—	—	(8)	—	(8)
Change in intercompany	(1)	—	1	—	—
Proceeds from the exercise of stock options	2	—	—	—	2
Return of capital received	80	80	—	(160)	—
Return of capital and dividends paid	(40)	(80)	(80)	160	(40)
Net cash provided by (used in) financing activities	<u>41</u>	<u>—</u>	<u>(87)</u>	<u>—</u>	<u>(46)</u>
Effect of foreign currency exchange rate changes on cash	—	—	3	—	3
Net increase (decrease) in cash and equivalents	60	—	(65)	—	(5)
Cash and equivalents at beginning of period	41	—	326	—	367
Cash and equivalents at end of period	<u>\$ 101</u>	<u>\$ —</u>	<u>\$ 261</u>	<u>\$ —</u>	<u>\$ 362</u>

Warner Music Group Corp.
Supplementary Information
Consolidating Statement of Cash Flows (unaudited)
For The Six Months Ended March 31, 2006

	<u>Warner Music Group Corp.</u>	<u>WMG Holdings Corp. (issuer)</u>	<u>WMG Acquisition Corp.</u> (in millions)	<u>Eliminations</u>	<u>Consolidated</u>
Cash flows from operating activities:					
Net income (loss)	\$ 62	\$ 62	\$ 70	\$ (132)	\$ 62
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Depreciation and amortization	—	—	117	—	117
Deferred taxes	—	—	(2)	—	(2)
Non-cash interest expense	—	8	18	—	26
Non-cash stock compensation expense	—	—	8	—	8
Equity in the gains of equity-method investees, including distributions	—	—	(1)	—	(1)
Equity in the (gains) losses of consolidated subsidiaries	(62)	(70)	—	132	—
Changes in operating assets and liabilities:					
Accounts receivable	—	—	108	—	108
Inventories	—	—	8	—	8
Royalty advances	—	—	(29)	—	(29)
Accounts payable and accrued liabilities	—	—	(70)	—	(70)
Other balance sheet changes	—	—	(22)	—	(22)
Net cash provided by operating activities	<u>—</u>	<u>—</u>	<u>205</u>	<u>—</u>	<u>205</u>
Cash flows from investing activities:					
Investments and acquisitions	—	—	(18)	—	(18)
Purchases in short term investments	(34)	—	(27)	—	(61)
Capital expenditures	—	—	(12)	—	(12)
Net cash used in investing activities	<u>(34)</u>	<u>—</u>	<u>(57)</u>	<u>—</u>	<u>(91)</u>
Cash flows from financing activities:					
Quarterly debt repayments	—	—	(8)	—	(8)
Capital contributions received/paid	(3)	3	—	—	—
Change in intercompany	—	(8)	8	—	—
Return of capital and dividends paid	45	4	(86)	—	(37)
Net cash provided by (used in) financing activities	<u>42</u>	<u>(1)</u>	<u>(86)</u>	<u>—</u>	<u>(45)</u>
Effect of foreign currency exchange rate changes on cash	—	—	2	—	2
Net increase (decrease) in cash and equivalents	8	(1)	64	—	71
Cash and equivalents at beginning of period	40	1	247	—	288
Cash and equivalents at end of period	<u>\$ 48</u>	<u>\$ —</u>	<u>\$ 311</u>	<u>\$ —</u>	<u>\$ 359</u>

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, 2007 (the "Quarterly Report"). This discussion contains forward-looking statements and involves numerous risks and uncertainties. Actual results may differ materially from those contained in any forward-looking statements.

We make available on our Internet 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 address is www.wmg.com. The information contained in our website is not incorporated by reference in 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 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, savings 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, to reduce future capital expenditures, to monetize our music content, including through new distribution channels and formats, to effectively deploy our capital, the development of digital music and the effect of digital distribution channels on our business, including whether or not the Internet will become an important sales channel and whether we will be able to achieve higher margins from digital sales, our success in limiting piracy, our ability to compete in the highly competitive markets in which we operate, the growth of the music industry and the effect of our and the music industry's efforts to combat piracy on the industry, our intention to pay regular quarterly dividends, the adequacy of our existing sources of cash to support our existing operations during the next twelve months and, the effect of litigation and other investigations 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;
- 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 and Internet peer-to-peer file-sharing;
- the significant threat posed to our business and the music industry by organized industrial piracy;

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- 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;
- the seasonal and cyclical nature of recorded music sales;
- 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;
- the ability to maintain product pricing in a competitive environment;
- 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 business;
- the impact of rates on other income streams that may be set by arbitration proceedings on our business; 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;
- legal or other developments related to pending litigation or investigations by the Attorney General of the State of New York, the Department of Justice and the European Commission;
- 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 impact of our recently announced realignment plan on our business;

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- the possibility that our owners' interests will conflict with ours or yours;
- increased costs and diversion of resources associated with complying with the internal control reporting or other requirements of the Sarbanes-Oxley Act of 2002;
- the effects associated with the formation of Sony BMG Music Entertainment ("Sony BMG") or the potential acquisition of BMG Music Publishing Group by Universal; and
- failure to attract and retain key personnel.

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

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

INTRODUCTION

Warner Music Group Corp. (the "Company" or "Parent") was formed by a private equity consortium of Investors (the "Investor Group") on November 21, 2003. The original Investor Group included Thomas H. Lee Partners, L.P. and its affiliates ("THL"), Bain Capital and its affiliates ("Bain"), Providence Equity Partners, Inc. and its affiliates ("Providence") and Music Capital Partners, L.P. ("Music Capital"). The shares held by Music Capital had been subject to a stockholders agreement among Music Capital, THL, Bain and Providence and certain other parties. On May 7, 2007, Music Capital made a pro rata distribution of all shares of common stock of the Company held by it to its partners. Music Capital's partnership agreement requires that the Music Capital partnership dissolve and commence winding up by the second anniversary of the Company's May 2005 initial public offering. At such time, 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 is the direct parent of WMG Holdings Corp. ("Holdings"), which is the direct parent of WMG Acquisition Corp. ("Acquisition Corp."). Acquisition Corp. is one of the world's major music-based content companies 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, Acquisition Corp. acquired such interests from Time Warner for approximately \$2.6 billion (the "Acquisition").

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

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

- *Overview.* This section provides a general description of our business, as well as recent developments that we believe are important in understanding our results of operations and financial condition and in anticipating future trends.
- *Results of operations.* This section provides an analysis of our results of operations for the three and six months ended March 31, 2007 and 2006. 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, 2007 and 2006, as well as a discussion of our financial condition and liquidity as of March 31, 2007. The discussion of our financial condition and liquidity includes (i) our available financial capacity under the revolving credit portion of our senior secured credit facility and (ii) a summary of our key debt compliance measures under our debt agreements.

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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 and non-cash amortization of 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 (loss), net income (loss) and other measures of financial performance reported in accordance with U.S. GAAP.

OVERVIEW

Description of Business

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 these operations is presented below.

Our business is seasonal. Therefore, operating results for the three and six month periods ended March 31, 2007 are not necessarily indicative of the results that may be expected for fiscal year ended September 30, 2007.

Recorded Music Operations

Our Recorded Music business consists of the discovery and development of artists and the related marketing, distribution and licensing of recorded music produced by such artists. In addition to the more traditional methods of discovering and developing artists, we established our Independent Label Group (“ILG”) to discover artists earlier in their careers and at a lower cost by leveraging our independent distribution network.

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 Entertainment (“Rhino”), a division that specializes in marketing our music catalog through compilations and reissues of previously released music and video titles, as well as in the licensing of recordings to and from third parties for various uses, including film and television soundtracks. On May 31, 2006, the Company completed the acquisition of Ryko Corporation (“Ryko”), a leading independent, integrated music and entertainment company. In January 2007, the Company acquired a majority interest in Roadrunner, which includes Roadrunner Records, one of the leading hard rock and heavy metal labels.

Outside the U.S., our Recorded Music activities are conducted in more than 50 countries through Warner Music International (“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 domestic record labels have international rights. In certain smaller countries, WMI licenses to unaffiliated third-party record labels the right to distribute its records.

Our Recorded Music distribution operations include Warner-Elektra-Atlantic Corporation (“WEA Corp.”), which markets and sells music products to retailers and wholesale distributors in the U.S.; Alternative Distribution Alliance (“ADA”), which distributes the products of independent labels to retail and wholesale distributors in the U.S.; Ryko Distribution, which distributes music and DVD releases from Rykodisc, Ryko’s record music label, and third-party record and video labels; 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 U.K., which provides ADA’s distribution services to independent labels in the U.K.

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Our principal Recorded Music revenue sources are sales of CDs, digital downloads, mobile phone ringtones and other recorded music products and license fees received for the ancillary uses of our recorded music catalog. 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;
- 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 rights holders, 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 Los Angeles 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. and Hallmark Entertainment. In addition to the more traditional methods, we have implemented new initiatives to promote and develop emerging songwriters, such as our label, Perfect Game Recording Co., which, similar to ILG, seeks to identify and nurture songwriters earlier in their careers.

Publishing revenues are derived from four main sources:

- *Mechanical*: the licensor receives royalties with respect to compositions embodied in recordings sold in any format or configuration, including physical recordings (e.g., CDs, DVDs, video cassettes), online and wireless downloads and mobile phone ringtones.
- *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.
- *Other*: the licensor receives royalties from other uses such as in toys or novelty items and for use in sheet music.

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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
- 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, 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, DVD-Audio formats and the distribution of music on mobile devices, significant revenue streams from these new formats are just beginning to emerge. 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 our music publishing business generates a portion of its revenues from mechanical royalties received from the sale of music in recorded music formats such as the CD. Due in part to the development of the new formats mentioned above and ongoing anti-piracy initiatives, we believe that the recorded music industry is positioned to improve over the coming years. However, the industry may relapse into a period of decline. In addition, there can be no assurances as to the timing or the extent of any improvement in the industry.

Realignment Plan for Fiscal Year 2007

The Company announced plans to implement changes intended to better align the Company's workforce with the changing nature of the music industry. These changes are part of the Company's continued evolution from a traditional record and songs-based business to a music-based content company and its ongoing management of its cost structure. The changes include a continued redeployment of resources to focus on new business initiatives to help the Company diversify its revenue streams, including digital opportunities. The realignment plan is also designed to improve the operating effectiveness and efficiency of our current businesses and to realign our management structure to, among other things, effectively address the continued development of digital distribution channels along with the decline of industry-wide CD sales.

The Company intends to enhance its effectiveness, flexibility, structure, and performance by reducing and realigning long-term costs. This will primarily consist of the reorganization of management structures to more adequately and carefully address regional needs and new business requirements, to reduce organizational complexity and to improve leadership channels. The Company also intends to continue to shift resources from our physical sales channels to efforts focused on digital distribution and emerging technologies and other new revenue streams. Part of the plan will also result in the outsourcing of some back-office functions as a cost-savings measure. To implement such changes, the Company expects to reduce its headcount by approximately 10%. In connection with these reductions, the Company expects to incur a charge ranging from \$55 million to \$65 million for severance and related benefits. In addition, the Company expects to incur implementation charges ranging from \$10 million to \$15 million related to consulting fees, costs of temporary workers and stay bonuses. All of these restructuring and implementation costs will be paid in cash. To implement such changes, the Company expects to reduce headcount by approximately 400 employees. The Company expects the majority of any cost savings to be offset by new hirings and ongoing investment focused on new business initiatives such as digital distribution and video.

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We anticipate that the changes described above will be implemented by the end of fiscal year 2007. The Company also expects to incur substantially all of the costs associated with the realignment plan by the end of the current fiscal year. Approximately \$12 million of restructuring costs were incurred in the Company's fiscal second quarter of 2007, consisting primarily of the elimination of duplicative positions and redirecting of resources to growth areas of the Company's businesses in Europe.

The 2004 Restructuring Plan

Immediately following the Acquisition, we executed a number of cost-saving initiatives in an attempt to realign our cost structure with the changing economics of the industry. These initiatives included significant headcount reductions from the consolidation of operations and the streamlining of corporate and label overhead, exiting certain leased facilities in an effort to consolidate locations and the sale of our manufacturing, packaging and physical distribution operations. We completed substantially all of our historical restructuring efforts in fiscal year 2005 and implemented approximately \$250 million of annualized cost savings.

RESULTS OF OPERATIONS

Three Months Ended March 31, 2007 Compared to Three Months Ended March 31, 2006

The following table summarizes our historical results of operations:

	<u>Three Months Ended</u> <u>March 31, 2007</u> <u>(unaudited)</u>	(in millions)	<u>Three Months Ended</u> <u>March 31, 2006</u> <u>(unaudited)</u>
Revenues	\$ 784		\$ 796
Costs and expenses:			
Cost of revenues (1)	(427)		(409)
Selling, general and administrative expenses (1)	(275)		(294)
Restructuring costs	(12)		—
Amortization of intangible assets	(51)		(48)
Total costs and expenses	<u>(765)</u>		<u>(751)</u>
Operating income	19		45
Interest expense, net	(45)		(45)
Equity in gains of equity-method investees, net	—		1
Other income, net	—		2
(Loss) income before income taxes	\$ (26)		\$ 3
Income tax expense	(1)		(10)
Net loss	<u>\$ (27)</u>		<u>\$ (7)</u>

(1) Includes depreciation expense of \$10 million and \$11 million for the three months ended March 31, 2007 and 2006, respectively.

Consolidated Historical Results

Revenues

Our revenues decreased \$12 million, or 2%, to \$784 million for the three months ended March 31, 2007 as compared to \$796 million for the three months ended March 31, 2006. Excluding a \$30 million favorable impact of foreign currency exchange rates, total revenue declined by \$42 million, or 5%, primarily resulting from a decrease in physical sales of \$66 million. This decrease was due to fewer major artist releases during the three

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months ended March 31, 2007, as compared to the prior year, and was offset in part by increases in digital revenue of \$19 million. Music Publishing revenues, excluding digital sales, increased by approximately \$12 million in the three months ended March 31, 2007. Excluding the impact of foreign currency exchange rates, Music Publishing revenues, excluding digital sales, increased by \$3 million.

Digital revenues increased \$21 million to \$111 million for the three months ended March 31, 2007 as compared to \$90 million for the three months ended March 31, 2006. Digital revenues represent 14% and 11% of consolidated revenues for the three months ended March 31, 2007 and 2006, respectively. Total digital revenues were comprised of U.S. revenues of \$80 million, or 72% of total digital revenues, and international revenues of \$31 million, or 28% of total digital revenues.

International operations represented \$365 million of consolidated revenues for the three months ended March 31, 2007 as compared to \$379 million of consolidated revenues for the three months ended March 31, 2006, comprising 47% and 48% of total revenues, respectively.

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

Cost of revenues

Our cost of revenues increased \$18 million, or 4%, to \$427 million for the three months ended March 31, 2007 as compared to \$409 million for the three months ended March 31, 2006. Expressed as a percentage of revenues, cost of revenues was 54% and 51% for the three months ended March 31, 2007 and 2006, respectively. Excluding a \$19 million impact of foreign currency exchange rates, our cost of revenues decreased \$1 million which was primarily driven by lower physical sales as compared to the prior year. As a percentage of revenues, royalty expenses grew approximately 3%, which was driven by a change in product mix. Product costs decreased by \$8 million, which was primarily driven by the decline in physical sales and increase in digital revenues.

Selling, general and administrative expenses

Our selling, general and administrative expenses decreased by \$19 million, or 6%, to \$275 million for the three months ended March 31, 2007 as compared to \$294 million for the three months ended March 31, 2006. Excluding an \$8 million impact of foreign currency exchange rates, selling, general and administrative expenses decreased by \$27 million, or 9%, which was driven primarily by a decrease in sales and marketing costs of \$14 million and a decrease in distribution costs of \$2 million, primarily associated with the decline in physical sales previously described. The remaining decrease was driven primarily by cost management efforts, which was offset in part by employee termination costs of \$4 million associated with our realignment plan.

Restructuring costs

Our restructuring costs were \$12 million for the three months ended March 31, 2007. These are mainly severance costs incurred in connection with our realignment plan. We did not record any restructuring costs in the three months ended March 31, 2006.

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Reconciliation of Consolidated Historical OIBDA to Operating Income and Net Income

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 income for purposes of the discussion that follows:

	Three Months Ended March 31, 2007 <u>(unaudited)</u>	(in millions)	Three Months Ended March 31, 2006 <u>(unaudited)</u>
OIBDA	\$ 80		\$ 104
Depreciation expense	(10)		(11)
Amortization expense	(51)		(48)
Operating income	19		45
Interest expense, net	(45)		(45)
Equity in gains of equity-method investees	—		1
Other income, net	—		2
(Loss) income before income taxes	\$ (26)		\$ 3
Income tax expense	(1)		(10)
Net loss	<u>\$ (27)</u>		<u>\$ (7)</u>

OIBDA

Our OIBDA decreased \$24 million, or 23% to \$80 million for the three months ended March 31, 2007 as compared to \$104 million for the three months ended March 31, 2006, primarily driven by the decline in physical sales and costs associated with our restructuring plan as previously discussed.

Depreciation expense

Our depreciation expense decreased by \$1 million to \$10 million for the three months ended March 31, 2007 as compared to \$11 million for the three months ended March 31, 2006. The decrease primarily relates to lower capital spending since the date of the Acquisition.

Amortization expense

Our amortization expense increased by \$3 million, or 6%, to \$51 million for the three months ended March 31, 2007 as compared to \$48 million for the three months ended March 31, 2006. The increase relates to the acquisition of certain recorded music catalog assets, including Ryko, and the acquisition of various music publishing copyrights.

Operating income

Our operating income decreased \$26 million, or 58% to \$19 million for the three months ended March 31, 2007 as compared to \$45 million for the three months ended March 31, 2006, which mainly relates to the decline in physical sales and to the restructuring costs previously discussed.

Interest expense, net

Our interest expense, net was \$45 million for each of the three months ended March 31, 2007 and 2006.

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Equity in gains of equity-method investees, net

Equity in the gains of equity method investees was less than \$1 million for the three months ended March 31, 2007 compared to \$1 million for the three months ended March 31, 2006.

Other income, net

Other income, net was less than \$1 million for the three months ended March 31, 2007 and \$2 million for the three months ended March 31, 2006. Our other income relates primarily to favorable foreign currency exchange rate movements associated with intercompany receivables and payables that are short-term in nature and therefore, required to be recognized in the Statement of Operations under U.S. GAAP.

Income tax expense

We provided an income tax expense of \$1 million for the three months ended March 31, 2007 compared to \$10 million for the three months ended March 31, 2006. This was a result of the decline in pre-tax income, which was primarily a result of the decrease in operating income discussed previously.

Net loss

Our net loss increased \$20 million to \$27 million for the three months ended March 31, 2007 as compared to \$7 million for the three months ended March 31, 2006. The decrease was due primarily to the decline in physical sales and restructuring costs previously discussed, off set in part by the decrease in income tax expense.

Business Segment Results

Revenue, OIBDA and operating income by business segment are as follows:

	<u>Three Months Ended</u> <u>March 31, 2007</u> <u>(unaudited)</u>	<u>Three Months Ended</u> <u>March 31, 2006</u> <u>(unaudited)</u>
	(in millions)	
Recorded Music		
Revenue	\$ 648	\$ 676
OIBDA	\$ 55	\$ 81
Operating income	\$ 13	\$ 40
Music Publishing		
Revenue	\$ 143	\$ 129
OIBDA	\$ 53	\$ 47
Operating income	\$ 38	\$ 32
Corporate and Revenue Eliminations		
Revenue	\$ (7)	\$ (9)
OIBDA	\$ (28)	\$ (24)
Operating loss	\$ (32)	\$ (27)
Total		
Revenue	\$ 784	\$ 796
OIBDA	\$ 80	\$ 104
Operating income	\$ 19	\$ 45

- (1) The OIBDA and Operating Income for the three months ended March 31, 2007 has been reduced by \$12 million of restructuring costs. Of such an amount, \$11 million relates to Recorded Music and \$1 million relates to Corporate.

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Recorded Music

Recorded Music revenues decreased by \$28 million, or 4%, to \$648 million for the three months ended March 31, 2007 from \$676 million for the three months ended March 31, 2006. Excluding a \$22 million favorable impact of foreign currency exchange rates, revenues decreased by \$50 million, or 7%, primarily resulting from a \$66 million decrease in physical sales, offset in part by an increase in digital sales of \$17 million. Physical sales declined as the current quarter reflected fewer major artist releases and weaker international markets, primarily in Europe, offset in part by increases in sales of domestic repertoire in the Asia Pacific region. The digital sales increase was comprised of an increase in U.S. and international digital sales of \$14 million and \$5 million, respectively, which reflect our efforts to develop new digital products and distribution methods. Digital sales comprised approximately 16% of Recorded Music revenues for the three months ended March 31, 2007, up from 13% of Recorded Music revenues for the three months ended March 31, 2006.

Recorded Music revenues represented 83% and 85% of consolidated revenues, prior to corporate and revenue eliminations, for the three months ended March 31, 2007 and 2006, respectively. U.S. Recorded Music revenues were \$358 million and \$361 million, or 55% and 53% of consolidated Recorded Music revenues for the three months ended March 31, 2007 and 2006, respectively. International Recorded Music revenues were \$290 million and \$315 million, or 45% and 47 % of consolidated Recorded Music revenues for the three months ended March 31, 2007 and 2006, respectively.

