Warner Music Group Corp.
Form 10-Q
May 08, 2008
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2008

OR

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

Commission File Number 001-32502

Warner Music Group Corp.

(Exact name of Registrant as specified in its charter)

Delaware		**13-4271875**
(State or other jurisdiction of incorporation or organization)		**(I.R.S. Employer Identification No.)**

75 Rockefeller Plaza

New York, NY 10019

(Address of principal executive offices)

(212) 275-2000

(Registrant s telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x 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 x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨ (Do not check if a smaller reporting company)

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

As of May 6, 2008, the number of shares of the Registrant s common stock, par value $0.001 per share, outstanding was 154,045,528.

Table of Contents

WARNER MUSIC GROUP CORP.

INDEX

		Page
Part I.	**Financial Information**	
Item 1.	Financial Statements (unaudited)	3
	Consolidated Balance Sheets as of March 31, 2008 and September 30, 2007	3
	Consolidated Statements of Operations for the Three and Six Months Ended March 31, 2008 and 2007	4
	Consolidated Statements of Cash Flows for the Six Months Ended March 31, 2008 and 2007	5
	Consolidated Statement of Shareholders Deficit for the Six Months Ended March 31, 2008	6
	Notes to Consolidated Interim Financial Statements	7
	Supplementary Information Consolidating Financial Statements	18
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	25
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	49
Item 4.	Controls and Procedures	50
Part II.	**Other Information**	
Item 1.	Legal Proceedings	50
Item 1A.	Risk Factors	51
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	60
Item 3.	Defaults Upon Senior Securities	61
Item 4.	Submission of Matters to a Vote of Security Holders	61
Item 5.	Other Information	61
Item 6.	Exhibits	63
Signatures		64

Table of Contents

Warner Music Group Corp.

Consolidated Balance Sheets

	March 31, 2008 (unaudited)	September 30, 2007 (audited)
	(in millions)	
Assets		
Current assets:		
Cash and equivalents	$ 249	$ 333
Accounts receivable, less allowances of $178 and $192 million	482	555
Inventories	61	58
Royalty advances expected to be recouped within one year	200	176
Deferred tax assets	49	40
Other current assets	30	33
Total current assets	1,071	1,195
Royalty advances expected to be recouped after one year	242	216
Investments	182	146
Property, plant and equipment, net	128	133
Goodwill	1,074	1,065
Intangible assets subject to amortization, net	1,651	1,632
Intangible assets not subject to amortization	100	100
Other assets	84	85
Total assets	$ 4,532	$ 4,572
Liabilities and Shareholders Deficit		
Current liabilities:		
Accounts payable	$ 214	$ 225
Accrued royalties	1,268	1,226
Taxes and other withholdings	26	33
Dividends payable	1	23
Current portion of long-term debt	17	17
Other current liabilities	358	358
Total current liabilities	1,884	1,882
Long-term debt	2,258	2,256
Dividends payable		1
Deferred tax liabilities	250	244
Other noncurrent liabilities	243	225
Total liabilities	$ 4,635	$ 4,608
Commitments and Contingencies (See Note 12)		
Shareholders deficit:		
Common stock ($0.001 par value; 500,000,000 shares authorized; 154,041,258 and 149,524,737 shares issued and outstanding)		
Additional paid-in capital	583	579
Accumulated deficit	(683)	(614)
Accumulated other comprehensive loss, net	(3)	(1)
Total shareholders deficit	$ (103)	$ (36)

Total liabilities and shareholders deficit	$ 4,532	$ 4,572

See accompanying notes.

Table of Contents

Warner Music Group Corp.

Consolidated Statements of Operations (Unaudited)

	Three Months Ended March 31,		Six Months Ended March 31,	
	2008	2007	2008	2007
	(in millions, except per share data)			