Recorded Music OIBDA decreased by \$26 million, or 32% to \$55 million for the three months ended March 31, 2007 compared to \$81 million for the three months ended March 31, 2006. Expressed as a percentage of Recorded Music revenues, Recorded Music OIBDA was 8% and 12% for the three months ended March 31, 2007 and 2006, respectively. Excluding a \$2 million impact of foreign currency exchange rates, OIBDA decreased by \$28 million, which was primarily caused by the significant decline in physical sales previously described, increased royalty costs related to product mix and \$11 million of severance costs related to our realignment plan.

Recorded Music operating income was \$13 million for the three months ended March 31, 2007, down 68% as compared to \$40 million for the three months ended March 31, 2006. Recorded Music operating income included the following components:

	<u>Three Months Ended</u> <u>March 31, 2007</u> <u>(unaudited)</u>	(in millions)	<u>Three Months Ended</u> <u>March 31, 2006</u> <u>(unaudited)</u>
OIBDA	\$ 55		\$ 81
Depreciation and amortization	<u>(42)</u>		<u>(41)</u>
Operating income	<u>\$ 13</u>		<u>\$ 40</u>

The \$27 million decrease in Recorded Music operating income related to the \$26 million decrease in Recorded Music OIBDA more fully discussed above, and a \$1 million an increase in Recorded Music depreciation and amortization.

Music Publishing

Music Publishing revenues increased \$14 million, or 11%, to \$143 million for the three months ended March 31, 2007 as compared to \$129 million for the three months ended March 31, 2006. Excluding a \$9 million favorable impact of foreign currency exchange rates, Music Publishing revenues increased by \$5 million, or 4%, which was primarily a result of timing and increases in performance revenue of \$7 million and digital revenue of \$2 million, offset by a decrease in mechanical revenue of \$4 million, which primarily related to market declines across a number of territories. Synchronization revenue was relatively flat as compared to the three months ended March 31, 2006.

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Music Publishing OIBDA increased \$6 million, or 13% to \$53 million for the three months ended March 31, 2007 as compared to \$47 million for the three months ended March 31, 2006. Excluding a \$1 million impact of foreign currency exchange rates, OIBDA increased \$5 million, which resulted primarily from the increase in revenue above and from adjustments to settlements of royalties payable balances to certain songwriters, offset in part by an increase in new songwriter spending.

Music Publishing operating income was \$38 million for the three months ended March 31, 2007 as compared to \$32 million for the three months ended March 31, 2006. Music Publishing operating income includes the following components:

	Three Months Ended March 31, 2007 (unaudited)	(in millions)	Three Months Ended March 31, 2006 (unaudited)
OIBDA	\$ 53		\$ 47
Depreciation and amortization	(15)		(15)
Operating income	<u>\$ 38</u>		<u>\$ 32</u>

The \$6 million increase in Music Publishing operating income related to the \$6 million increase in Music Publishing OIBDA described above.

Corporate Expenses and Eliminations

Corporate expenses before depreciation and amortization expense increased \$4 million, or 17% to \$28 million for the three months ended March 31, 2007 as compared to \$24 million for the three months ended March 31, 2006. The increase primarily relates to an increase in consulting and professional fees costs along with \$1 million of restructuring costs.

Six Months Ended March 31, 2007 Compared to Six Months Ended March 31, 2006

The following table summarizes our historical results of operations:

	Six Months Ended March 31, 2007 (unaudited)	(in millions)	Six Months Ended March 31, 2006 (unaudited)
Revenues	\$ 1,712		\$ 1,840
Costs and expenses:			
Cost of revenues (1)	(935)		(939)
Selling, general and administrative expenses (1)	(565)		(617)
Restructuring costs	(12)		—
Amortization of intangible assets	(101)		(95)
Total costs and expenses	<u>(1,613)</u>		<u>(1,651)</u>
Operating income	99		189
Interest expense, net	(92)		(90)
Equity in gains of equity-method investees, net	—		1
Other income, net	—		2
Income before income taxes	\$ 7		\$ 102
Income tax expense	(16)		(40)
Net (loss) income	<u>\$ (9)</u>		<u>\$ 62</u>

(1) Includes depreciation expense of \$20 million and \$22 million for the six months ended March 31, 2007 and 2006, respectively.

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Consolidated Historical Results

Revenues

Our revenues decreased \$128 million, or 7%, to \$1.712 billion for the six months ended March 31, 2007 as compared to \$1.840 billion for the six months ended March 31, 2006. Excluding a \$64 million favorable impact of foreign currency exchange rates, total revenue declined by \$192 million, or 10%, primarily resulting from a decrease in physical sales of \$259 million. This decrease was due to fewer major artist releases during the six months ended March 31, 2007, as compared to the prior year, and was offset in part by increases in digital revenue of \$50 million and licensing revenue of \$16 million. Music Publishing revenues, excluding digital sales, increased by \$12 million or 5% in the six months ended March 31, 2007 to \$263 million compared to \$251 million in the six months ended March 31, 2006. Excluding the impact of foreign currency exchange rates, Music Publishing revenues, excluding digital sales, decreased by \$3 million.

Digital revenues increased \$52 million to \$211 million for the six months ended March 31, 2007 as compared to \$159 million for the six months ended March 31, 2006. Digital revenues represent 12% and 9% of consolidated revenues for the six months ended March 31, 2007 and 2006, respectively. Total digital revenues were comprised of U.S. revenues of \$145 million, or 69% of total digital revenues, and international revenues of \$66 million, or 31% of total digital revenues.

International operations represented \$887 million of consolidated revenues for the six months ended March 31, 2007 as compared to \$964 million of consolidated revenues for the six months ended March 31, 2006, comprising 52% of total revenues for each of the six months ended March 31, 2007 and 2006.

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

Cost of revenues

Our cost of revenues decreased \$4 million to \$935 million for the six months ended March 31, 2007 as compared to \$939 million for the six months ended March 31, 2006. Expressed as a percentage of revenues, cost of revenues was 55% and 51% for the six months ended March 31, 2007 and 2006, respectively. Excluding a \$39 million impact of foreign currency exchange rates, our cost of revenues decreased \$43 million which was primarily driven by lower physical sales as compared to the prior year. As a percentage of revenues, royalty expenses grew approximately 3%, which was driven by a change in product mix. In addition, royalty advance write-offs drove an additional 1% increase in costs of revenues as a percentage of revenue, due primarily to increased new artist spending in the current year, in both our Recorded Music and our Music Publishing businesses.

Selling, general and administrative expenses

Our selling, general and administrative expenses decreased by \$52 million, or 8%, to \$565 million for the six months ended March 31, 2007 as compared to \$617 million for the six months ended March 31, 2006. Excluding a \$16 million impact of foreign currency exchange rates, selling, general and administrative expenses decreased by \$68 million, or 11%, which was driven primarily by decreases in distribution expenses of \$13 million and decreases in marketing costs of \$38 million, primarily related to the decrease in physical sales. The remaining decrease was driven by cost management efforts, which was offset in part by severance costs of \$4 million associated with our realignment initiative.

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Reconciliation of Consolidated Historical OIBDA to Operating Income and Net Income

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 income for purposes of the discussion that follows:

	Six Months Ended March 31, 2007 <u>(unaudited)</u>	(in millions)	Six Months Ended March 31, 2006 <u>(unaudited)</u>
OIBDA	\$ 220		\$ 306
Depreciation expense	(20)		(22)
Amortization expense	(101)		(95)
Operating income	99		189
Interest expense, net	(92)		(90)
Equity in gains of equity-method investees, net	—		1
Other Income, net	—		2
Income before income taxes	\$ 7		\$ 102
Income tax expense	(16)		(40)
Net (loss) income	<u>\$ (9)</u>		<u>\$ 62</u>

OIBDA

Our OIBDA decreased \$86 million, or 28% to \$220 million for the six months ended March 31, 2007 as compared to \$306 million for the six months ended March 31, 2006, primarily driven by the decline in physical sales and costs associated with our restructuring plan and cost-saving initiatives previously discussed.

Depreciation expense

Our depreciation expense decreased by \$2 million to \$20 million for the six months ended March 31, 2007 as compared to \$22 million for the six months ended March 31, 2006. The decrease primarily relates to lower capital spending since the date of the Acquisition.

Amortization expense

Our amortization expense increased by \$6 million, or 6%, to \$101 million for the six months ended March 31, 2007 as compared to \$95 million for the six months ended March 31, 2006. The increase relates to the recent acquisition of certain recorded music catalog, including Ryko, and the acquisition of various music publishing copyrights.

Operating income

Our operating income decreased \$90 million, or 48% to \$99 million for the six months ended March 31, 2007 as compared to \$189 million for the six months ended March 31, 2006, which mainly relates to the decline in physical sales and costs associated with our restructuring plan and cost-saving initiatives previously discussed.

Interest expense, net

Our interest expense, net increased to \$92 million for the six months ended March 31, 2007 compared to \$90 million for the six months ended March 31, 2006. The increase in interest expense, net is a result of fluctuations in interest rates.

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Income tax expense

We provided an income tax expense of \$16 million for the six months ended March 31, 2007 compared to \$40 million for the six months ended March 31, 2006. This was a result of the decline in pre-tax income, which was primarily a result of the decrease in operating income discussed previously.

Equity in gains of equity method investees

The six months ended March 31, 2007 includes less than \$1 million of equity in the gains of equity method investees. The six months ended March 31, 2006 includes \$1 million of equity in the gains of equity method investees.

Other income, net

We recognized other income, net of \$2 million for the six months ended March 31, 2006. Our other income relates primarily to favorable foreign currency on exchange rate movements associated with intercompany receivables and payables that are short-term in nature and therefore, required to be recognized in the Statement of Operations under U.S. GAAP. There was no such income in the six months ended March 31, 2007.

Net (loss) income

We incurred a net loss of \$9 million for the six months ended March 31, 2007 compared to net income of \$62 million for the six months ended March 31, 2006. The decrease was due primarily to the decline in physical sales previously discussed, offset in part by the decrease in income tax expense.

Business Segment Results

Revenue, OIBDA and operating income by business segment are as follows:

	<u>Six Months Ended</u> <u>March 31, 2007</u> <u>(unaudited)</u>	<u>Six Months Ended</u> <u>March 31, 2006</u> <u>(unaudited)</u>
	(in millions)	
Recorded Music		
Revenue	\$ 1,448	\$ 1,596
OIBDA	\$ 196	\$ 287
Operating income	\$ 112	\$ 206
Music Publishing		
Revenue	\$ 276	\$ 260
OIBDA	\$ 72	\$ 68
Operating income	\$ 41	\$ 38
Corporate and Revenue Eliminations		
Revenue	\$ (12)	\$ (16)
OIBDA	\$ (48)	\$ (49)
Operating loss	\$ (54)	\$ (55)
Total		
Revenue	\$ 1,712	\$ 1,840
OIBDA	\$ 220	\$ 306
Operating income	\$ 99	\$ 189

- (1) The OIBDA and Operating Income for the six months ended March 31, 2007 has been reduced by \$12 million of restructuring costs. Of such an amount, \$11 million relates to Recorded Music and \$1 million relates to Corporate.

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Recorded Music

Recorded Music revenues decreased by \$148 million, or 9%, to \$1.448 billion for the six months ended March 31, 2007 from \$1.596 billion for the six months ended March 31, 2006. Excluding a \$49 million favorable impact of foreign currency exchange rates, revenues decreased by \$197 million, or 12%, primarily resulting from a \$259 million decrease in physical sales, offset in part by an increase in digital sales of \$46 million and an increase in licensing revenues of \$16 million. Physical sales declined as the current six month period end March 31, 2007 reflected fewer major artist releases and weaker international markets, primarily in Europe, offset in part by increases in sales of domestic repertoire in the Asia Pacific region. Digital sales were comprised of an increase in U.S. digital sales of \$29 million and an increase in international digital sales of \$17 million, excluding the impact of foreign currency exchange rates, which reflect our efforts to develop new digital products and distribution methods. Digital sales comprised approximately 14% of Recorded Music revenues for the six months ended March 31, 2007, up from 9% of Recorded Music revenues for the six months ended March 31, 2006.

Recorded Music revenues represented 85% and 87% of consolidated revenues, prior to corporate and revenue eliminations, for the three months ended March 31, 2007 and 2006, respectively. U.S. Recorded Music revenues were \$720 million and \$768 million, or 50% and 48% of consolidated Recorded Music revenues for the six months ended March 31, 2007 and 2006, respectively. International Recorded Music revenues were \$728 million and \$828 million, or 50% and 52% of consolidated Recorded Music revenues for the six months ended March 31, 2007 and 2006, respectively.

Recorded Music OIBDA decreased by \$91 million, or 32% to \$196 million for the six months ended March 31, 2007 compared to \$287 million for the six months ended March 31, 2006. Expressed as a percentage of Recorded Music revenues, Recorded Music OIBDA was 14% and 18% for the six months ended March 31, 2007 and 2006, respectively. Excluding a \$7 million impact of foreign currency exchange rates, OIBDA decreased by \$98 million, which was primarily caused by the significant decline in physical sales previously described, the increase in royalty expense related to a variance in product mix from the prior period and the impact of the restructuring plan.

Recorded Music operating income was \$112 million for the six months ended March 31, 2007 as compared to \$206 million for the six months ended March 31, 2006. Recorded Music operating income included the following components:

	<u>Six Months Ended</u> <u>March 31, 2007</u> <u>(unaudited)</u>	<u>Six Months Ended</u> <u>March 31, 2006</u> <u>(unaudited)</u>
	(in millions)	
OIBDA	\$ 196	\$ 287
Depreciation and amortization	(84)	(81)
Operating income	<u>\$ 112</u>	<u>\$ 206</u>

The \$94 million decrease in Recorded Music operating income related to the \$91 million decrease in Recorded Music OIBDA more fully discussed above, and an increase in Recorded Music depreciation and amortization of \$3 million.

Music Publishing

Music Publishing revenues increased \$16 million, or 6%, to \$276 million for the six months ended March 31, 2007 as compared to \$260 million for the six months ended March 31, 2006. Excluding a \$15 million favorable impact of foreign currency exchange rates, Music Publishing revenues increased by \$1 million, which was primarily the result of timing and increases in performance revenue of \$7 million and digital revenue of \$4

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million, offset by a decrease in mechanical revenue of \$7 million related to market declines across various territories and a decrease in other revenue of \$3 million. Synchronization revenue was flat for the six months ended March 31, 2007 as compared to the six months ended March 31, 2006.

Music Publishing OIBDA increased \$4 million to \$72 million for the six months ended March 31, 2007 as compared to \$68 million for the six months ended March 31, 2006. Excluding a \$2 million impact of foreign currency exchange rates, OIBDA increased \$2 million, which resulted primarily from the increase in revenue discussed above and a decrease in costs of revenues due to the change in revenue composition. Additionally, the increase was due to adjustments to settlements of royalties payable balances of certain songwriters, offset in part by an increase in new songwriter spending.

Music Publishing operating income was \$41 million for the six months ended March 31, 2007 as compared to \$38 million for the six months ended March 31, 2006. Music Publishing operating income includes the following components:

	<u>Six Months Ended</u> <u>March 31, 2007</u> <u>(unaudited)</u>	(in millions)	<u>Six Months Ended</u> <u>March 31, 2006</u> <u>(unaudited)</u>
OIBDA	\$ 72		\$ 68
Depreciation and amortization	(31)		(30)
Operating income	<u>\$ 41</u>		<u>\$ 38</u>

The \$3 million increase in Music Publishing operating income related to the \$4 million increase in Music Publishing OIBDA described above and the \$1 million increase in depreciation and amortization.

Corporate Expenses and Eliminations

Corporate expenses before depreciation and amortization expense decreased by \$1 million, or 2% to \$48 million for the six months ended March 31, 2007 as compared to \$49 million for the six months ended March 31, 2006. The decrease primarily relates to a decrease in consulting and professional fees.

FINANCIAL CONDITION AND LIQUIDITY

Financial Condition

At March 31, 2007, we had \$2.266 billion of debt, \$362 million of cash and equivalents (net debt of \$1.904 billion, defined as total debt less cash and equivalents and short-term investments) and \$4 million of shareholders' equity. This compares to \$2.256 billion of debt, \$367 million of cash and equivalents, \$18 million of short-term investments (net debt of \$1.871 billion) and \$58 million of shareholders' equity at September 30, 2006. Net debt increased by \$33 million as a result of (i) a \$5 million decrease in cash and equivalents, (ii) an \$18 million decrease in short-term investments, (iii) a \$9 million impact of foreign exchange rates on our Acquisition Corp. Sterling-denominated Senior Subordinated Notes due 2014 and (iv) \$9 million of accretion on our Holdings Discount Notes, offset by a \$8 million decrease in debt as a result of quarterly repayments of our term loans under our senior secured credit facility.

Short-term investments include high-quality, investment grade securities such as taxable auction rate securities as well as commercial paper and corporate bonds with maturities greater than 90 days but less than one year. We have expanded our investment portfolio in order to increase yield while maintaining safety of principal consistent with an investment policy approved by our Board of Directors. At March 31, 2006, our short-term investment balance was \$18 million. At March 31, 2007, we had no short-term investment balance.

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The \$54 million decrease in shareholders' equity during the six months ended March 31, 2007 consisted of \$5 million of stock compensation and \$2 million of stock option exercises, offset primarily by \$9 million of net losses for the six months ended March 31, 2007, deferred losses on derivative financial instruments of \$7 million, foreign currency exchange movements of \$6 million and by our \$38 million in dividends declared on December 29, 2006 and March 8, 2007.

Cash Flows

The following table summarizes our historical cash flows. The financial data for the six months ended March 31, 2007 and 2006 are unaudited and are derived from our interim financial statements included elsewhere herein.

	<u>Six Months Ended</u> <u>March 31, 2007</u> <u>(unaudited)</u>	<u>Six Months Ended</u> <u>March 31, 2006</u> <u>(unaudited)</u>
	(in millions)	
Cash provided by (used in):		
Operating activities	\$ 107	\$ 205
Investing activities	(69)	(91)
Financing activities	(46)	(45)

Operating Activities

Cash provided by operations was \$107 million for the six months ended March 31, 2007 compared to \$205 million for the six months ended March 31, 2006. The \$98 million decrease in cash provided by operations primarily reflects the decrease in physical sales for the last six months of calendar 2006, which resulted in lower collections in the first six months of fiscal year 2007 as compared to the first six months of fiscal year 2006. This decrease was offset in part by the variable timing of our working capital requirements in association with the variances in our business.

Investing Activities

Cash used in investing activities was \$69 million for the six months ended March 31, 2007 as compared to \$91 million for the six months ended March 31, 2006. The \$69 million of cash used in investing activities in the six months ended March 31, 2007 consisted primarily of payments to acquire Roadrunner, which included \$36 million paid to acquire 73.5% of Roadrunner, net of cash acquired of \$23 million, and a loan to the seller of approximately \$14 million. In addition, we paid approximately \$11 million to acquire a video production company in the U.K., net of cash acquired, and \$5 million to acquire a digital distribution company in Germany, net of cash acquired, and paid approximately \$13 million for capital expenditures. This was offset by the receipt of approximately \$7 million related to the sale of certain buildings and \$18 million related to the liquidation of short-term investments, including auction-rate securities. The \$91 million of cash used in investing activities in the six months ended March 31, 2006 primarily reflects \$61 million of cash invested in auction-rate securities and other short-term investments, \$12 million of capital expenditures, and the acquisition of a small independent record label in Australia.

Financing Activities

Cash used in financing activities was \$46 million for the six months ended March 31, 2007 compared to \$45 million for the six months ended March 31, 2006. The \$46 million of cash used in financing activities in the six months ended March 31, 2007 consisted of \$8 million of our quarterly repayments of debt and dividend payments of approximately \$40 million offset by the receipt of cash for stock option exercises. The \$45 million of cash used in financing activities in the six months ended March 31, 2006 consisted of \$8 million of our quarterly repayments of debt and dividend payments of \$37 million.

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Liquidity

Our primary sources of liquidity are the cash flow generated from our subsidiaries' operations, availability under the unused \$250 million (less \$4 million of outstanding letters of credit as of March 31, 2007) revolving credit portion of our senior secured credit facility 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 regular quarterly dividends. We believe that our existing sources of cash will be sufficient to support our existing operations over the next twelve months.

As of March 31, 2007, our long-term debt consisted of \$1.405 billion of borrowings (including \$17 million of debt that is classified as a current obligation) under the term loan portion of our senior secured credit facility, \$661 million of Acquisition Corp. Senior Subordinated Notes and \$200 million of Holdings Discount Notes. There were no borrowings under the revolving portion of our senior secured credit facility as of March 31, 2007.

Senior Secured Credit Facility

The senior secured credit facility consists of a \$1.405 billion outstanding term loan portion and a \$250 million revolving credit portion. The term loan portion of the facility matures in February 2011. We are required to prepay outstanding term loans, subject to certain exceptions and conditions, with excess cash flow or in the event of certain asset sales and casualty and condemnation events and incurrence of debt. We are required to make minimum repayments under the term loan portion of our facility in quarterly principal amounts of approximately \$4 million through November 2010, with a remaining balloon payment in February 2011. The revolving credit portion of the senior secured credit facility matures in February 2010. There are no mandatory reductions in borrowing availability for the revolving credit portion of the facility through its term.

Borrowings under both the term loan and revolving credit portion of the senior secured credit facility currently bear interest at a rate equal to an applicable margin plus, at our option, either (a) a base rate determined by reference to the higher of (1) the prime rate of Bank of America, N.A. and (2) the federal funds rate plus $\frac{1}{2}$ of 1% or (b) a LIBOR rate determined by reference to the costs of funds for deposits in the currency of such borrowing for the interest period relevant to such borrowing adjusted for certain additional costs. As of March 31, 2007, the applicable margins with respect to base rate borrowings and LIBOR borrowings were 1.25% and 2.25%, respectively, for borrowings under the revolving credit facility. The applicable margins are variable subject to changes in certain leverage ratios. For borrowings under the term loan facility, the margins with respect to the base rate borrowings and LIBOR borrowings are 1.00% and 2.00%, respectively, but will be 0.75% and 1.75%, respectively, if the senior secured debt of Acquisition Corp. is rated at least BB by S&P and Ba2 by Moody's. As of May 4, 2007, our term loan facility was rated BB- by S&P and Ba2 by Moody's.

In addition to paying interest on outstanding principal under the senior secured credit facility, we are required to pay a commitment fee to the lenders under the revolving credit facility in respect of the unutilized commitments. The initial commitment fee rate was 0.5%. As of March 31, 2007, the commitment fee rate was 0.375%. The commitment fee rate is variable subject to changes in certain of our leverage ratios. We also are required to pay customary letter of credit fees, as necessary.

The senior secured credit facility contains a number of covenants that, among other things, restrict, subject to certain exceptions, our ability and the ability of our subsidiaries to sell assets, incur additional indebtedness or issue preferred stock, repay other indebtedness, pay dividends and distributions or repurchase capital stock, create liens on assets, make investments, loans or advances, make certain acquisitions, engage in mergers or consolidations, engage in certain transactions with affiliates, amend certain material agreements, change the business conducted by us and enter into agreements that restrict dividends from subsidiaries. In addition, the senior secured credit facility requires us to maintain the following financial covenants: a maximum total leverage ratio and a minimum interest coverage ratio, both tested quarterly, and a maximum annual capital expenditures limitation. The occurrence of an event of default under the senior secured credit facility could result in all

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amounts outstanding under the facility to be immediately due and payable, which could have a material adverse impact on our results of operations, financial position and cash flows. As of March 31, 2007, we were in compliance with all covenants under the senior secured credit facility.

Senior Subordinated Notes of Acquisition Corp.

Acquisition Corp. has outstanding two tranches of senior subordinated notes due 2014: \$465 million principal amount of U.S. dollar-denominated notes and £100 million principal amount of Sterling-denominated notes (collectively, the "Subordinated Notes"). The Subordinated Notes mature on April 15, 2014. The Subordinated Notes bear interest at a fixed rate of 7 ³/₈% per annum on the \$465 million dollar notes and 8 ¹/₈% per annum on the £100 million sterling notes. The indenture governing the 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 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 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 are required. However, interest accrues 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 will equal the principal amount at maturity on December 15, 2009. Thereafter, cash interest on the Holdings Discount Notes is payable semiannually at a fixed rate of 9.5% per annum. The Holdings Discount Notes mature on December 15, 2014. The Company redeemed 35% of the Holdings Discount Notes on June 15, 2005.

The terms of the indentures governing the Acquisition Corp. Senior Subordinated Notes and Holdings Discount Notes significantly restrict Acquisition Corp., Holdings and our 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 June 1, 2004 and July 1, 2004, respectively. 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 to interest expense ratio of at least 2.0 to 1 after giving effect to any such payments. Acquisition Corp. may also make a restricted payment, including payments to Holdings, prior to April 15, 2009 if, immediately after giving pro forma effect to such restricted payment and any indebtedness incurred to finance such restricted payment, its net indebtedness to adjusted EBITDA ratio would not exceed 3.75 to 1 and its net senior indebtedness to adjusted EBITDA ratio would not exceed 2.50 to 1. In addition, Holdings may make a restricted payment if, immediately after giving pro forma effect to such restricted payment and any indebtedness incurred to finance such restricted payment, its net indebtedness to adjusted EBITDA ratio would not exceed 4.25 to 1.0. Notwithstanding such restrictions, the indentures permit an aggregate of \$45.0 million and \$75.0 million of such payments to be made by Acquisition Corp. and Holdings, respectively, whether or not there is availability under the formula or the conditions to its use are met. Acquisition Corp.'s senior secured credit facility permits Acquisition Corp. to make additional restricted payments to Holdings, the proceeds of which may be utilized by Holdings to make additional restricted payments, in an aggregate amount not to exceed \$10.0 million (such amount subject to increase to \$35.0 million if the leverage ratio as of the last day of the immediately preceding four fiscal quarters was less than 4.0 to 1 and to \$50.0 million if the leverage ratio as of the last day of the immediately preceding four fiscal quarters was less than 3.5 to 1), and subject to further increase in an amount equal to 50% of cumulative excess cash flow that is

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not otherwise applied pursuant to Acquisition Corp.'s senior secured credit facility, and, in addition, permits Acquisition Corp. to make restricted payments to Holdings, the proceeds of which may be utilized by Holdings to make additional restricted payments not to exceed \$90 million in any fiscal year, provided that the proceeds of such restricted payments shall be applied solely to pay cash dividends on the Company's common stock. Furthermore, Holdings' subsidiaries will be permitted under the terms of Acquisition Corp.'s existing senior secured credit facility, as it may be amended, and under other indebtedness, to incur additional indebtedness that may restrict or prohibit the making of distributions, the payment of dividends or the making of loans by such subsidiaries to Holdings.

Dividends

We intend to pay regular quarterly dividends on our common stock outstanding in an amount not to exceed \$80 million per year. Any decision to declare and pay dividends in the future will be made at the discretion of our board of directors and will depend on, among other things, our results of operations, cash requirements, financial condition, contractual restrictions and other factors our board of directors may deem relevant.

Summary

Management believes that future funds generated from our operations and available borrowing capacity will be sufficient to fund our debt service requirements, working capital requirements, capital expenditure requirements and payment of regular dividends on our common stock. 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 decline of industry-wide CD sales.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As discussed in Note 21 to our audited consolidated financial statements for the twelve months ended September 30, 2006, the Company is exposed to market risk arising from changes in market rates and prices, including movements in foreign currency exchange rates and interest rates. As of March 31, 2007, other than as described below, there have been no material changes to the Company's exposure to market risk since September 30, 2006.

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 domestic companies for the sale, or anticipated sale, of U.S.-copyrighted products abroad may be adversely affected by changes in foreign currency exchange rates. We focus on managing the level of exposure to the risk of foreign current exchange rate fluctuations on our major currencies, which include the British pound sterling, euro, Japanese yen, Canadian dollar and Australian dollar. During the six months ended March 31, 2007, the Company entered into additional foreign exchange hedge contracts and, as of March 31, 2007, the Company has outstanding hedge contracts for the sale of \$413 million and the purchase of \$161 million of foreign currencies at fixed rates. The Company did not enter into any significant foreign exchange contracts subsequent to March 31, 2007.

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.

We are exposed to foreign currency exchange rate risk with respect to our Acquisition Corp. £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, 2007, these Sterling-denominated notes had a carrying value of approximately

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\$196 million. However, a 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, as these notes are completely hedged as of March 31, 2007. We did not enter into any additional hedges related to this debt subsequent to March 31, 2007.

We are exposed to interest rate risk with respect to our floating rate debt. The Company did not enter into additional interest rate swap agreements to hedge the variability of its expected future cash interest payments. The total notional amount of debt hedged as of March 31, 2007 was \$897 million. We did not enter into any additional interest rate swap agreements subsequent to March 31, 2007.

We monitor our positions with, and the credit quality of, the financial institutions that are party to any of our financial transactions. Credit risk relating to the interest rate swaps is considered low because the swaps are entered into with strong, credit-worthy counterparties, and the credit risk is confined to the net settlement of the interest over the remaining life of the swaps.

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 SEC’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 SEC’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

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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 the SEC's rules and forms.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal controls over financial reporting or other factors during the period ended March 31, 2007 that have materially affected, or are reasonably likely to materially affect, our Internal Controls.

Management's Report on Internal Control Over Financial Reporting

Management's report on internal control over financial reporting is located on page 83 in the Company's annual report on Form 10-K for the fiscal year ended September 30, 2006. Ernst & Young LLP's Report of Independent Registered Public Accounting Firm on internal control over financial reporting is located on page 85 in the Company's annual report on Form 10-K for the fiscal year ended September 30, 2006.

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Litigation

Radio Promotion Activities

Two independent labels have filed antitrust suits against the Company alleging that its radio promotion activities are anticompetitive. *Radikal Records, Inc. v. Warner Music Group, et al.* was filed on March 21, 2006 in U.S. District Court in the Central District of California, Western Division. *TSR Records, Inc. v. Warner Music Group, et al.* was filed on March 28, 2006 in U.S. District Court in the Central District of California, Western Division. The Company filed a Notice of Related Case and was successful in having both of these cases consolidated. On May 16, 2006, the Company filed a Motion to Dismiss in both cases. On October 11, 2006, the court denied the Company's Motion to Dismiss as to the antitrust claims but granted the motion, with leave to amend, as to the state tort claim for interference with prospective economic advantage. On October 24, 2006, Plaintiffs filed amended complaints, attempting to cure the defects in their tort claim. The Company again moved to dismiss the state court claims and on January 31, 2007, the court granted the Company's motion, but allowed plaintiffs to replead. The Company intends to defend against these lawsuits vigorously, but is unable to predict the outcome of these suits.

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. The Company has provided documents and other information in response to these requests and intends 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 have been 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. The Company intends to defend against these lawsuits vigorously, but is unable to predict the outcome of these suits. Any litigation the Company may become involved in as a result of the inquiries of the Attorney General and Department of Justice, regardless of the merits of the claim, could be costly and divert the time and resources of management.

Statement of Objections

On March 30, 2007, the European Commission ("EC") issued a Statement of Objections to Apple Inc., iTunes S.a.r.l. and one of our subsidiaries, WEA International Inc. ("WEA"). The Company believes that similar Statements of Objections were also issued to Apple Inc. and each of the other major recorded music companies. The Statement of Objections targets Apple Inc.'s practice of applying certain territorial restrictions in relation to its iTunes stores in the European Economic Area ("EEA"). The EC alleges that these restrictions arise, among other ways, as a result of the agreement between Apple Inc. and WEA for the sale of downloaded music in the EEA. In the EC's preliminary view, these restrictions may lead to a distortion of competition, infringing Article 81 of the EC Treaty. In particular, the EC asserts that (i) consumers resident in a particular EEA country in which

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iTunes does not operate a dedicated online store are prevented from acquiring downloaded music from iTunes and (ii) consumers resident in a particular EEA country may be required to pay a higher price for the same download than consumers resident in another EEA country or may not have access to the same downloads as are available to consumers resident in another EEA country. The EC, if it finds an infringement, may require that the alleged restriction be eliminated and also has the authority to impose fines on the parties to any infringement. The Company intends to cooperate with the EC but believes that its practices have not infringed Article 81 of the EC Treaty.

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 our common stock. Any of the following risks could materially and adversely affect our business, financial condition or results of operations.

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. Illegal downloading of music from the Internet, 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. According to RIAA, from 1999 to 2004, annual dollar sales of physical music product in the U.S. are estimated to have declined at a CAGR of 4%, although there was a 2.5% year-over-year increase recorded in 2004. In 2005, the physical business experienced an 8% year-over-year decline. However, new formats for selling recorded music product have been created, including the legal downloading of digital music using the Internet, physical format product innovations such as DVD-Audio and the soon-to-be launched MVI disc and the distribution of music on mobile devices, and revenue streams from these new markets are beginning to emerge. These new digital revenue streams are important to offset declines in physical sales and represent the fastest growing area of our business. As reported by IFPI, sales of music via the Internet and mobile phones generated an estimated \$2 billion in trade revenues for record companies in 2006, doubling the worldwide digital music market year-over-year and sales of music through new avenues such as digital tracks are beginning to offset the declines seen in prior years. RIAA announced in April 2007 that the overall value of the U.S. record industry was \$11.5 billion in 2006, a 6.2% decline compared to 2005. RIAA additionally reported that the value of CD shipments to retail and specialty outlets totaled \$9.2 billion in 2006, a 12.9% drop from the previous year, while sales of digital music content—via online as well as mobile outlets—rose 73% in value to \$1.9 billion. For 2006, according to SoundScan, total album sales were down 5% on a unit basis compared with the same period last year. However, when including “Track Equivalent Albums”, total album sales were down 1.2% for 2006. Track Equivalent Albums convert digital track sales to album sales using SoundScan’s standard of ten tracks per album. This SoundScan comparison with prior years also does not reflect the impact of sales on mobile devices or online subscription sales. However, it is too soon to determine if the industry has stabilized or the impact of sales of

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music through new channels might have on the industry and the recorded music industry performance may continue to negatively impact our operating results. 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, primarily from the sale of music in CD and other recorded music formats.

There may be downward pressure on our pricing and our profit margins.

There are a variety of factors that could cause us to reduce our prices and reduce our profit margins. They are, among others, increased price competition among record companies resulting from the Universal and Sony BMG recorded music duopoly, price competition from the sale of motion pictures in 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, the adoption by record companies of initially lower-margin formats such as DVD-Audio 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 wholesale 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 will continue to grow as a result of the decline of specialty music retailers, which could increase their negotiating leverage. Several large specialty music retailers, including Tower Records and Musicland, have recently filed for bankruptcy protection. See "Risk Factors—We may be materially and adversely affected by the formation of Sony BMG Music Entertainment and the potential acquisition of BMG Music Publishing Group by Universal" and "Risk Factors—We are substantially dependent on a limited number of online music stores, in particular Apple 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 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 under terms that are economically attractive to us. Our competitive position is dependent on our continuing ability to attract and develop talent 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 and songwriters 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 general economic and retail environment of the countries in which we operate, 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, CDs and MP3 files. An estimated 20 billion songs were illegally swapped or downloaded worldwide in 2005, according to IFPI. A substantial portion of our

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revenue comes from the sale of audio products that are potentially subject to unauthorized consumer copying and widespread dissemination on the Internet without an economic return to us. We are working to control this problem through litigation, by lobbying governments for new, stronger copyright protection laws and more stringent enforcement of current laws and technological means 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 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. Worldwide, industrial pirated music (which encompasses unauthorized physical copies manufactured for sale but does not include Internet downloads or home CD burning) is estimated to have generated over \$4.5 billion in revenues in 2005, according to IFPI. IFPI estimates that 1.2 billion pirated units were manufactured in 2005. According to IFPI estimates, approximately 37% of all music CDs sold worldwide in 2005 were pirated. 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, a field that has encountered increasing 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, 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 timing of the release of 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.

Our operating results fluctuate on a seasonal and quarterly basis, and, in the event we do not generate sufficient net sales in our first fiscal quarter, we may not be able to meet our debt service and other obligations.

Our business is seasonal. For the fiscal year ended September 30, 2006, we derived approximately 85% of our revenues from our Recorded Music business. In the recorded music business, purchases are heavily weighted towards the last three months of the calendar year, which represent our first quarter under our September 30 fiscal year. Historically, we have realized approximately 35% of recorded music net sales worldwide during the last three months of the calendar year, making those three months (*i.e.*, our first fiscal quarter) material to our

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full-year performance. We realized 28%, 32% and 32% of recorded music calendar year net sales during the last three months of calendar 2006, 2005 and 2004, respectively. This sales seasonality affects our operating cash flow from quarter to quarter. We cannot assure you that our recorded music net sales for the last three months of any calendar year will continue to be sufficient to meet our obligations or that they will be higher than such net sales for our other quarters. In the event that we do not derive sufficient recorded music net sales in such last three months, we may not be able to meet our debt service requirements, working capital requirements, capital expenditure requirements, payment of regular dividends on our common stock and other obligations. As digital revenue increases as a percentage of our total revenue, this may affect the overall seasonality of our business. For example, sales of MP3 players or gift cards to purchase digital music sold in the holiday season tend to result in sales of digital music in subsequent periods. However, seasonality with respect to the sale of music in new formats, such as digital, is still developing.

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 artists or songwriters or to match the prices or the quality of products and services, offered by our competitors. 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 adversely affected by technological developments that facilitate the piracy of music, such as Internet peer-to-peer file-sharing and CD-R activity; by its inability to enforce our intellectual property rights in digital environments; and by its failure to develop a successful business model applicable to a digital environment, including such channels of distribution as satellite radio. It 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;
- 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;

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- 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.

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 to, among other things, continue to maximize the value of our music assets, significantly reduce costs to maximize flexibility and adjust to new realities of the market, continue to act to contain digital piracy, to diversify our revenue streams and 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. The results of the 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 the 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 wireless 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 revenues from 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

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products such as manufacturing, distribution, inventory and return costs do not apply. 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 assure you 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. While recent studies have indicated that consumers spend more on music in general when they begin to purchase music in digital form than previously, it remains unclear how consumer behavior will change when faced with the opportunity to purchase only their 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. In addition, as new distribution channels continue to develop we have to implement systems to process royalties on these new revenue streams. If we are not able to successfully expand our processing capability or introduce technology to allow us to determine and pay royalty amounts due in a timely manner and automate these tasks, we may experience delays 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 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 revenue from sales of music through digital distribution channels. We are currently dependent on a small number of leading online music stores that sell to consumers digital music. Currently, the largest U.S. online music store, iTunes, charges U.S. consumers \$0.99 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 70% of the legitimate digital music download business. If iTunes were to adopt a lower pricing model for our music recordings or if there is a pricing structure change to other pricing models, we may receive substantially less per download for our music recordings, which could cause a material reduction in our revenue, 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 post 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 recordings they will accept from music content owners like us, our revenue 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 industry negotiations contemplated by the U.S. Copyright Act 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. The U.S. Copyright Office recently decided that the use of compositions as ringtones fall under the compulsory license provisions of section 115 of the Copyright Act. If this decision is not reversed on appeal, it will likely lower the cost of mechanical licenses for ringtones, which is favorable for our Recorded Music business but unfavorable for our Music Publishing 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 appealable arbitration process under the U.S. Copyright Act unless rates are determined through voluntary negotiations. It is

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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 these and other income sources are set too low through this process, it could have a material adverse impact on our Recorded Music business or our business prospects.

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. For the fiscal year ended September 30, 2006, approximately 52% of our revenues related to operations in foreign territories. For the six months ended March 31, 2007 approximately 52% of our revenues related to operations in foreign territories. 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, 2007, we have hedged 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.

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.

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 California to repeal Subsection (b) and then withdrawn. A bill regarding personal service contracts was introduced into the California legislature this year. Unlike in prior years, the bill does not seek to repeal sections applying to the music industry. Legislation was also reintroduced in New York in January 2007 to create a statute similar to Section 2855 to limit contracts between artists and record companies to a term of three years, potentially affecting the duration of artist contracts. There is no assurance that California or any other state will not reintroduce 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.

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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 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 musical compositions that are not “works made for hire”. If any of our commercially available recordings were determined not to be “works made for hire”, then the recording artists (or their heirs) could have the right to terminate the 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 rights could have an adverse effect on our Recorded Music business. From time to time, authors (or their heirs) can terminate our 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 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 its progress and success are uncertain. 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 and allow for continued payment of regular dividends 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 spent and this could have a negative impact on our businesses or our company as a whole.

Our realignment plan may not be successful and may adversely affect our business.

We have recently begun to implement a realignment plan aimed at better aligning our workforce with the changing nature of the music industry. These changes are part of the continued evolution from a traditional record and songs-based business to a music-based content company and the ongoing management of our cost structure. The changes include a continued redeployment of resources to focus on new business initiatives to help us diversify our revenue streams, including digital opportunities. The realignment plan is also designed to improve the operating effectiveness of our current businesses and to realign our management structure to, among other things, effectively address the continued development of digital distribution channels along with declining physical sales. Our future competitiveness depends upon our continued success in implementing these initiatives throughout our operations. Although we will seek to successfully implement these actions in a manner that does not negatively impact our results of operations or impair our ability to compete successfully, we cannot be certain that these actions will accomplish their intended objective. Substantially all of the restructuring charges associated with the realignment plan have required or will require the outlay of cash.

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

The Investor Group controls a majority of our common stock on a fully diluted basis. In addition, representatives of the Investor Group occupy substantially all of the seats on our board of directors and pursuant to a stockholders agreement, will have the right to appoint all of the independent directors to our board. As a result, the 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 our common stock or other securities, the payments of dividends, if any, on our common stock, the incurrence of debt by us and the amendment of our certificate of incorporation and bylaws. The Investor Group will have 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 Investor Group could cause us to make acquisitions that increase our indebtedness or to sell revenue-generating assets. Additionally, the Investor Group are 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 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 Investor Group continues to hold a majority of our outstanding common stock the Investor Group 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 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. 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, we would have difficulty satisfying our commitments to our wholesale and retail customers, which could have an adverse impact on our revenues. 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 itself 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 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 Sony BMG Music Entertainment and the potential acquisition of BMG Music Publishing Group by Universal.

In August 2004, Sony Music Entertainment ("Sony") and Bertelsmann Music Group ("BMG") merged their recorded music businesses to form Sony BMG. As a result, the recorded music industry now consists of four major players (Universal, Sony BMG, EMI and us) rather than five (Universal, Sony, BMG, EMI and us). Prior to the formation of Sony BMG, there was one appreciably larger major, Universal, with approximately 25% of the global recorded music revenues and four other majors relatively equal in size ranging between 11% and 14%

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of recorded music revenues. Now there are two appreciably larger majors, Universal and Sony BMG, and two significantly smaller majors, EMI and us. On July 13, 2006, the European Court of First Instance annulled the European Commission's decision approving the formation of Sony BMG. Sony and Bertelsmann are now re-applying to the European Commission to seek clearance for the formation of Sony BMG and the European Commission will have to re-examine the combination. As a result of this re-examination, the European Commission could clear the transaction without conditions, clear the transaction with conditions or block the transaction forcing Sony BMG to unwind. In the interim, Sony BMG has appealed the ruling to the European Court of Justice. We cannot predict what actions will be taken by the European Commission, Sony or Bertelsmann as a result of the ruling or the outcome or timing of the European Commission's re-examination of Sony BMG or the appeal of the ruling, or what impact the final decision regarding the formation of SonyBMG might have on us. Further, in September 2006, it was announced that Universal had agreed to acquire the BMG Music Publishing Group from Bertelsmann. The acquisition has been approved by U.S. merger authorities but still requires the approval of EU merger authorities and, if approved, would result in the formation of the largest music publishing company with a share of global revenues potentially in excess of 25%, making Universal both the largest recorded music company and music publishing company. We cannot predict what impact the acquisition of BMG Music Publishing by Universal 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, 2007, our total consolidated indebtedness was \$2,266 billion. We have an additional \$250 million available for borrowing under the revolving portion of our senior secured credit facility (less \$4 million of letters of credit).

Our high degree of leverage could have important consequences for you, 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;
- exposing us to the risk of increased interest rates as certain of the borrowings of our subsidiaries, including borrowings under our senior secured credit facility, will be at variable rates of interest;
- 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 senior secured credit facility and the 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.

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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 cannot assure you that we will 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, including the notes.

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 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. Our senior secured credit facility and the indenture 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.

Holdings also will be relying on Acquisition Corp. and its subsidiaries to make payments on the Holdings Notes. If Acquisition Corp. does not dividend funds to Holdings in an amount sufficient to make such payments, Holdings may default under the indenture governing the Holdings Notes, which would result in all such notes becoming due and payable. Because Acquisition Corp.'s debt agreements have covenants that limit its ability to make payments to Holdings, Holdings may not have access to funds in an amount sufficient to service its indebtedness.

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

Our senior secured credit facility and the indentures governing our outstanding notes contain various covenants that limit our ability to engage in specified types of transactions. These covenants limit 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 our common stock or make other restricted payments;
- make certain investments;
- sell certain assets;
- create liens on certain indebtedness without securing the notes;
- 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.

In addition, under our senior secured credit facility, our subsidiaries are required to satisfy and maintain specified financial ratios and other financial condition tests. Their ability to meet those financial ratios and tests can be affected by events beyond our control, and they may not be able to meet those ratios and tests. A breach of any of these covenants could result in a default under our senior secured credit facility. Upon the occurrence of an event of default under our senior secured credit facility, the lenders could elect to declare all amounts outstanding under our senior secured credit facility to be immediately due and payable and terminate all commitments to extend further credit. If we were unable to repay those amounts, the lenders under our senior

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secured credit facility could proceed against the collateral granted to them to secure that indebtedness. We have pledged a significant portion of our assets as collateral under our senior secured credit facility. If the lenders under our senior secured credit facility accelerate the repayment of borrowings, we may not have sufficient assets to repay our senior secured credit facility as well as any unsecured indebtedness.

Risks Related to our Common Stock

We are a “controlled company” within the meaning of the New York Stock Exchange rules and, as a result, will qualify for, and intend to rely on, exemptions from certain corporate governance requirements.

The Investor Group controls a majority of our outstanding common stock. As a result, we are a “controlled company” within the meaning of the New York Stock Exchange corporate governance standards. Under the New York Stock Exchange rules, a company of which more than 50% of the voting power is held by an individual, a group, or another company is a “controlled company” and may elect not to comply with certain New York Stock Exchange corporate governance requirements, as applicable, including (1) the requirement that a majority of the board of directors consist of independent directors, (2) the requirement that we have a nominating/corporate governance committee that is composed entirely of independent directors with a written charter addressing the committee’s purpose and responsibilities and (3) the requirement that we have a compensation committee that is composed entirely of independent directors with a written charter addressing the committee’s purpose and responsibilities. We are and intend to continue to utilize these exemptions while we are a controlled company. As a result, we will not have a majority of independent directors nor will our nominating and corporate governance committee, which also serves as our executive committee, and compensation committee consist entirely of independent directors. Accordingly, you will not have the same protections afforded to stockholders of companies that are subject to all of the New York Stock Exchange corporate governance requirements.

Future sales of our shares could depress the market price of our common stock.

The market price of our common stock could decline as a result of sales of a large number of shares of common stock in the market or the perception that such sales could occur. These sales, or the possibility that these sales may occur, also might make it more difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate. As of March 31, 2007 we had approximately 149.6 million shares of common stock outstanding. As of May 8, 2007, approximately 93.3 million shares are held by the Investor Group and are eligible for resale from time to time, subject to contractual and Securities Act restrictions. The Investor Group has the ability to cause us to register the resale of their shares and certain other holders of our common stock, including members of our management and certain other parties that have piggyback registration rights, will be able to participate in such registration. In addition we registered approximately 8.3 million shares of restricted common stock and approximately 8.4 million shares underlying options issued and securities that may be issued in the future pursuant to our benefit plans and arrangements on registration statements on Form S-8. Shares registered on these registration statements on Form S-8 may be sold as provided in the respective registration statements on Form S-8.

The market price of our common stock may be volatile, which could cause the value of your investment to decline.

Securities markets worldwide experience significant price and volume fluctuations. This market volatility, as well as general economic, market or potential conditions, could reduce the market price of our common stock in spite of our operating performance. In addition, our operating results could be below the expectations of securities analysts and investors, and in response, the market price of our common stock could decrease significantly. As a result, the market price of our common stock could decline below price at which you purchase it. You may be unable to resell your shares of our common stock at or above such price. Among other factors that could affect our stock price are:

- actual or anticipated variations in operating results;

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- changes in financial estimates or investment recommendations by research analysts;
- actual or anticipated changes in economic, political or market conditions, such as recessions or international currency fluctuations;
- actual or anticipated changes in the regulatory environment affecting the music industry;
- changes in the retailing environment;
- changes in the market valuations of other music industry peers; and
- announcements by us or our competitors of significant acquisitions, strategic partnerships, divestitures, joint ventures or other strategic initiatives.

See “Risk Factors—Due to the nature of our business, our results of operations and cash flows may fluctuate significantly from period to period.” In the past, following periods of volatility in the market price of a company’s securities, stockholders have often instituted class action securities litigation against those companies. Such litigation, if instituted, could result in substantial costs and a diversion of management attention and resources, which could significantly harm our profitability and reputation.

Provisions in our Charter and amended and restated bylaws and Delaware law may discourage a takeover attempt.

Provisions contained in our Charter and amended and restated bylaws (“Bylaws”) and Delaware law could make it more difficult for a third party to acquire us, even if doing so might be beneficial to our stockholders. Provisions of our Charter and Bylaws impose various procedural and other requirements, which could make it more difficult for shareholders to effect certain corporate actions. For example, our Charter authorizes our board of directors to determine the rights, preferences, privileges and restrictions of unissued series of preferred stock, without any vote or action by our shareholders. Thus, our board of directors can authorize and issue shares of preferred stock with voting or conversion rights that could adversely affect the voting or other rights of holders of our common stock. These rights may have the effect of delaying or deterring a change of control of our company. These provisions could limit the price that certain investors might be willing to pay in the future for shares of our common stock.

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

The following table provides information about purchases by us during the three months ending March 31, 2007 of equity securities that are registered by us pursuant to Section 12 of the Securities Act:

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
10/1/06-10/31/06	10,841(1)	\$ 25.95	—	—
3/1/07-3/31/07	28,498(1)	\$ 16.54	—	—
Total	39,339	\$ 19.13	—	—

- (1) Reflects shares of common stock withheld from restricted stock that vested during fiscal year 2007 that were surrendered to the Company to satisfy withholding tax requirements related to the vesting of the awards. The value of these shares was determined based on the average of the high and low prices of our common stock on the day prior to the date of vesting.

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ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Item 3 is not applicable and has been omitted.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Annual Meeting of Stockholders of Warner Music Group Corp. was held on February 23, 2007. The following matters were voted on at the meeting: (i) the election of 14 directors for a term of one year and until their successors are duly elected and qualified, (ii) the approval of the Company's Amended and Restated 2005 Omnibus Award Plan and (iii) the ratification of the appointment of Ernst & Young LLP to serve as the independent auditors of the Company for the fiscal year ended September 30, 2007.

(i) The entire nominated board of directors was elected and the votes cast for or withheld with respect to the election of each director were as follows:

<u>Name</u>	<u>Number of Votes Cast For</u>	<u>Number of Votes Withheld</u>
Edgar Bronfman, Jr.	129,188,839	10,247,685
Len Blavatnik	121,811,819	17,624,705
Shelby W. Bonnie	138,267,659	1,168,865
Richard Bressler	128,524,493	10,911,581
John P. Connaughton	128,492,638	10,943,886
Phyllis E. Grann	138,262,196	1,174,328
Michele J. Hooper	138,295,096	1,141,428
Scott L. Jaeckel	128,492,638	10,943,886
Seth W. Lawry	126,967,951	12,468,573
Thomas H. Lee	126,940,514	12,496,010
Ian Loring	126,940,514	12,496,010
Jonathan M. Nelson	121,062,500	18,374,024
Mark Nunnelly	126,940,514	12,496,010
Scott M. Sperling	126,772,114	12,664,410

(ii) The votes cast for, against or abstaining with respect to the approval of the Company's Amended and Restated 2005 Omnibus Award Plan were as follows:

<u>For:</u>	<u>Against:</u>	<u>Abstain:</u>
136,622,682	2,806,995	6,847

(iii) The votes cast for, against or abstaining with respect to the ratification of the appointment of Ernst & Young LLP to serve as the independent auditors of the Company for the fiscal year ended September 30, 2007 were as follows:

<u>For:</u>	<u>Against:</u>	<u>Abstain:</u>
139,410,669	16,108	9,747

ITEM 5. OTHER INFORMATION

The Company entered into an employment agreement amendment, effective as of April 1, 2007, with David H. Johnson, under which Mr. Johnson will serve as Chairman & CEO of Warner/Chappell Music Inc. The employment agreement amendment extends the term of Mr. Johnson's employment agreement through June 30, 2008. Under the terms of the employment agreement amendment, Mr. Johnson will be paid an annual salary equal to \$700,000. Mr. Johnson is also eligible to receive an annual cash bonus, with a target of \$800,000. In the event that Mr. Johnson's employment is terminated for any reason other than cause, or if he terminates his

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employment for good reason, as defined in the agreement, the amendment provides that his severance payment would equal one year of salary plus one year of bonus target, plus a pro rata bonus for the year of termination. In the event of non-renewal of his agreement, Mr. Johnson would receive a payment equal to one year of salary plus one year of bonus target, plus a pro rata bonus for the year of termination. Other terms of his agreement remain unchanged by this amendment.

Simultaneously with the execution of the employment agreement amendment, the Company designated Paul M. Robinson, General Counsel, as an executive officer of the Company.

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ITEM 6. EXHIBITS

- 3.1 Amended and Restated Certificate of Incorporation of Warner Music Group Corp. (1)
- 3.2 Amended and Restated Bylaws of Warner Music Group Corp. (1)
- 10.1 Amendment dated March 13, 2007 to U.S. Manufacturing and Packaging Agreement, dated as of October 24, 2003, between Warner-Elektra-Atlantic Corporation and Cinram Manufacturing LLC, formerly known as Cinram Manufacturing Inc., and International Manufacturing and Packaging Agreement, dated as of October 24, 2003, between WEA International Inc. and Cinram GmbH*(2)
- 10.2 Amendment dated March 13, 2007 to U.S. Pick, Pack and Shipping Services Agreement, dated as of October 24, 2003, between Warner-Elektra-Atlantic Corporation and Cinram Distribution LLC and International Pick, Pack and Shipping Services Agreement, dated as of October 24, 2003, between WEA International Inc. and Cinram GmbH* (2)
- 10.3 Amended and Restated 2005 Omnibus Award Plan*
- 10.4 Employment Agreement Amendment dated May 4, 2007, between Warner Music Inc. and David H. Johnson*
- 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.

** Pursuant to SEC Release No. 33-8212, 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 Warner Music Group Corp.’s Quarterly Report on Form 10-Q for the period ended March 31, 2005.

(2) Exhibit omits certain information that has been filed separately with the Securities and Exchange Commission pursuant to a confidential treatment request pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, as amended.

CERTAIN CONFIDENTIAL INFORMATION CONTAINED IN THIS DOCUMENT, MARKED BY ASTERISKS, HAS BEEN OMITTED AND FILED SEPARATELY WITH THE SECURITIES AND EXCHANGE COMMISSION PURSUANT TO RULE 24B-2 UNDER THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

WARNER-ELEKTRA-ATLANTIC CORPORATION
75 Rockefeller Plaza
New York, New York 10019

Dated: March 13, 2007

Cinram Manufacturing, Inc.
Cinram GmbH
c/o Cinram International Inc.
2255 Markham Road
Scarborough, Ontario M1B 2W3
Canada
Attention: Dave Rubenstein

Gentlemen:

Reference is made to each of the US Manufacturing and Packaging Agreement between Cinram Manufacturing LLC, formerly known as Cinram Manufacturing, Inc. ("Cinram Manufacturing") and Warner-Elektra-Atlantic Corporation ("WEA") dated as of October 24, 2003 (the "US Manufacturing Agreement") and the International Manufacturing and Packaging Agreement between Cinram GmbH and WEA International Inc. ("WMI") dated as of October 24, 2003 (the "International Manufacturing Agreement"). Any terms which are used below and which are defined in the US Manufacturing Agreement or the International Manufacturing Agreement shall have the same meanings and definitions as set forth therein, unless otherwise indicated. This letter, when signed by Cinram Manufacturing, Cinram GmbH, WEA and WMI, shall constitute an agreement to modify each of the US Manufacturing Agreement and International Manufacturing Agreement as hereinafter provided, effective as of the date hereof.

1. (a) Subparagraph 12(a) of the US Manufacturing Agreement is hereby amended by adding the following sentence at the end of the subparagraph:
[*]
(b) Subparagraph 12(d) of the US Manufacturing Agreement is hereby deleted in its entirety.
2. (a) Subparagraph 12(a) of the International Manufacturing Agreement is hereby amended by adding the following sentence at the end of the subparagraph:
[*]
(b) Subparagraph 12(c) of the International Manufacturing Agreement is hereby deleted in its entirety.
3. (a) Subparagraph 14(a)(xxxviii) of the US Manufacturing Agreement is hereby deleted in its entirety and replaced with the following:
“(xxxviii) “*Term*” shall mean the period commencing on the Closing Date, as such term is defined in the Stock Purchase Agreement, and ending on December 31, 2010, subject to earlier termination in accordance with Paragraph 10.”

CERTAIN CONFIDENTIAL INFORMATION CONTAINED IN THIS DOCUMENT, MARKED BY ASTERISKS, HAS BEEN OMITTED AND FILED SEPARATELY WITH THE SECURITIES AND EXCHANGE COMMISSION PURSUANT TO RULE 24B-2 UNDER THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED.

WARNER-ELEKTRA-ATLANTIC CORPORATION
75 Rockefeller Plaza
New York, New York 10019

Dated: March 13, 2007

Cinram Distribution LLC
Cinram GmbH
c/o Cinram International Inc.
2255 Markham Road
Scarborough, Ontario M1B 2W3
Canada
Attention: Dave Rubenstein

Gentlemen:

Reference is made to each of the US Pick, Pack and Shipping Services Agreement between Cinram Distribution LLC ("Cinram Distribution") and Warner-Elektra-Atlantic Corporation ("WEA") dated as of October 24, 2003 (the "US PPS Agreement"), the International Pick, Pack and Shipping Services Agreement between Cinram GmbH and WEA International Inc. ("WMI") dated as of October 24, 2003 (the "International PPS Agreement") and the amendment to each of the US PPS Agreement and the International PPS Agreement dated as of September 6, 2006 (the "First Amendment"). Any terms which are used below and which are defined in the US PPS Agreement or the International PPS Agreement shall have the same meanings and definitions as set forth therein, unless otherwise indicated. This letter, when signed by Cinram Distribution, Cinram GmbH, WEA and WMI, shall constitute an agreement to further modify each of the US PPS Agreement and International PPS Agreement as hereinafter provided, effective as of the date hereof.

1. (a) Subparagraph 13(a)(xxix) of the US PPS Agreement, as amended by the First Amendment, is hereby deleted in its entirety and replaced with the following:

"(xxix) *Term*" shall mean the period commencing on the Closing Date, as such term is defined in the Stock Purchase Agreement, and ending on December 31, 2010, subject to earlier termination in accordance with Paragraph 11."

(b) Subparagraph 13(a)(v) of the International PPS Agreement is hereby deleted in its entirety and replaced with the following:

"(v) *Exclusive Territory*" shall mean Germany, Austria, Switzerland, Netherlands, Denmark, Belgium, the Czech Republic, Finland, Norway, and Sweden."

(c) Subparagraph 13(a)(xxvi) of the International PPS Agreement, as amended by the First Amendment, is hereby deleted in its entirety and replaced with the following:

"(xxvi) *Term*" shall mean the period commencing on the Closing Date, as such term is defined in the Stock Purchase Agreement, and ending on December 31, 2010, subject to earlier termination in accordance with Paragraph 11."

Schedule A
Service Level Requirements

[*]

[*]

[*]

[*]

[*]

[*]

Schedule B

WMI'S Code of Conduct For Third Party Service Providers

1. Company will not (without WMI's written consent) manufacture merchandise utilizing any properties the copyright or trademark to which is owned or licensed exclusively by WMI, or its wholly owned or controlled affiliates other than Products in accordance with this Agreement.
2. Company shall not use child labor in the manufacturing, packaging or distribution of Products. The term "child" refers to a person younger than the local legal minimum age for employment or the age for completing compulsory education, but in no case shall any child younger than fifteen (15) years of age (or fourteen (14) years of age where local law allows) be employed in the manufacturing, packaging or distribution of Products.
3. Company shall only employ persons whose presence is voluntary. Company shall not use any forced or involuntary labor, whether prison, bonded, indentured or otherwise.
4. Company shall treat each employee with dignity and respect, and shall not use corporal punishment, threats of violence, or other forms of physical, sexual, psychological or verbal harassment or abuse.
5. Company shall not discriminate in hiring and employment practices, including salary, benefits, advancement, discipline, termination, or retirement on the basis of race, religion, age, nationality, social or ethnic origin, sexual orientation, gender, political opinion or disability.
6. Company recognizes that wages are essential to meeting employees' basic needs. Company shall comply, at a minimum, with all applicable wage and hour laws, including minimum wage, overtime, maximum hours, piece rates and other elements of compensation, and shall provide legally mandated benefits. If local laws do not provide for overtime pay, Company shall pay at least regular wages for overtime work. Except in extraordinary business circumstances, Company shall not require employees to work more than the lesser of (a) forty-eight (48) hours per week and twelve (12) hours overtime or (b) the limits on regular and overtime hours allowed by local law, or, where local law does not limit the hours of work, the regular work week in such country plus twelve (12) hours overtime. In addition, except in extraordinary business circumstances, employees will be entitled to at least one (1) day off in every seven (7)-day period. Company agrees that, where local industry standards are higher than applicable legal requirements, it will meet the higher standards.
7. Company shall provide employees with a safe and healthy workplace in compliance with all applicable laws, ensuring, at a minimum, reasonable access to potable water and sanitary facilities, fire safety, and adequate lighting and ventilation. Company also shall ensure that the same standards of health and safety are applied in any housing it provides for employees. Company shall provide WMI with all information WMI may request about manufacturing, packaging and distribution facilities for the Products.
8. Company shall respect the rights of employees to associate, organize and bargain collectively in a lawful and peaceful manner, without penalty or interference, in accordance with applicable laws.
9. Company shall comply with all applicable laws, including those pertaining to the manufacture, pricing, sale and distribution of Products.
10. Company shall comply with all applicable environmental laws.

Schedule C
Fee Schedule

[*]

Schedule D
Insurance Coverage

1. *Property Insurance, Including Extra Expense and Business Interruption:* Company at all times and at its own cost and expense shall insure WMI's property as defined and required in this Agreement under so-called "all risk" policies of insurance, including but not limited to coverage for extended perils, earthquake, windstorm, flood, collapse, open cargo, war risk cargo and terrorism, and non-physical damage to source material. WMI's property shall consist of and not be limited to source material, finished goods and inventory, returned stock, master recordings, digital files, DVDs, CDs and all printing and packaging material.

Either dedicated policies or portfolio (blanket) coverage forms may provide the "all risk" property insurance, providing that the aggregate per occurrence limit of insurance available with respect to the WMI property at any Company location for property damage, business interruption, and extra expense shall not be less than [*]. The deductible on said policy shall be the sole responsibility of Company and be of no greater amount than is commercially reasonable for a company of its financial standing. These policies shall be primary to any policy maintained by or on behalf of WMI. WMI may, at any time, review the amount of insurance required hereunder, and may, from time to time, but in no event more than annually, require a lower or higher amount depending on the best available estimate of the aggregate exposure to loss arising from damage to WMI's property under this Agreement.

The open cargo and war risk cargo insurance policies shall provide per shipment limits of indemnity of no less than [*] and contain a warehouse coverage endorsement. In the event that the [*] limit of insurance is not adequate to fully insure any given shipment under this Agreement, Company shall purchase additional insurance to cover the full replacement cost of the shipment. The deductible on these policies shall be no greater than what is commercially reasonable for an enterprise with Company's financial standing. The deductible shall be the responsibility of Company and this coverage shall be primary to any coverage maintained by WMI.

All policies shall provide for a reimbursement value with respect to WMI's property at replacement cost for new property of like kind and quality, with no deduction for depreciation, and shall include WMI, its partners, officers, employees, and affiliates as loss payees under the policies as their interest may appear, and shall provide that no act or omission on the part of Company as the title insured shall prejudice a direct claim by the additional insured. All property policies shall include a waiver of subrogation in favor of WMI. Further, Company agrees to secure terms with its insurer that in the event that Company fails to pay premium resulting in a cancellation of coverage that WMI will be given the opportunity to maintain coverage for its insured property under the policy; and Company will reimburse WMI within [*] of notice for the expense incurred.

2. *Public Liability Insurance:* Company shall also be required to obtain and maintain comprehensive general liability insurance and a follow-form "umbrella liability" policy, providing insurance against claims for bodily injury, including death, property damage, personal and advertising injury, blanket contractual liability, broad form property damage liability, explosion, collapse and underground hazard, and products and completed operations, for such claims occurring or alleged to have occurred in the course of any operations or activities contemplated by this Agreement, in such amounts as from time to time are carried by prudent owners of comparable operations, but in no event less than [*] per occurrence and [*] in the annual aggregate, and covering as additional insureds all the WMI individuals and entities for which and to the extent it is responsible under this Agreement.

3. *Workers' Compensation and Employers' Liability Insurance:*

The Workers' Compensation policy shall include the following coverage:

1. Coverage A	Statutory
2. Coverage B	Employers' Liability
Bodily Injury by Accident	[*] each accident
Bodily Injury by Disease	[*] policy limit
Bodily Injury by Disease	[*] each employee

Company shall maintain any other employment related insurance coverage required by any jurisdiction having control over any employees or operations used in connection with this Agreement.

4. *Automobile Liability Insurance:* Company shall purchase and maintain automobile liability and follow-form “umbrella liability” insurance for all owned, non-owned and hired vehicles with limits of not less than [*] combined single limit for bodily injury and property damage. This insurance coverage must include all automotive and truck equipment used in the performance of the work under this Agreement, and must include the loading and unloading of same.

5. *Environmental Liability Insurance:* In the event Company encounters and must perform or engage a contractor to perform work related to the remediation or abatement of “hazardous material” which includes, without limitation, any flammable explosives, radioactive materials, hazardous materials, hazardous waste, hazardous or toxic substances, or related materials defined in the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended (42 U.S.C. Section 9601, *et seq.*), the Superfund Amendments and Reauthorization Action of 1986 (Pub. L. No. 99-499, 100 stat. 1613 (1986)), the Hazardous Material Transportation Act, as amended (49 U.S.C. Section 1801, *et seq.*) and in the regulations adopted and publications promulgated pursuant thereto, or any other federal, state or local environmental law, ordinance, rule, or regulation (or applicable law in any jurisdiction outside the U.S.), Company, or any contractor performing such work on behalf of Company, shall provide “contractor’s pollution liability” insurance, as applicable to the work to be performed, covering claims from third-party injury and property damage as a result of pollution conditions emanating from on-site, under the site, or off the site arising out of its operations and completed operations. Completed operations coverage shall remain in effect for no less than [*] after final completion. Minimum liability limits, including excess liability coverage, shall be [*] each occurrence and [*] in the aggregate.

The automobile liability insurance must contain provisions for thirty (30) days prior written notice of cancellation, nonrenewal, material change or reduction of insurance sent by certified mail return receipt requested, and waiver of subrogation in favor of WMI, additional insureds and all other such entities, as may be reasonably requested by WMI.

6. *Provisions Applicable to All Policies of Insurance Required Hereunder:* All policies of insurance shall be underwritten by an insurer with an AM Best rating of no less than A- and a financial size class of VII or better (or an equivalent rating from an alternate rating agency). All insurance companies are to be licensed to issue such insurance in the U.S. and or respective jurisdiction where WMI’s property will be located or where operations may be conducted under this Agreement, and the coverage territory for all such policies shall include all such territories. Satisfactory evidence of insurance shall be provided before the commencement of this Agreement and shall be evidenced at each renewal by a binder and certificate of insurance at least ten (10) days before expiration of coverage and upon request of WMI, on an annual basis or as necessitated by a material change in coverage or legal action. Company shall forward to WMI a copy of all required policy forms upon request. With respect to property located outside the U.S., any loss payable to WMI shall be adjusted and paid in the currency of the United States of America, subject to the rate of exchange published in The Wall Street Journal on the date of the loss. If Company elects to maintain insurance for property located outside the U.S., where the policy is denominated in a currency other than the U.S. dollar, such policy limits and deductibles shall at all times be sufficient to meet the U.S. dollar denominated requirements set forth on this Schedule D.

Each of WMI and Company agrees to negotiate in good faith to attempt to resolve any disagreement which in any way affects any insurance required to be carried hereunder. In the event that such good faith negotiation does not result in the resolution of any such disagreement within a fifteen (15)-day period, the parties shall retain an arbitrator to make a fair and reasonable determination as to any such disagreement (the “*Insurance Arbitrator*”). The Insurance Arbitrator shall be a retired executive or attorney with substantial experience in the insurance industry, preferably in the field of distribution, shall be independent of each of WMI and Company, and shall endeavor to provide a determination of any dispute among the parties within thirty (30) days of being retained, but in each case, as quickly as possible. The parties shall jointly appoint the Insurance Arbitrator and

the identity of the Insurance Arbitrator shall be satisfactory to each of the parties. The parties shall share equally in the cost and expense of retaining the Insurance Arbitrator. If the parties cannot agree upon a person to act as the Insurance Arbitrator within thirty (30) days of the expiry of the fifteen (15)-day negotiation period specified in this Paragraph 6, then the Arbitrator shall be selected by the American Arbitration Association. Any arbitration hereunder shall be conducted in conformance with the rules established by the American Arbitration Association. Any determination made by the Insurance Arbitrator shall be final and binding on each of the parties. For the avoidance of doubt, Company shall at all times including during the pendency of any dispute and until such time as such dispute is resolved be required to continue to procure insurance policies at its sole expense in full force and effect as required in this Agreement and as specified herein.

Schedule E
Non-Exclusive Territories

Argentina
Australia
Brazil
Canada
Chile
China
Colombia
Eire

France
Greece
Hong Kong
Hungary
Indonesia
Italy
Japan
Korea
Malaysia
Mexico
New Zealand

Philippines
Poland
Portugal

Singapore
Spain

Taiwan
Thailand
UK
Venezuela

Bulgaria
Croatia
Ecuador
Estonia
Ghana
India
Israel
Ivory Coast
Kenya
Latvia
Lithuania
Mauritius
Romania
Saudi Arabia
Lebanon
United Arab Emirates
Slovenia
South Africa
Turkey
West Indies
Zimbabwe
USA (subject to exclusivity under the US Pick, Pack and Shipping Services Agreement)
Export Territories

All locations in the Territory designated by WMI

Schedule F
PP&S Services

A. WAREHOUSE MANAGEMENT ACTIVITIES

1. Inbound Logistics Activity

- [*]
- [*]
- [*]
- [*]
- [*]
- [*]
- [*]
- [*]

2. Custody and Storage Activities

- [*]
- [*]
- [*]
- [*]
- [*]

3. Order Processing Activities

- [*]
- [*]
- [*]
- [*]
- [*]
- [*]
- [*]
- [*]

4. Dispatch Activities

- [*]
- [*]
- [*]
- [*]
- [*]
- [*]
- [*]
- [*]
- [*]

5. Returns Processing Activities

- [*]
- [*]
- [*]

[*]
[*]

6. New Releases Processing Activities

[*]
[*]
[*]

7. Additional Activities

[*]
[*]
[*]
[*]
[*]

8. Communication Activities

[*]
[*]

B. TRANSPORTATION SERVICES

[*]
[*]

- [*]
- [*]
- [*]
- [*]
- [*]
- [*]
- [*]
- [*]
- [*]
- [*]
- [*]
- [*]

C. SPECIALIST SERVICES

[*]
[*]

Pre Pack Order

[*]
[*]
[*]

D. PERFORMANCE METRICS

[*]

[*]

Warner Music Group Corp.
2005 Omnibus Award Plan
(Amended and Restated Effective February 23, 2007)

1. Purpose

The purpose of the Plan is to provide a means through which the Company and its Affiliates may attract able persons to enter and remain in the employ of the Company and its Affiliates and to provide a means whereby employees, directors and consultants of the Company and its Affiliates can acquire and maintain Common Stock ownership, or be paid incentive compensation measured by reference to the value of Common Stock, thereby strengthening their commitment to the welfare of the Company and its Affiliates and promoting an identity of interest between stockholders and these persons.

So that the appropriate incentive can be provided, the Plan provides for granting Incentive Stock Options, Nonqualified Stock Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, Phantom Stock Awards, Stock Bonuses and Performance Compensation Awards, or any combination of the foregoing.

2. Definitions

The following definitions shall be applicable throughout the Plan.

(a) "Affiliate" means any entity that directly or indirectly is controlled by, controls or is under common control with the Company.

(b) "Award" means, individually or collectively, any Incentive Stock Option, Nonqualified Stock Option, Stock Appreciation Right, Restricted Stock, Restricted Stock Unit, Phantom Stock Award, Stock Bonus or Performance Compensation Award granted under the Plan.

(c) "Board" means the Board of Directors of the Company.

(d) "Cause" means the Company or an Affiliate having "cause" to terminate a Participant's employment or service, as defined in any existing employment, consulting or any other agreement between the Participant and the Company or an Affiliate or, in the absence of such an employment, consulting or other agreement, upon (i) the determination by the Committee that the Participant has ceased to perform his duties to the Company, or an Affiliate (other than as a result of his incapacity due to physical or mental illness or injury), which failure amounts to an intentional and extended neglect of his duties to such party, (ii) the Committee's determination that the Participant has engaged or is about to engage in conduct materially injurious to the Company or an Affiliate, (iii) the Participant having been convicted of, or plead guilty or no contest to, a felony or any crime involving as a material element fraud or dishonesty, (iv) the failure of the Participant to follow the lawful instructions of the Board or his direct superiors or (v) in the case of a Participant who is a non-employee director, the Participant ceasing to be a member of the Board in connection with the Participant engaging in any of the activities described in clauses (i) through (iv) above.

(e) "Change in Control" shall, unless in the case of a particular Award the applicable Award agreement states otherwise or contains a different definition of "Change in Control," have the meaning set forth in the Certificate of Incorporation of the Company.

(f) "Code" means the Internal Revenue Code of 1986, as amended. Reference in the Plan to any section of the Code shall be deemed to include any amendments or successor provisions to such section and any regulations under such section.

(g) "Committee" means a committee of at least two people as the Board may appoint to administer the Plan or, if no such committee has been appointed by the Board, the Board. Unless the Board is acting as the

Committee or the Board specifically determines otherwise, each member of the Committee shall, at the time he takes any action with respect to an Award under the Plan, be an Eligible Director. However, the fact that a Committee member shall fail to qualify as an Eligible Director shall not invalidate any Award granted by the Committee which Award is otherwise validly granted under the Plan.

(h) "Common Stock" means the common stock, par value \$0.01 per share, of the Company and any stock into which such common stock may be converted or into which it may be exchanged.

(i) "Company" means Warner Music Group Corp. and any successor thereto.

(j) "Date of Grant" means the date on which the granting of an Award is authorized, or such other date as may be specified in such authorization or, if there is no such date, the date indicated on the applicable Award agreement.

(k) "Disability" means, unless in the case of a particular Award the applicable Award agreement states otherwise, the Company or an Affiliate having cause to terminate a Participant's employment or service on account of "disability," as defined in any existing employment, consulting or other similar agreement between the Participant and the Company or an Affiliate or, in the absence of such an employment, consulting or other agreement, a condition entitling the Participant to receive benefits under a long-term disability plan of the Company or an Affiliate or, in the absence of such a plan, the complete and permanent inability by reason of illness or accident to perform the duties of the occupation at which a Participant was employed or served when such disability commenced, as determined by the Committee based upon medical evidence acceptable to it.

(l) "Effective Date" means the date upon which the Pricing Committee of the Board sets the price at which the shares of Common Stock are to be sold to a group of underwriters in the underwritten initial public offering of Common Stock, immediately following the recapitalization of the Common Stock in preparation for such initial public offering.

(m) "Eligible Director" means a person who is (i) a "non-employee director" within the meaning of Rule 16b-3 under the Exchange Act, or a person meeting any similar requirement under any successor rule or regulation and (ii) an "outside director" within the meaning of Section 162(m) of the Code, and the Treasury Regulations promulgated thereunder; *provided, however*, that clause (ii) shall apply only with respect to grants of Awards with respect to which the Company's tax deduction could be limited by Section 162(m) of the Code if such clause did not apply.

(n) "Eligible Person" means any (i) individual regularly employed by the Company or Affiliate who satisfies all of the requirements of Section 6; *provided, however*, that no such employee covered by a collective bargaining agreement shall be an Eligible Person unless and to the extent that such eligibility is set forth in such collective bargaining agreement or in an agreement or instrument relating thereto; (ii) director of the Company or an Affiliate; or (iii) consultant or advisor to the Company or an Affiliate who may be offered securities pursuant to Form S-8.

(o) "Exchange Act" means the Securities Exchange Act of 1934, as amended.

(p) "Fair Market Value", on a given date means (i) if the Stock is listed on a national securities exchange, the closing sales price reported as having occurred on the primary exchange with which the Stock is listed and traded on such date, or, if there is no such sale on that date, then on the last preceding date on which such a sale was reported; (ii) if the Stock is not listed on any national securities exchange but is quoted in the Nasdaq National Market (the "Nasdaq") on a last sale basis, the last sales price reported on such date, or, if there is no such sale on that date, then on the last preceding date on which a sale was reported; or (iii) if the Stock is not listed on a national securities exchange nor quoted in the Nasdaq on a last sale basis, the amount determined by the Committee to be the fair market value based upon a good faith attempt to value the Stock accurately and computed in accordance with applicable regulations of the Internal Revenue Service.

(q) "Good Reason" shall have the meaning, if any, set forth in a Participant's employment agreement, if any, with the Company or an Affiliate, and shall not apply in respect of any Participant who does not have such an employment agreement.

(r) "Incentive Stock Option" means an Option granted by the Committee to a Participant under the Plan which is designated by the Committee as an incentive stock option as described in Section 422 of the Code and otherwise meets the requirements set forth herein.

(s) "Mature Shares" means shares of Stock owned by a Participant which are not subject to any pledge or other security interest and have such other requirements as the Committee may determine are necessary in order to avoid an accounting earnings charge on account of the use of such shares to pay the Option Price or satisfy a withholding obligation in respect of an Option.

(t) "Negative Discretion" shall mean the discretion authorized by the Plan to be applied by the Committee to eliminate or reduce the size of a Performance Compensation Award in accordance with Section 11(d)(iv) of the Plan; *provided*, that the exercise of such discretion would not cause the Performance Compensation Award to fail to qualify as "performance-based compensation" under Section 162(m) of the Code.

(u) "Nonqualified Stock Option" means an Option granted by the Committee to a Participant under the Plan which is not designated by the Committee as an Incentive Stock Option.

(v) "Option" means an Award granted under Section 7 of the Plan.

(w) "Option Period" means the period described in Section 7(c) of the Plan.

(x) "Option Price" means the exercise price for an Option as described in Section 7(a) of the Plan.

(y) "Participant" means an Eligible Person who has been selected by the Committee to participate in the Plan and to receive an Award pursuant to Section 6 of the Plan.

(z) "Parent" means any parent of the Company as defined in Section 424(e) of the Code.

(aa) "Performance Compensation Award" shall mean any Award designated by the Committee as a Performance Compensation Award pursuant to Section 11 of the Plan.

(bb) "Performance Criteria" shall mean the criterion or criteria that the Committee shall select for purposes of establishing the Performance Goal(s) for a Performance Period with respect to any Performance Compensation Award under the Plan. The Performance Criteria that will be used to establish the Performance Goal(s) shall be based on the attainment of specific levels of performance of the Company (or Affiliate, division or operational unit of the Company) and shall be limited to the following:

- (i) net earnings or net income (before or after taxes);
- (ii) basic or diluted earnings per share (before or after taxes) or earnings per shares growth;
- (iii) net revenue or net revenue growth;
- (iv) gross profit or gross profit growth;
- (v) net operating profit (before or after taxes) or net operating profit growth;
- (vi) return measures (including, but not limited to, return on assets, capital, invested capital, equity, or sales);
- (vii) cash flow (including, but not limited to, operating cash flow, free cash flow, and cash flow return on capital);
- (viii) earnings before or after taxes, interest, depreciation and/or amortization (EBITDA) or EBITDA growth;

-
- (ix) operating income before or after depreciation and/or amortization (OIBDA) or OIBDA growth;
 - (x) gross or operating margins;
 - (xi) productivity ratios;
 - (xii) share price (including, but not limited to, growth measures and total stockholder return);
 - (xiii) expense targets;
 - (xiv) margins;
 - (xv) operating efficiency;
 - (xvi) objective measures of customer satisfaction;
 - (xvii) working capital targets;
 - (xviii) measures of economic value added;
 - (xix) inventory control; and
 - (xx) enterprise value.

Any one or more of the Performance Criterion may be used on an absolute or relative basis to measure the performance of the Company and/or an Affiliate as a whole or any business unit of the Company and/or an Affiliate or any combination thereof, as the Committee may deem appropriate, or any of the above Performance Criteria as compared to the performance of a group of comparator companies, or published or special index that the Committee, in its sole discretion, deems appropriate, or the Company may select Performance Criterion (xi) above as compared to various stock market indices. The Committee also has the authority to provide for accelerated vesting of any Award based on the achievement of Performance Goals pursuant to the Performance Criteria specified in this paragraph. To the extent required under Section 162(m) of the Code, the Committee shall, within the first 90 days of a Performance Period (or, if longer or shorter, within the maximum period allowed under Section 162(m) of the Code), define in an objective fashion the manner of calculating the Performance Criteria it selects to use for such Performance Period. In the event that applicable tax and/or securities laws change to permit Committee discretion to alter the governing Performance Criteria without obtaining stockholder approval of such changes, the Committee shall have sole discretion to make such changes without obtaining stockholder approval.

(cc) "Performance Formula" shall mean, for a Performance Period, the one or more objective formulas applied against the relevant Performance Goal to determine, with regard to the Performance Compensation Award of a particular Participant, whether all, some portion but less than all, or none of the Performance Compensation Award has been earned for the Performance Period.

(dd) "Performance Goals" shall mean, for a Performance Period, the one or more goals established by the Committee for the Performance Period based upon the Performance Criteria. The Committee is authorized at any time during the first 90 days of a Performance Period (or, if longer or shorter, within the maximum period allowed under Section 162(m) of the Code), or at any time thereafter to the extent allowed under Section 162(m) of the Code, in its sole and absolute discretion, to adjust or modify the calculation of a Performance Goal for such Performance Period in order to prevent the dilution or enlargement of the rights of Participants based on the following events:

- (i) asset write-downs;
- (ii) litigation or claim judgments or settlements;
- (iii) the effect of changes in tax laws, accounting principles, or other laws or regulatory rules affecting reported results;
- (iv) any reorganization and restructuring programs;
- (v) extraordinary nonrecurring items as described in Accounting Principles Board Opinion No. 30 (or any successor pronouncement thereto) and/or in management's discussion and analysis of

financial condition and results of operations appearing in the Company's annual report to stockholders for the applicable year;

- (vi) acquisitions or divestitures;
- (vii) any other specific unusual or nonrecurring events, or objectively determinable category thereof;
- (viii) foreign exchange gains and losses; and
- (ix) a change in the Company's fiscal year.

(ee) "Performance Period" shall mean the one or more periods of time not less than one (1) year in duration, as the Committee may select, over which the attainment of one or more Performance Goals will be measured for the purpose of determining a Participant's right to, and the payment of, a Performance Compensation Award.

(ff) "Phantom Stock Award" shall mean a cash award whose value is determined based on the change in the value of the Company Common Stock from the Effective Date.

(gg) "Plan" means this Warner Music Group Corp. 2005 Omnibus Award Plan.

(hh) "Restricted Period" means, with respect to any Award of Restricted Stock or any Restricted Stock Unit, the period of time determined by the Committee during which such Award is subject to the restrictions set forth in Section 9 or, as applicable, the period of time within which performance is measured for purposes of determining whether an Award has been earned.

(ii) "Restricted Stock Unit" means a hypothetical investment equivalent to one share of Stock granted in connection with an Award made under Section 9.

(jj) "Restricted Stock" means shares of Stock issued or transferred to a Participant subject to forfeiture and the other restrictions set forth in Section 9 of the Plan.

(kk) "Securities Act" means the Securities Act of 1933, as amended.

(ll) "Stock" means the Common Stock or such other authorized shares of stock of the Company as the Committee may from time to time authorize for use under the Plan.

(mm) "Stock Appreciation Right" or "SAR" means an Award granted under Section 8 of the Plan.

(nn) "Stock Bonus" means an Award granted under Section 10 of the Plan.

(oo) "Stock Option Agreement" means any agreement between the Company and a Participant who has been granted an Option pursuant to Section 7 which defines the rights and obligations of the parties thereto.

(pp) "Strike Price" means, (i) in the case of a SAR granted in tandem with an Option, the Option Price of the related Option, or (ii) in the case of a SAR granted independent of an Option, the Fair Market Value on the Date of Grant.

(qq) "Subsidiary" means any subsidiary of the Company as defined in Section 424(f) of the Code.

(rr) "Substitution Award" means an Award that is intended to replace any existing incentive award held by an employee or director of, or consultant or advisor to, an entity acquired by the Company or an Affiliate of the Company. The terms and conditions of any Substitution Award shall be set forth in an Award agreement and shall, except as may be inconsistent with any provision of the Plan, to the extent practicable provide the recipient with benefits (including economic value) substantially similar to those provided to the recipient under the existing award which such Substitution Award is intended to replace.

(ss) "Vested Unit" shall have the meaning ascribed thereto in Section 9(d) of the Plan.

(tt) "Voting Stock" of a person means all classes of capital stock or other interests, including partnership interests, of such person then outstanding and normally entitled, without regard to the occurrence of any contingency, to vote in the election of directors, managers, or trustee thereof.

3. Effective Date, Duration and Shareholder Approval

The Plan is effective as of the Effective Date. No Option shall be treated as an Incentive Stock Option unless the Plan has been approved by the shareholders of the Company in a manner intended to comply with the shareholder approval requirements of Section 422(b)(i) of the Code; *provided*, that any Option intended to be an Incentive Stock Option shall not fail to be effective solely on account of a failure to obtain such approval, but rather such Option shall be treated as a Nonqualified Stock Option unless and until such approval is obtained.

The expiration date of the Plan, on and after which no Awards may be granted hereunder, shall be the tenth anniversary of the Effective Date; *provided, however*, that such expiration shall not affect Awards then outstanding, and the terms and conditions of the Plan shall continue to apply to such Awards.

4. Administration

(a) The Committee shall administer the Plan. The majority of the members of the Committee shall constitute a quorum. The acts of a majority of the members present at any meeting at which a quorum is present or acts approved in writing by a majority of the Committee shall be deemed the acts of the Committee.

(b) Subject to the provisions of the Plan and applicable law, the Committee shall have the power, and in addition to other express powers and authorizations conferred on the Committee by the Plan, to: (i) designate Participants; (ii) determine the type or types of Awards to be granted to a Participant; (iii) determine the number of shares of Stock to be covered by, or with respect to which payments, rights, or other matters are to be calculated in connection with, Awards; (iv) determine the terms and conditions of any Award; (v) determine whether, to what extent, and under what circumstances Awards may be settled or exercised in cash, shares of Stock, other securities, other Awards or other property, or canceled, forfeited, or suspended and the method or methods by which Awards may be settled, exercised, canceled, forfeited, or suspended; (vi) determine whether, to what extent, and under what circumstances the delivery of cash, Stock, other securities, other Options, other property and other amounts payable with respect to an Award shall be deferred either automatically or at the election of the holder thereof or of the Committee; (vii) interpret, administer, reconcile any inconsistency, correct any defect and/or supply any omission in the Plan and any instrument or agreement relating to, or Award granted under, the Plan; (viii) establish, amend, suspend, or waive such rules and regulations; (ix) appoint such agents as it shall deem appropriate for the proper administration of the Plan; and (x) make any other determination and take any other action that the Committee deems necessary or desirable for the administration of the Plan.

(c) Notwithstanding the foregoing, the committee may delegate to any officer of the Company or any Affiliate the authority to act on behalf of the Committee with respect to any matter, right, obligation, or election which is the responsibility of or which is allocated to the Committee herein, and which may be so delegated as a matter of law, except for grants of Awards to (i) "covered employees" under Code Section 162(m) (other than Awards exempt from the application of Code Section 162(m)) and (ii) persons subject to Section 16 of the 1934 Act.

(d) Unless otherwise expressly provided in the Plan, all designations, determinations, interpretations, and other decisions under or with respect to the Plan or any Award or any documents evidencing Awards granted pursuant to the Plan shall be within the sole discretion of the Committee, may be made at any time and shall be final, conclusive and binding upon all parties, including, without limitation, the Company, any Affiliate, any Participant, any holder or beneficiary of any Award, and any shareholder.

(e) No member of the Committee shall be liable for any action or determination made in good faith with respect to the Plan or any Award hereunder.

5. Grant of Awards; Shares Subject to the Plan

The Committee may, from time to time, grant Awards of Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, Phantom Stock Awards, Stock Bonuses and/or Performance Compensation Awards to one or more Eligible Persons; *provided, however*, that:

(a) Subject to Section 13, the aggregate number of shares of Stock in respect of which Awards may be granted under the Plan is 3,416,133 shares;

(b) Shares of Stock shall be deemed to have been used in settlement of Awards whether or not they are actually delivered or the Fair Market Value equivalent of such shares is paid in cash; *provided, however*, that shares of Stock delivered (either directly or by means of attestation) in full or partial payment of the Option Price in accordance with Section 7(b) shall be deducted from the number of shares of Stock delivered to the Participant pursuant to such Option for purposes of determining the number of shares of Stock acquired pursuant to the Plan. In accordance with (and without limitation upon) the preceding sentence, if and to the extent an Award under the Plan expires, terminates or is canceled for any reason whatsoever without the Participant having received any benefit therefrom, the shares covered by such Award shall again become available for future Awards under the Plan. For purposes of the foregoing sentence, a Participant shall not be deemed to have received any "benefit" (i) in the case of forfeited Restricted Stock Awards by reason of having enjoyed voting rights and dividend rights prior to the date of forfeiture or (ii) in the case of an Award canceled by reason of a new Award being granted in substitution therefor;

(c) Stock delivered by the Company in settlement of Awards may be authorized and unissued Stock, Stock held in the treasury of the Company, Stock purchased on the open market or by private purchase, or a combination of the foregoing; and

(d) Subject to Section 13, no person may be granted Options or SARs under the Plan during any calendar year with respect to more than 1,500,000 shares of Stock.

6. Eligibility

Participation shall be limited to Eligible Persons who have entered into an Award agreement or who have received written notification from the Committee, or from a person designated by the Committee, that they have been selected to participate in the Plan.

7. Options

The Committee is authorized to grant one or more Incentive Stock Options or Nonqualified Stock Options to any Eligible Person; *provided, however*, that no Incentive Stock Option shall be granted to any Eligible Person who is not an employee of the Company or a Parent or Subsidiary. Each Option so granted shall be subject to the conditions set forth in this Section 7, or to such other conditions as may be reflected in the applicable Stock Option Agreement.

(a) **Option Price.** The exercise price ("Option Price") per share of Stock for each Option which is not a Substitution Award shall be set by the Committee at the time of grant but shall not be less than the Fair Market Value of a share of Stock on the Date of Grant.

(b) **Manner of Exercise and Form of Payment.** No shares of Stock shall be delivered pursuant to any exercise of an Option until payment in full of the Option Price therefor is received by the Company. Options which have become exercisable may be exercised by delivery of written notice of exercise to the Committee accompanied by payment of the Option Price. The Option Price shall be payable (i) in cash, check, cash equivalent and/or shares of Stock valued at the Fair Market Value at the time the Option is exercised (including by means of attestation of ownership of a sufficient number of shares of Stock in lieu of actual delivery of such shares to the Company); *provided*, that such shares of Stock are Mature Shares; (ii) in the discretion of the

Committee, either (A) in other property having a fair market value on the date of exercise equal to the Option Price or (B) by delivering to the Committee a copy of irrevocable instructions to a stockbroker to deliver promptly to the Company an amount sufficient to pay the Option Price; or (iii) by such other method as the Committee may allow. Notwithstanding the foregoing, in no event shall a Participant be permitted to exercise an Option in a manner which the Committee determines would violate the Sarbanes-Oxley Act of 2002, or any other applicable law or the applicable rules and regulations of the Securities and Exchange Commission or the applicable rules and regulations of any securities exchange or inter dealer quotation system on which the securities of the Company or any Affiliates are listed or traded.

(c) **Vesting, Option Period and Expiration.** Options shall vest and become exercisable in such manner and on such date or dates determined by the Committee and shall expire after such period, not to exceed ten years, as may be determined by the Committee (the "Option Period"); *provided, however*, that notwithstanding any vesting dates set by the Committee, the Committee may, in its sole discretion, accelerate the exercisability of any Option, which acceleration shall not affect the terms and conditions of such Option other than with respect to exercisability. If an Option is exercisable in installments, such installments or portions thereof which become exercisable shall remain exercisable until the Option expires.

(d) **Stock Option Agreement—Other Terms and Conditions.** Each Option granted under the Plan shall be evidenced by a Stock Option Agreement. Except as specifically provided otherwise in such Stock Option Agreement, each Option granted under the Plan shall be subject to the following terms and conditions:

(i) Each Option or portion thereof that is exercisable shall be exercisable for the full amount or for any part thereof.

(ii) Each share of Stock purchased through the exercise of an Option shall be paid for in full at the time of the exercise. Each Option shall cease to be exercisable, as to any share of Stock, when the Participant purchases the share or exercises a related SAR or when the Option expires.

(iii) Subject to Section 12(k), Options shall not be transferable by the Participant except by will or the laws of descent and distribution and shall be exercisable during the Participant's lifetime only by him.

(iv) Each Option shall vest and become exercisable by the Participant in accordance with the vesting schedule established by the Committee and set forth in the Stock Option Agreement.

(v) At the time of any exercise of an Option, the Committee may, in its sole discretion, require a Participant to deliver to the Committee a written representation that the shares of Stock to be acquired upon such exercise are to be acquired for investment and not for resale or with a view to the distribution thereof and any other representation deemed necessary by the Committee to ensure compliance with all applicable federal and state securities laws. Upon such a request by the Committee, delivery of such representation prior to the delivery of any shares issued upon exercise of an Option shall be a condition precedent to the right of the Participant or such other person to purchase any shares. In the event certificates for Stock are delivered under the Plan with respect to which such investment representation has been obtained, the Committee may cause a legend or legends to be placed on such certificates to make appropriate reference to such representation and to restrict transfer in the absence of compliance with applicable federal or state securities laws.

(vi) Each Participant awarded an Incentive Stock Option under the Plan shall notify the Company in writing immediately after the date he or she makes a disqualifying disposition of any Stock acquired pursuant to the exercise of such Incentive Stock Option. A disqualifying disposition is any disposition (including any sale) of such Stock before the later of (A) two years after the Date of Grant of the Incentive Stock Option or (B) one year after the date the Participant acquired the Stock by exercising the Incentive Stock Option. The Company may, if determined by the Committee and in accordance with procedures established by it, retain possession of any Stock acquired pursuant to the exercise of an Incentive Stock Option as agent for the applicable Participant until the end of the period described in the preceding sentence, subject to complying with any instructions from such Participant as to the sale of such Stock.

(e) **Incentive Stock Option Grants to 10% Stockholders.** Notwithstanding anything to the contrary in this Section 7, if an Incentive Stock Option is granted to a Participant who owns stock representing

more than ten percent of the voting power of all classes of stock of the Company or of a Subsidiary or Parent, the Option Period shall not exceed five years from the Date of Grant of such Option and the Option Price shall be at least 110 percent of the Fair Market Value (on the Date of Grant) of the Stock subject to the Option.

(f) **\$100,000 Per Year Limitation for Incentive Stock Options.** To the extent the aggregate Fair Market Value (determined as of the Date of Grant) of Stock for which Incentive Stock Options are exercisable for the first time by any Participant during any calendar year (under all plans of the Company) exceeds \$100,000, such excess Incentive Stock Options shall be treated as Nonqualified Stock Options.

8. Stock Appreciation Rights

Any Option granted under the Plan may include SARs, either at the Date of Grant or, except in the case of an Incentive Stock Option, by subsequent amendment. The Committee also may award SARs to Eligible Persons independent of any Option. A SAR shall be subject to such terms and conditions not inconsistent with the Plan as the Committee shall impose, including, but not limited to, the following:

(a) **Vesting, Transferability and Expiration.** A SAR granted in connection with an Option shall become exercisable, be transferable and shall expire according to the same vesting schedule, transferability rules and expiration provisions as the corresponding Option. A SAR granted independent of an Option shall become exercisable, be transferable and shall expire in accordance with a vesting schedule, transferability rules and expiration provisions as established by the Committee and reflected in an Award agreement.

(b) **Automatic Exercise.** If on the last day of the Option Period (or in the case of a SAR independent of an option, the period established by the Committee after which the SAR shall expire), the Fair Market Value exceeds the Strike Price, the Participant has not exercised the SAR or the corresponding Option, and neither the SAR nor the corresponding Option has expired, such SAR shall be deemed to have been exercised by the Participant on such last day and the Company shall make the appropriate payment therefor.

(c) **Payment.** Upon the exercise of a SAR, the Company shall pay to the Participant an amount equal to the number of shares subject to the SAR multiplied by the excess, if any, of the Fair Market Value of one share of Stock on the exercise date over the Strike Price. The Company shall pay such excess in cash or in shares of Stock valued at Fair Market Value.

(d) **Method of Exercise.** A Participant may exercise a SAR at such time or times as may be determined by the Committee at the time of grant by filing an irrevocable written notice with the Committee or its designee, specifying the number of SARs to be exercised and the date on which such SARs were awarded.

(e) **Expiration.** Except as otherwise provided in the case of SARs granted in connection with Options, a SAR shall expire on a date designated by the Committee which is not later than ten years after the Date of Grant of the SAR.

9. Restricted Stock and Restricted Stock Units

(a) Award of Restricted Stock and Restricted Stock Units.

(i) The Committee shall have the authority (A) to grant Restricted Stock and Restricted Stock Units to Eligible Persons, (B) to issue or transfer Restricted Stock to Participants, and (C) to establish terms, conditions and restrictions applicable to such Restricted Stock and Restricted Stock Units, including the Restricted Period, as applicable, which may differ with respect to each grantee, the time or times at which Restricted Stock or Restricted Stock Units shall be granted or become vested and the number of shares or units to be covered by each grant.

(ii) Each Participant granted Restricted Stock shall execute and deliver to the Company an Award agreement with respect to the Restricted Stock setting forth the restrictions and other terms and conditions

applicable to such Restricted Stock. If the Committee determines that the Restricted Stock shall be held by the Company or in escrow rather than delivered to the Participant pending the release of the applicable restrictions, the Committee may require the Participant to additionally execute and deliver to the Company (A) an escrow agreement satisfactory to the Committee, if applicable, and (B) the appropriate blank stock power with respect to the Restricted Stock covered by such agreement. If a Participant shall fail to execute an agreement evidencing an Award of Restricted Stock and, if applicable, an escrow agreement and stock power, the Award shall be null and void. Subject to the restrictions set forth in Section 9(b), the Participant generally shall have the rights and privileges of a stockholder as to such Restricted Stock, including the right to vote such Restricted Stock. At the discretion of the Committee, cash dividends and stock dividends with respect to the Restricted Stock may be either currently paid to the Participant or withheld by the Company for the Participant's account, and interest may be credited on the amount of dividends withheld at a rate and subject to such terms as determined by the Committee. The cash dividends or stock dividends so withheld by the Committee and attributable to any particular share of Restricted Stock (and earnings thereon, if applicable) shall be distributed to the Participant in cash or, at the discretion of the Committee, in shares of Stock having a Fair Market Value equal to the amount of such dividends and earnings, if applicable, upon the release of restrictions on such share and, if such share is forfeited, the Participant shall have no right to such cash dividends, stock dividends or earnings.

(iii) Upon the grant of Restricted Stock, the Committee shall cause a stock certificate registered in the name of the Participant to be issued and, if it so determines, deposited together with the stock powers with an escrow agent designated by the Committee. If an escrow arrangement is used, the Committee may cause the escrow agent to issue to the Participant a receipt evidencing any stock certificate held by it, registered in the name of the Participant.

(iv) The terms and conditions of a grant of Restricted Stock Units shall be reflected in a written Award agreement. No shares of Stock shall be issued at the time a Restricted Stock Unit is granted, and the Company will not be required to set aside a fund for the payment of any such Award. At the discretion of the Committee, each Restricted Stock Unit (representing one share of Stock) may be credited with cash and stock dividends paid by the Company in respect of one share of Stock ("Dividend Equivalents"). At the discretion of the Committee, Dividend Equivalents may be either currently paid to the Participant or withheld by the Company for the Participant's account, and interest may be credited on the amount of cash Dividend Equivalents withheld at a rate and subject to such terms as determined by the Committee. Dividend Equivalents credited to a Participant's account and attributable to any particular Restricted Stock Unit (and earnings thereon, if applicable) shall be distributed in cash or, at the discretion of the Committee, in shares of Stock having a Fair Market Value equal to the amount of such Dividend Equivalents and earnings, if applicable, to the Participant upon settlement of such Restricted Stock Unit and, if such Restricted Stock Unit is forfeited, the Participant shall have no right to such Dividend Equivalents.

(b) Restrictions.

(i) Restricted Stock awarded to a Participant shall be subject to the following restrictions until the expiration of the Restricted Period, and to such other terms and conditions as may be set forth in the applicable Award agreement: (A) if an escrow arrangement is used, the Participant shall not be entitled to delivery of the stock certificate; (B) the shares shall be subject to the restrictions on transferability set forth in the Award agreement; (C) the shares shall be subject to forfeiture to the extent provided in Section 9(d) and the applicable Award agreement; and (D) to the extent such shares are forfeited, the stock certificates shall be returned to the Company, and all rights of the Participant to such shares and as a shareholder shall terminate without further obligation on the part of the Company.

(ii) Restricted Stock Units awarded to any Participant shall be subject to (A) forfeiture until the expiration of the Restricted Period, and satisfaction of any applicable Performance Goals during such period, to the extent provided in the applicable Award agreement, and to the extent such Restricted Stock Units are forfeited, all rights of the Participant to such Restricted Stock Units shall terminate without further obligation on the part of the Company and (B) such other terms and conditions as may be set forth in the applicable Award agreement.

(iii) The Committee shall have the authority to remove any or all of the restrictions on the Restricted Stock and Restricted Stock Units whenever it may determine that, by reason of changes in applicable laws or other changes in circumstances arising after the date of the Restricted Stock or Restricted Stock Units are granted, such action is appropriate.

(c) **Restricted Period.** The Restricted Period of Restricted Stock and Restricted Stock Units shall commence on the Date of Grant and shall expire from time to time as to that part of the Restricted Stock and Restricted Stock Units indicated in a schedule established by the Committee in the applicable Award agreement.

(d) **Delivery of Restricted Stock and Settlement of Restricted Stock Units.** Upon the expiration of the Restricted Period with respect to any shares of Restricted Stock, the restrictions set forth in Section 9(b) and the applicable Award agreement shall be of no further force or effect with respect to such shares, except as set forth in the applicable Award agreement. If an escrow arrangement is used, upon such expiration, the Company shall deliver to the Participant, or his beneficiary, without charge, the stock certificate evidencing the shares of Restricted Stock which have not then been forfeited and with respect to which the Restricted Period has expired (to the nearest full share) and any cash dividends or stock dividends credited to the Participant's account with respect to such Restricted Stock and the interest thereon, if any.

Upon the expiration of the Restricted Period with respect to any outstanding Restricted Stock Units, the Company shall deliver to the Participant, or his beneficiary, without charge, one share of Stock for each such outstanding Restricted Stock Unit ("Vested Unit") and cash equal to any Dividend Equivalents credited with respect to each such Vested Unit in accordance with Section 9(a)(iv) hereof and the interest thereon or, at the discretion of the Committee, in shares of Stock having a Fair Market Value equal to such Dividend Equivalents and interest thereon, if any; *provided, however*, that, if explicitly provided in the applicable Award agreement, the Committee may, in its sole discretion, elect to (i) pay cash or part cash and part Stock in lieu of delivering only shares of Stock for Vested Units or (ii) delay the delivery of Stock (or cash or part Stock and part cash, as the case may be) beyond the expiration of the Restricted Period. If a cash payment is made in lieu of delivering shares of Stock, the amount of such payment shall be equal to the Fair Market Value of the Stock as of the date on which the Restricted Period lapsed with respect to such Vested Unit.

(e) **Stock Restrictions.** Each certificate representing Restricted Stock awarded under the Plan shall bear a legend substantially in the form of the following until the lapse of all restrictions with respect to such Stock as well as any other information the Company deems appropriate:

Transfer of this certificate and the shares represented hereby is restricted pursuant to the terms of the Warner Music Group Corp. 2005 Omnibus Award Plan and a Restricted Stock Purchase and Award Agreement, dated as of _____, between Warner Music Group Corp. and _____.

. A copy of such Plan and Agreement is on file at the offices of Warner Music Group Corp.

Stop transfer orders shall be entered with the Company's transfer agent and registrar against the transfer of legended securities.

10. Stock Bonus Awards

The Committee may issue unrestricted Stock, or other Awards denominated in Stock, under the Plan to Eligible Persons, alone or in tandem with other Awards, in such amounts and subject to such terms and conditions as the Committee shall from time to time in its sole discretion determine. A Stock Bonus Award under the Plan shall be granted as, or in payment of, a bonus, or to provide incentives or recognize special achievements or contributions.

11. Performance Compensation Awards

(a) **General.** The Committee shall have the authority, at the time of grant of any Award described in Sections 7 through 10 (other than Options and Stock Appreciation Rights granted with an exercise price or

grant price, as the case may be, equal to or greater than the Fair Market Value per share of Stock on the date of grant), to designate such Award as a Performance Compensation Award in order to qualify such Award as “performance-based compensation” under Section 162(m) of the Code. The Committee shall have the authority to grant cash bonuses under the Plan with the intent that such bonuses shall qualify for the exemption from Section 162(m) of the Code provided pursuant to Treasury Regulation Section 1.162-27(f)(1), for the reliance period described in Treasury Regulation Section 1.162-27(f)(2). In addition, the Committee shall have the authority to make an award of a cash bonus to any Participant and designate such Award as a Performance Compensation Award in order to qualify such Award as “performance-based compensation” under Section 162(m).

(b) **Eligibility.** The Committee will, in its sole discretion, designate which Participants will be eligible to receive Performance Compensation Awards in respect of such Performance Period. However, designation of a Participant eligible to receive an Award hereunder for a Performance Period shall not in any manner entitle the Participant to receive payment in respect of any Performance Compensation Award for such Performance Period. The determination as to whether or not such Participant becomes entitled to payment in respect of any Performance Compensation Award shall be decided solely in accordance with the provisions of this Section 11. Moreover, designation of a Participant eligible to receive an Award hereunder for a particular Performance Period shall not require designation of such Participant eligible to receive an Award hereunder in any subsequent Performance Period and designation of one person as a Participant eligible to receive an Award hereunder shall not require designation of any other person as a Participant eligible to receive an Award hereunder in such period or in any other period.

(c) **Discretion of Committee with Respect to Performance Compensation Awards.** With regard to a particular Performance Period, the Committee shall have full discretion to select the length of such Performance Period (provided any such Performance Period shall be not less than one (1) year in duration), the type(s) of Performance Compensation Awards to be issued, the Performance Criteria that will be used to establish the Performance Goal(s), the kind(s) and/or level(s) of the Performance Goals(s) that is(are) to apply to the Company and the Performance Formula. Within the first 90 days of a Performance Period (or, if longer or shorter, within the maximum period allowed under Section 162(m) of the Code), the Committee shall, with regard to the Performance Compensation Awards to be issued for such Performance Period, exercise its discretion with respect to each of the matters enumerated in the immediately preceding sentence of this Section 11(c) and record the same in writing.

(d) **Payment of Performance Compensation Awards**

(i) **Condition to Receipt of Payment.** Unless otherwise provided in the applicable Award agreement, a Participant must be employed by the Company on the last day of a Performance Period to be eligible for payment in respect of a Performance Compensation Award for such Performance Period.

(ii) **Limitation.** A Participant shall be eligible to receive payment in respect of a Performance Compensation Award only to the extent that: (A) the Performance Goals for such period are achieved; and (B) the Performance Formula as applied against such Performance Goals determines that all or some portion of such Participant’s Performance Award has been earned for the Performance Period.

(iii) **Certification.** Following the completion of a Performance Period, the Committee shall review and certify in writing whether, and to what extent, the Performance Goals for the Performance Period have been achieved and, if so, calculate and certify in writing that amount of the Performance Compensation Awards earned for the period based upon the Performance Formula. The Committee shall then determine the actual size of each Participant’s Performance Compensation Award for the Performance Period and, in so doing, may apply Negative Discretion in accordance with Section 11(d)(iv) hereof, if and when it deems appropriate.

(iv) **Use of Discretion.** In determining the actual size of an individual Performance Award for a Performance Period, the Committee may reduce or eliminate the amount of the Performance Compensation Award earned under the Performance Formula in the Performance Period through the use of Negative Discretion if, in its sole judgment, such reduction or elimination is appropriate. The Committee shall not have the discretion to (a) grant or provide payment in respect of Performance Compensation Awards for a

Performance Period if the Performance Goals for such Performance Period have not been attained; or (b) increase a Performance Compensation Award above the maximum amount payable under Section 5(a) or Section 11(d)(vi) of the Plan.

(v) **Timing of Award Payments.** Performance Compensation Awards granted for a Performance Period shall be paid to Participants as soon as administratively practicable following completion of the certifications required by this Section 11.

(vi) **Maximum Award Payable.** Notwithstanding any provision contained in this Plan to the contrary, the maximum Performance Compensation Award payable to any one Participant under the Plan for a Performance Period is 1,500,000 shares of Stock or, in the event such Performance Compensation Award is paid in cash, the equivalent cash value thereof on the first or last day of the Performance Period to which such Award relates, as determined by the Committee. The maximum amount that can be paid in any calendar year to any Participant pursuant to a cash bonus Award described in the last sentence of Section 11(a) shall be \$10,000,000. Furthermore, any Performance Compensation Award that has been deferred shall not (between the date as of which the Award is deferred and the payment date) increase (A) with respect to Performance Compensation Award that is payable in cash, by a measuring factor for each fiscal year greater than a reasonable rate of interest set by the Committee or (B) with respect to a Performance Compensation Award that is payable in shares of Stock, by an amount greater than the appreciation of a share of Stock from the date such Award is deferred to the payment date.

12. General

(a) **Additional Provisions of an Award.** Awards to a Participant under the Plan also may be subject to such other provisions (whether or not applicable to Awards granted to any other Participant) as the Committee determines appropriate, including, without limitation, provisions (in addition to those provisions of Section 9 providing for the payment of dividends with respect to Restricted Stock and Dividend Equivalents with respect to Restricted Stock Units) adding dividend equivalent rights or other protections to Participants in respect of dividends paid on Stock underlying any Award, provisions for the forfeiture of or restrictions on resale or other disposition of shares of Stock acquired under any Award, provisions giving the Company the right to repurchase shares of Stock acquired under any Award in the event the Participant elects to dispose of such shares, provisions allowing the Participant to elect to defer the receipt of payment in respect of Awards for a specified period or until a specified event, and provisions to comply with Federal and state securities laws and Federal and state tax withholding requirements; provided, however, that any such deferral does not result in acceleration of taxability of an Award prior to receipt, or tax penalties, under Section 409A of the Code. Any such provisions shall be reflected in the applicable Award agreement.

(b) **Privileges of Stock Ownership.** Except as otherwise specifically provided in the Plan, no person shall be entitled to the privileges of ownership in respect of shares of Stock which are subject to Awards hereunder until such shares have been issued to that person.

(c) **Government and Other Regulations.** The obligation of the Company to settle Awards in Stock shall be subject to all applicable laws, rules, and regulations, and to such approvals by governmental agencies as may be required. Notwithstanding any terms or conditions of any Award to the contrary, the Company shall be under no obligation to offer to sell or to sell, and shall be prohibited from offering to sell or selling, any shares of Stock pursuant to an Award unless such shares have been properly registered for sale pursuant to the Securities Act with the Securities and Exchange Commission or unless the Company has received an opinion of counsel, satisfactory to the Company, that such shares may be offered or sold without such registration pursuant to an available exemption therefrom and the terms and conditions of such exemption have been fully complied with. The Company shall be under no obligation to register for sale under the Securities Act any of the shares of Stock to be offered or sold under the Plan. If the shares of Stock offered for sale or sold under the Plan are offered or sold pursuant to an exemption from registration under the Securities Act, the Company may restrict the transfer of such shares and may legend the Stock certificates representing such shares in such manner as it deems advisable to ensure the availability of any such exemption.

(d) Tax Withholding.

(i) A Participant may be required to pay to the Company or any Affiliate, and the Company or any Affiliate shall have the right and is hereby authorized to withhold from any shares of Stock or other property deliverable under any Award or from any compensation or other amounts owing to a Participant, the amount (in cash, Stock or other property) of any required income tax withholding and payroll taxes in respect of an Award, its exercise, or any payment or transfer under an Award or under the Plan and to take such other action as may be necessary in the opinion of the Company to satisfy all obligations for the payment of such withholding and taxes.

(ii) Without limiting the generality of clause (i) above, the Committee may, in its sole discretion, permit a Participant to satisfy, in whole or in part, the foregoing withholding liability (but no more than the minimum required withholding liability) by (A) the delivery of Mature Shares owned by the Participant having a Fair Market Value equal to such withholding liability or (B) having the Company withhold from the number of shares of Stock otherwise issuable pursuant to the exercise or settlement of the Award a number of shares with a Fair Market Value equal to such withholding liability.

(e) Claim to Awards and Employment Rights. No employee of the Company or an Affiliate, or other person, shall have any claim or right to be granted an Award under the Plan or, having been selected for the grant of an Award, to be selected for a grant of any other Award. Neither the Plan nor any action taken hereunder shall be construed as giving any Participant any right to be retained in the employ or service of the Company or an Affiliate.

(f) Designation and Change of Beneficiary. Each Participant may file with the Committee a written designation of one or more persons as the beneficiary who shall be entitled to receive the amounts payable with respect to an Award, if any, due under the Plan upon his death. A Participant may, from time to time, revoke or change his beneficiary designation without the consent of any prior beneficiary by filing a new designation with the Committee. The last such designation received by the Committee shall be controlling; *provided, however*, that no designation, or change or revocation thereof, shall be effective unless received by the Committee prior to the Participant's death, and in no event shall it be effective as of a date prior to such receipt. If no beneficiary designation is filed by a Participant, the beneficiary shall be deemed to be his or her spouse or, if the Participant is unmarried at the time of death, his or her estate.

(g) Payments to Persons Other Than Participants. If the Committee shall find that any person to whom any amount is payable under the Plan is unable to care for his affairs because of illness or accident, or is a minor, or has died, then any payment due to such person or his estate (unless a prior claim therefor has been made by a duly appointed legal representative) may, if the Committee so directs the Company, be paid to his spouse, child, relative, an institution maintaining or having custody of such person, or any other person deemed by the Committee to be a proper recipient on behalf of such person otherwise entitled to payment. Any such payment shall be a complete discharge of the liability of the Committee and the Company therefor.

(h) No Liability of Committee Members. No member of the Committee shall be personally liable by reason of any contract or other instrument executed by such member or on his behalf in his capacity as a member of the Committee nor for any mistake of judgment made in good faith, and the Company shall indemnify and hold harmless each member of the Committee and each other employee, officer or director of the Company to whom any duty or power relating to the administration or interpretation of the Plan may be allocated or delegated, against any cost or expense (including counsel fees) or liability (including any sum paid in settlement of a claim) arising out of any act or omission to act in connection with the Plan unless arising out of such person's own fraud or willful bad faith; *provided, however*, that approval of the Board shall be required for the payment of any amount in settlement of a claim against any such person. The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such persons may be entitled under the Company's Articles of Incorporation or By-Laws, as a matter of law, or otherwise, or any power that the Company may have to indemnify them or hold them harmless.

(i) Governing Law. The Plan shall be governed by and construed in accordance with the internal laws of the State of Delaware applicable to contracts made and performed wholly within the State of Delaware.

(j) **Funding.** No provision of the Plan shall require the Company, for the purpose of satisfying any obligations under the Plan, to purchase assets or place any assets in a trust or other entity to which contributions are made or otherwise to segregate any assets, nor shall the Company maintain separate bank accounts, books, records or other evidence of the existence of a segregated or separately maintained or administered fund for such purposes. Participants shall have no rights under the Plan other than as unsecured general creditors of the Company, except that insofar as they may have become entitled to payment of additional compensation by performance of services, they shall have the same rights as other employees under general law.

(k) **Nontransferability.**

(i) Each Award shall be exercisable only by a Participant during the Participant's lifetime, or, if permissible under applicable law, by the Participant's legal guardian or representative. No Award may be assigned, alienated, pledged, attached, sold or otherwise transferred or encumbered by a Participant other than by will or by the laws of descent and distribution and any such purported assignment, alienation, pledge, attachment, sale, transfer or encumbrance shall be void and unenforceable against the Company or an Affiliate; provided that the designation of a beneficiary shall not constitute an assignment, alienation, pledge, attachment, sale, transfer or encumbrance.

(ii) Notwithstanding the foregoing, the Committee may, in its sole discretion, permit Awards other than Incentive Stock Options to be transferred by a Participant, without consideration, subject to such rules as the Committee may adopt consistent with any applicable Award agreement to preserve the purposes of the Plan, to:

- (A) any person who is a "family member" of the Participant, as such term is used in the instructions to Form S-8 (collectively, the "Immediate Family Members");
- (B) a trust solely for the benefit of the Participant and his or her Immediate Family Members;
- (C) a partnership or limited liability company whose only partners or shareholders are the Participant and his or her Immediate Family Members; or
- (D) any other transferee as may be approved either (a) by the Board or the Committee in its sole discretion, or (b) as provided in the applicable Award agreement;

(each transferee described in clauses (A), (B), (C) and (D) above is hereinafter referred to as a "Permitted Transferee"); *provided* that the Participant gives the Committee advance written notice describing the terms and conditions of the proposed transfer and the Committee notifies the Participant in writing that such a transfer would comply with the requirements of the Plan.

(iii) The terms of any Award transferred in accordance with the immediately preceding sentence shall apply to the Permitted Transferee and any reference in the Plan, or in any applicable Award agreement, to a Participant shall be deemed to refer to the Permitted Transferee, except that (A) Permitted Transferees shall not be entitled to transfer any Award, other than by will or the laws of descent and distribution; (B) Permitted Transferees shall not be entitled to exercise any transferred Option unless there shall be in effect a registration statement on an appropriate form covering the shares of Stock to be acquired pursuant to the exercise of such Option if the Committee determines, consistent with any applicable Award agreement, that such a registration statement is necessary or appropriate; (C) the Committee or the Company shall not be required to provide any notice to a Permitted Transferee, whether or not such notice is or would otherwise have been required to be given to the Participant under the Plan or otherwise; and (D) the consequences of the termination of the Participant's employment by, or services to, the Company or an Affiliate under the terms of the Plan and the applicable Award agreement shall continue to be applied with respect to the Participant, including, without limitation, that an Option shall be exercisable by the Permitted Transferee only to the extent, and for the periods, specified in the Plan and the applicable Award agreement.

(l) **Reliance on Reports.** Each member of the Committee and each member of the Board shall be fully justified in acting or failing to act, as the case may be, and shall not be liable for having so acted or failed to act in good faith, in reliance upon any report made by the independent public accountant of the Company and its

Affiliates and/or any other information furnished in connection with the Plan by any person or persons other than himself.

(m) **Relationship to Other Benefits.** No payment under the Plan shall be taken into account in determining any benefits under any pension, retirement, profit sharing, group insurance or other benefit plan of the Company except as otherwise specifically provided in such other plan.

(n) **Expenses.** The expenses of administering the Plan shall be borne by the Company and Affiliates.

(o) **Pronouns.** Masculine pronouns and other words of masculine gender shall refer to both men and women.

(p) **Titles and Headings.** The titles and headings of the sections in the Plan are for convenience of reference only, and in the event of any conflict, the text of the Plan, rather than such titles or headings shall control.

(q) **Termination of Employment.** Unless an applicable Award agreement provides otherwise, for purposes of the Plan a person who transfers from employment or service with the Company to employment or service with an Affiliate or vice versa shall not be deemed to have terminated employment or service with the Company or an Affiliate.

(r) **Severability.** If any provision of the Plan or any Award agreement is or becomes or is deemed to be invalid, illegal, or unenforceable in any jurisdiction or as to any person or Award, or would disqualify the Plan or any Award under any law deemed applicable by the Committee, such provision shall be construed or deemed amended to conform to the applicable laws, or if it cannot be construed or deemed amended without, in the determination of the Committee, materially altering the intent of the Plan or the Award, such provision shall be stricken as to such jurisdiction, person or Award and the remainder of the Plan and any such Award shall remain in full force and effect.

(s) **Compliance with Applicable Law.** Notwithstanding any provision in the Plan to the contrary, the Committee reserves the right to add any additional terms or provisions to any Award granted under the Plan that it in its sole discretion deems necessary or advisable in order that such Award (i) complies with the legal requirements of any governmental entity to whose jurisdiction the Award is subject and (ii) does not result in unintended adverse tax consequences to the Company or Participants.

(t) **409A of the Code.** Notwithstanding other provisions of the Plan or any Award agreements thereunder, no Award shall be granted, deferred, accelerated, extended, paid out or modified under this Plan in a manner that would result in the imposition of an additional tax under Section 409A of the Code upon a Participant. In the event that it is reasonably determined by the Committee that, as a result of Section 409A of the Code, payments in respect of any Award under the Plan may not be made at the time contemplated by the terms of the Plan or the relevant Award agreement, as the case may be, without causing the Participant holding such Award to be subject to taxation under Section 409A of the Code, the Company will make such payment on the first day that would not result in the Participant incurring any tax liability under Section 409A of the Code.

13. Changes in Capital Structure

Awards granted under the Plan and any agreements evidencing such Awards, the maximum number of shares of Stock subject to all Awards stated in Section 5(a) and the maximum number of shares of Stock with respect to which any one person may be granted Awards during any period stated in Sections 5(d) or 11(d)(vi) shall be subject to adjustment or substitution, as determined by the Committee in its sole discretion, as to the number, price or kind of a share of Stock or other consideration subject to such Awards or as otherwise determined by the Committee to be equitable (i) in the event of changes in the outstanding Stock or in the capital structure of the Company by reason of stock or extraordinary cash dividends, stock splits, reverse stock splits,

recapitalization, reorganizations, mergers, consolidations, combinations, exchanges, or other relevant changes in capitalization occurring after the Date of Grant of any such Award or (ii) in the event of any change in applicable laws or any change in circumstances which results in or would result in any substantial dilution or enlargement of the rights granted to, or available for, Participants, or which otherwise warrants equitable adjustment because it interferes with the intended operation of the Plan. Any adjustment in Incentive Stock Options under this Section 13 shall be made only to the extent not constituting a “modification” within the meaning of Section 424(h)(3) of the Code, and any adjustments under this Section 13 shall be made in a manner which does not adversely affect the exemption provided pursuant to Rule 16b-3 under the Exchange Act. Further, with respect to Awards intended to qualify as “performance-based compensation” under Section 162(m) of the Code, such adjustments or substitutions shall be made only to the extent that the Committee determines that such adjustments or substitutions may be made without causing the Company to be denied a tax deduction on account of Section 162(m) of the Code. The Company shall give each Participant notice of an adjustment hereunder and, upon notice, such adjustment shall be conclusive and binding for all purposes.

Notwithstanding the above, in the event of any of the following:

A. The Company is merged or consolidated with another corporation or entity and, in connection therewith, consideration is received by shareholders of the Company in a form other than stock or other equity interests of the surviving entity;

B. All or substantially all of the assets of the Company are acquired by another person;

C. The reorganization or liquidation of the Company; or

D. The Company shall enter into a written agreement to undergo an event described in clauses A, B or C above,

then the Committee may, in its discretion and upon at least 10 days advance notice to the affected persons, cancel any outstanding Awards and cause the holders thereof to be paid, in cash or stock, or any combination thereof, the value of such Awards based upon the price per share of Stock received or to be received by other shareholders of the Company in the event. The terms of this Section 13 may be varied by the Committee in any particular Award agreement.

14. Effect of Change in Control

(a) Except to the extent provided in a particular Award agreement:

(i) In the event of a Participant’s termination of employment without Cause or voluntary termination for Good Reason, if applicable, in either case following a Change in Control, notwithstanding any provision of the Plan to the contrary, all Options and SARs awarded to such Participant shall become exercisable with respect to 100 percent of the shares subject to such Option or SAR, and the Restricted Period shall expire with respect to 100 percent of such shares of Restricted Stock or Restricted Stock Units (including a waiver of any applicable Performance Goals). Notwithstanding the foregoing, the Committee may, upon a Change in Control and in its sole discretion, make any Options and SARs immediately exercisable, and may cause the Restricted Period to expire with respect to any Shares of Restricted Stock or Restricted Stock Units.

(ii) In the event of a Change in Control, all incomplete Performance Periods in effect on the date the Change in Control occurs shall end on the date of such change, and the Committee shall (A) determine the extent to which Performance Goals with respect to each such Award Period have been met based upon such audited or unaudited financial information then available as it deems relevant, (B) cause to be paid to each Participant partial or full Awards with respect to Performance Goals for each such Award Period based upon the Committee’s determination of the degree of attainment of Performance Goals which Awards may be adjusted, at the discretion of the Committee, to reflect the portion of the Award Period occurring before such Change in Control, and (C) cause all previously deferred Awards to be settled in full as soon as possible, provided, however, that any such payment does not result in acceleration of taxability of an Award prior to receipt, or tax penalties, under Section 409A of the Code.

(b) In addition, in the event of a Change in Control, the Committee may in its discretion and upon at least 10 days' advance notice to the affected persons, cancel any outstanding Awards and pay to the holders thereof, in cash or stock, or any combination thereof, the value of such Awards based upon the price per share of Stock received or to be received by other shareholders of the Company in the event.

(c) The obligations of the Company under the Plan shall be binding upon any successor corporation or organization resulting from the merger, consolidation or other reorganization of the Company, or upon any successor corporation or organization succeeding to substantially all of the assets and business of the Company. The Company agrees that it will make appropriate provisions for the preservation of Participants' rights under the Plan in any agreement or plan which it may enter into or adopt to effect any such merger, consolidation, reorganization or transfer of assets.

15. Nonexclusivity of the Plan

Neither the adoption of this Plan by the Board nor the submission of this Plan to the stockholders of the Company for approval shall be construed as creating any limitations on the power of the Board to adopt such other incentive arrangements as it may deem desirable, including, without limitation, the granting of stock options otherwise than under this Plan, and such arrangements may be either applicable generally or only in specific cases.

16. Amendments and Termination

(a) **Amendment and Termination of the Plan.** The Board may amend, alter, suspend, discontinue, or terminate the Plan or any portion thereof at any time; *provided*, that no such amendment, alteration, suspension, discontinuation or termination shall be made without shareholder approval if such approval is necessary to comply with any tax or regulatory requirement applicable to the Plan (including as necessary to comply with any applicable stock exchange listing requirement or to prevent the Company from being denied a tax deduction on account of Section 162(m) of the Code); and *provided, further*, that any such amendment, alteration, suspension, discontinuance or termination that would materially impair the rights of any Participant or any holder or beneficiary of any Award theretofore granted shall not to that extent be effective without the consent of the affected Participant, holder or beneficiary. The expiration date of the Plan is the tenth anniversary of the Effective Date, as described in Section 3 of the Plan.

(b) **Amendment of Award Agreements.** The Committee may, to the extent consistent with the terms of any applicable Award agreement, waive any conditions or rights under, amend any terms of, or alter, suspend, discontinue, cancel or terminate, any Award theretofore granted or the associated Award agreement, prospectively or retroactively; provided that any such waiver, amendment, alteration, suspension, discontinuance, cancellation or termination that would materially impair the rights of any Participant or any holder or beneficiary of any Award theretofore granted shall not to that extent be effective without the consent of the affected Participant, holder or beneficiary; and *provided, further*, that, without stockholder approval, (i) no amendment or modification may reduce the Option Price of any Option or the Strike Price of any SAR, (ii) the Committee may not cancel any outstanding Option or SAR and replace it with a new Option or SAR (with a lower Option Price or Strike Price, as the case may be) in a manner which would either (A) be reportable on the Company's proxy statement as Options which have been "repriced" (as such term is used in Item 402 of Regulation S-K promulgated under the Exchange Act), or (B) result in any "repricing" for financial statement reporting purposes and (iii) the Committee may not take any other action which is considered a "repricing" for purposes of the shareholder approval rules of any applicable stock exchange.

(c) Section 162(m) Approval

If so determined by the Committee, (i) the Plan shall be approved by the stockholders of the Company no later than the first meeting of stockholders at which directors are to be elected that occurs after the close of the third calendar year following the calendar year in which the Company's initial public offering occurs, and (ii) the provisions of the Plan regarding Performance Compensation Awards shall be disclosed and reapproved by stockholders of the Company no later than the first stockholder meeting that occurs in the fifth year following the

year that stockholders previously approved such provisions following the Company's initial public offering, in each case in order for certain Awards granted after such time to be exempt from the deduction limitations of Section 162(m) of the Code. Nothing in this Section 16(c), however, shall affect the validity of Awards granted after such time if such stockholder approval has not been obtained.

WARNER MUSIC INC.
75 Rockefeller Plaza
New York, New York 10019

May 4, 2007
Effective as of April 1, 2007

Dave Johnson
Warner Music Inc.
75 Rockefeller Plaza
New York, NY 10019

Dear Dave:

Please refer to the employment agreement between Warner Music Inc. ("Company") and you dated December 15, 1998, as amended by letter (the "2003 Amendment") dated May 13, 2003 (as so amended, the "Agreement").

This letter, when countersigned, shall constitute our agreement to amend the Agreement as set forth herein. Unless otherwise indicated, capitalized terms shall have the meanings set forth in the Agreement.

1. The modifications of the Agreement set out in the 2003 Amendment shall cease to be effective as of the March 31, 2007.
2. Paragraph 1 of the Agreement is hereby amended to provide that you shall render services to Company as Interim Chairman & CEO of Warner/Chappell Music Inc.
3. Paragraph 2 of the Agreement is hereby amended to extend the Term through June 30, 2008. The period from April 1, 2007 through June 30, 2008 is referred to herein as the "Extension Period."
4. Paragraph 3(a) of the Agreement is hereby amended to provide that Company shall pay you salary at the rate of \$700,000 per annum during and with respect to the Extension Period.
5. Paragraph 3(d) of the Agreement is hereby amended in its entirety to read as follows:
"(d) Annual Discretionary Bonus: With respect to each fiscal year of the Term (commencing with the full 2007 fiscal year), Company shall consider granting to you an annual bonus (or a pro rata portion of such annual bonus for a portion of such fiscal year). The amount of each annual bonus shall be determined by Company at its discretion; provided, that, your target bonus for each year of the

Term shall be \$800,000 (or a pro rata portion of such amount for a portion of a year), based on the strength of your performance and on the performance of Company.”

6. Paragraph 7 of the Agreement is hereby amended in its entirety to read as follows:

“7. Place of Employment: The greater New York and Los Angeles metropolitan areas, devoting such time to each such location as you and the Chairman & CEO of Company shall agree. You shall render services at the offices designated by Company at such locations. You also agree to travel on temporary trips to such other place or places as may be required from time to time to perform your duties hereunder.”

7. Paragraph 13 of the Agreement is hereby amended in its entirety to read as follows:

“13. Termination by You for Good Reason; Consequences of Breach by Company or Non-renewal:

(a) Termination by You for Good Reason: (i) For purposes of this Paragraph 13(a), Company shall be in breach of its obligations to you hereunder if there shall have occurred any of the following events (each such event being referred to as a “Good Reason”): (A) a change in your title and position shall have been put into effect such that you are no longer either Chairman & CEO of Warner/Chappell Music or Executive Vice President and General Counsel of Company; (B) you shall have been required to report to anyone other than as provided in Paragraph 6 hereof; (C) any monies required to be paid to you hereunder shall not be paid when due; (D) Company assigns its rights and obligations under this Agreement in contravention of the provisions of Paragraph 18(e) below or (E) Company requires you to relocate your primary residence outside the greater Los Angeles or New York metropolitan area (if you are serving as the Chairman & CEO of Warner/Chappell Music) or the greater New York metropolitan area (if you are serving as the Executive Vice President and General Counsel of Company) in order to perform your duties to Company hereunder.

(ii) You may exercise your right to terminate the Term of this Agreement for Good Reason pursuant to this Paragraph 13(a) by notice given to Company in writing specifying the Good Reason for termination within sixty (60) days after the occurrence of any such event constituting Good Reason, otherwise your right to terminate this Agreement by reason of the occurrence of such event shall expire and shall be deemed to have permanently lapsed. Any such termination in compliance with the provisions of this Paragraph 13(b) shall be effective thirty (30) days after the date of your written notice of termination, except that if Company shall cure such specified cause within such thirty-day period, you shall not be entitled to terminate the term of this Agreement by reason

of such specified Good Reason and the notice of termination given by you shall be null and void and of no effect whatsoever.

(b) In the event of a "Special Termination" (as defined below) of your employment, your sole remedy shall be that, upon your execution of a Release (as defined below) Company shall promptly pay to you the "Special Termination Payments" (as defined below), and in the event of a "Qualifying Non-renewal" (as defined below), your sole remedy shall be that, upon your execution of a Release, Company shall pay to you the "Non-renewal Payments" (as defined below). Special Termination Payments and Non-renewal Payments are sometimes herein referred to collectively as the "Termination Payments."

(c) The "Basic Termination Payments" shall mean any accrued but unpaid salary, awarded but unpaid annual bonuses, accrued vacation pay in accordance with Company policy, any unreimbursed expenses pursuant to Paragraph 8, plus any accrued but unpaid benefits in accordance with Paragraph 9, in each case to the date on which your employment terminates pursuant to an event described in subparagraph (e) or (g), below, as applicable (the "Termination Date").

(d) A "Release" shall mean a release agreement in Company's standard form, attached hereto as Exhibit A.

(e) A "Special Termination" shall have occurred in the event that (i) Company terminates your employment hereunder other than pursuant to Paragraphs 11 or 12 hereof or (ii) you terminate this Agreement for Good Reason in accordance with Paragraph 13(a).

(f) "Special Termination Payments" shall mean (i) the Basic Termination Payments; plus (ii) the greater of (A) the "Severance Amount" (as defined below) and (B) the sum of (I) \$1,500,000, plus (II) an amount equal to \$800,000 multiplied by a fraction, the numerator of which is the number of days in the period beginning on the first day of the fiscal year in which your termination occurs and ending on the date of your termination, and the denominator of which is 365.

(g) A "Qualifying Non-renewal" shall have occurred in the event that, at the end of the Term: (i) Company declines to offer you continued employment with Company or one of its affiliates; or (ii) Company offers you continued employment with Company or one of its affiliates at salary or target bonus lower than your salary or target bonus as in effect on the last day of the Term, or containing severance provisions less favorable to you than the severance provisions set out in this paragraph 13, and you elect to decline such offer and terminate your employment with Company.

(h) The "Non-renewal Payments" shall mean (i) the Basic Termination Payments; plus (ii) the greater of (A) the amount of severance pay (the

“Severance Amount”) that would have been payable to you under Company policy as in effect on the Termination Date had you not been subject to an employment agreement with Company and (B) the sum of (I) \$1,500,000 plus (II) an amount equal to \$800,000 multiplied by a fraction, the numerator of which is the number of days in the period beginning on the first day of the fiscal year in which your employment terminates and ending on the date on which your employment terminates, and the denominator of which is 365.

(i) Any Termination Payments payable to you under Paragraph 11(f) or (h) above shall be made by Company in accordance with its regular payroll practices by means of continued payments to you (i) of your salary at the same rate as was in effect as of the Termination Date for the applicable period as is necessary to cause the full amount due under such clause to be paid, or (ii) of salary for such other period as Company determines is necessary to prevent such amount from being deemed “deferred compensation” under applicable tax law; provided that in the event that the Payment Period is so modified, your rate of pay during such period shall be modified accordingly in order to cause the payment in full of the amounts required to be paid to you pursuant to this Paragraph 13 (the “Payment Period”). During the Payment Period, Company shall continue to provide you with coverage under Company’s medical plans in accordance with the terms of such plans, and you shall be entitled to no other benefits during such period.

(j) In the event you elect not to execute and deliver a Release in connection with a Special Termination or a Qualifying Non-renewal, Company shall only be obligated to pay to you the Basic Termination Payments. Following the delivery of an executed Release pursuant to this Paragraph 13, you shall have no duty to seek substitute employment, and Company shall have no right of offset against any amounts paid to you under this Paragraph 13 with respect to any compensation or fees thereafter received by you from any employment thereafter obtained or consultancy arrangement thereafter entered into by you.”

8. Paragraph 18(g) of the Agreement is hereby amended in its entirety to read as follows:

(g) This Agreement shall be governed by and construed according to the laws of the State of New York as applicable to agreements executed in and to be wholly performed within such State.

Except as expressly amended herein, the terms and provisions of the Agreement shall remain in full force and effect.

If the foregoing correctly sets forth our understanding, please sign below and return this agreement to Company.

WARNER MUSIC INC.

By: /s/ Edgar Bronfman, Jr.

Accepted and Agreed:

/s/ Dave Johnson

Dave Johnson

SEPARATION AGREEMENT AND RELEASE

SEPARATION AGREEMENT ("Agreement") made and entered into on _____, 200_ between **(name)** ("you") and **(company)** ("Company").

In consideration of the mutual covenants, conditions and obligations contained in this Agreement, you and Company agree as follows:

1. Your employment with Company shall end effective **(date)**. As of that date, you shall have no further responsibilities as an employee of Company and as of such date the employment agreement (the "Employment Agreement") between you and Company dated **(date)**, [as amended], shall be terminated with no liability of either party to the other thereunder whatsoever, except as specifically set out in this Agreement.

2. (a) Subject to your compliance with the terms of this Agreement, Company shall during the period from the date hereof to _____ (the "Payment Period") pay you salary at a rate of \$_____ per annum (less required withholding). All payments to you hereunder shall be payable in accordance with the regular payroll practices of the Company. You shall have no duty to mitigate Company's damages by seeking other employment, and Company shall have no right to reduce the amounts payable to you under this Agreement in the event that you obtain other earnings.

(b) Company shall continue to provide you and your dependent family members (to the extent such individuals are eligible for such coverage under the terms of the applicable programs) with coverage under Company's medical and dental plans until the earlier of (i) the end of the Payment Period or (ii) the date as of which you become eligible for another medical insurance plan.

(c) For so long as you are on a payroll of Company, you shall continue to participate in Company's basic life insurance as if you were a full time employee of Company, subject to the terms and conditions of each such plan.

(d) The Company shall pay you any accrued and unused vacation time through _____, 200_ (to the extent not paid prior to the date hereof).

3. In accordance with the terms and conditions of the Consolidated Omnibus Budget Reconciliation Act ("COBRA"), you shall have the right, at your expense, to elect to continue medical insurance coverage under the group insurance plan maintained by Company for a period of eighteen months beginning on **(date)**. Further information regarding COBRA's coverage, including enrollment forms and premium quotations, will be sent to you separately.

4. (a) In consideration of, and exchange for, the payment and other benefits to be received by you under this Agreement, you hereby waive, release and forever discharge Company and its successors, their directors, officers, agents, representatives and employees, and the parents, subsidiaries and affiliates, and the directors, officers, agents and employees thereof (the "Company Group") from all claims, causes of action, lawsuits and demands, attorney's fees, expenses or other compensation ("Claims") which in any way relate to or arise out of the Employment Agreement or your employment with Company or the termination of your employment, which you may now or hereafter have under any common law, federal, state or local law, regulation or order, including without limitation, (i) any Claim under Title VII of the Civil Rights Act of 1964, as amended, the Age Discrimination in Employment Act, as amended, as well as all liability for any acts that may have violated your rights under any contract or local fair employment practices law, any employee relations statute, executive law or ordinance, any unemployment or workers compensation law or any other duty or obligation of any kind or nature; (ii) all Claims relating to or arising out of any alleged tortious act, including but not limited to, wrongful termination, intentional infliction of emotional distress and defamation; (iii) all Claims which may be alleged against or imputed to Company by you or by anyone acting on your behalf; and (iv) all Claims for wages, (including, but not limited to, all Claims in connection with any long-term incentive compensation plan of Company), monetary and equitable relief, employment or reemployment with Company in any position.

(b) The Company Group, in exchange for the consideration embodied in this Agreement, waives, releases, and forever discharges you from all Claims which the Company Group may now or hereafter have against you under any common law, federal, state or local law, regulation or order, arising out of your employment with Company.

5. Neither you nor Company shall file or cause to be filed any action, suit, claim, charge or proceeding with any federal, state or local court or agency relating to any Claims within the scope of paragraph 4.

6. You and Company each acknowledge that nothing in this Agreement constitutes (or shall be deemed) an admission of liability or wrongdoing by either you or the Company.

7. (a) You shall not at any time exploit, use, sell, publish, disclose, or communicate to any person, corporation or entity, either directly or indirectly, any trade secrets or confidential information regarding the Company Group, including, without limitation, the terms of any agreements between Company or any of its affiliates and any third party (except that you may disclose the financial terms of this Agreement to tax authorities, and to your attorneys and accountants). You shall not during the one-year period following the date hereof, without the prior approval of Company, discuss any "Company Topic" (as defined below) with any press or media representative, nor shall you provide any information regarding any Company Topic to any press or media representative. "Company Topic" shall mean any matter relating to Company or its affiliates, including any of their respective employees or artists.

(b) Company shall not at any time, use, sell, publish, disclose, or communicate to any person, corporation or entity, either directly or indirectly, any confidential information regarding you

(except that Company may disclose the financial terms of this Agreement to tax authorities, attorneys or accountants).

(c) You agree to promptly return to Company all property of Company in your possession, including, but not limited to keys, identification cards, files, records, credit cards, electronic equipment and books and manuals issued to you by Company.

8. For a period of one year after the date hereof, you shall not, without the prior written consent of Company, directly or indirectly, as an employee, agent, consultant, partner, joint venturer, owner, officer, director, or member of any other person, firm, partnership, corporation or other entity, or in any other capacity, (a) call upon, solicit, negotiate with, offer or enter into a recording or other contract with any recording artist (including a duo or a group) or songwriter who at the time is, either directly or through a furnishing entity, under contract to Company or an affiliate of Company or a label distributed by Company or an affiliate of Company, or (b) solicit, induce or encourage any of the Company's employees or Company's affiliates to leave their employment.

9. You acknowledge that you have read this Agreement and that you have executed and delivered this Agreement freely and voluntarily, with full knowledge of all material facts.

10. (a) You acknowledge that you have been advised to seek independent advice and counsel in connection with this Agreement and have retained **(attorney name)** of the firm of **(firm name)** for such purpose, and that you have been afforded the time and opportunity necessary to seek such advice and counsel to the full extent you may have desired; and that you have been afforded at least 21 days in which to consider this Agreement. You understand your obligations and rights under this Agreement and with such knowledge have entered into and executed this Agreement freely and voluntarily.

(b) You understand that you may revoke this Agreement within seven days of its execution, by notifying Company in writing of your desire to revoke the Agreement, whereupon this Agreement shall be rendered null and void. The provisions of this Agreement including any payment due to you shall not be binding upon Company until eight days after the execution of this Agreement by you.

11. It is Company's and your intention that this Agreement shall be effective as a full and final accord and satisfaction and release of each and every matter hereinabove referred to. You and Company acknowledge that you and Company are familiar with Section 1542 of the Civil Code of the State of California which provides as follows:

"A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM MUST HAVE MATERIALLY AFFECTED HIS SETTLEMENT WITH THE DEBTOR"

You and Company waive and relinquish any right and benefit which you and Company have or may have under Section 1542 to the full extent that you and Company may lawfully waive all such rights and benefits pertaining to the subject matter hereof.

12. This Agreement constitutes the final and complete Agreement between you and Company with respect to the subject matter hereof. This Agreement supersedes any and all prior agreements between you and Company, including, but not limited to, the Employment Agreement. No modification or waiver of the terms of this Agreement shall be valid unless in writing and signed by Company and you.

13. This Agreement shall be governed by and construed according to the laws of the State of **(state)** as applicable to agreements executed in and to be wholly performed within such State.

IN WITNESS WHEREOF, the undersigned have acknowledged and executed this Agreement as of the date first set forth above.

SAMPLE

(name)

[COMPANY NAME]

SAMPLE

By: _____

CHIEF EXECUTIVE OFFICER CERTIFICATION

I, Edgar Bronfman, Jr., Chief Executive Officer and Chairman of the Board of Directors of Warner Music Group Corp., certify that:

1. I have reviewed this quarterly report on Form 10-Q for the period ended March 31, 2007 of Warner Music Group 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 we 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 my 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;
 - 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 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 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 8, 2007

/s/ EDGAR BRONFMAN, JR.

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

CHIEF FINANCIAL OFFICER CERTIFICATION

I, Michael D. Fleisher, Chief Financial Officer of Warner Music Group Corp., certify that:

1. I have reviewed this quarterly report on Form 10-Q for the period ended March 31, 2007 of Warner Music Group 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 we 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 my 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;
 - 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 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 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 8, 2007

/s/ MICHAEL D. FLEISHER

Chief Financial Officer (Principal Financial and
Accounting Officer)

**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 Warner Music Group Corp. (the "Company") on Form 10-Q for the period ended March 31, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Edgar Bronfman, Jr., Chief Executive Officer of Warner Music Group Corp., 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 8, 2007

/s/ EDGAR BRONFMAN, JR.

Edgar Bronfman, Jr.
Chief Executive Officer

**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 Warner Music Group Corp. (the "Company") on Form 10-Q for the period ended March 31, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Michael D. Fleisher, Chief Financial Officer of Warner Music Group Corp., 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 8, 2007

/s/ MICHAEL D. FLEISHER

Michael D. Fleisher
Chief Financial Officer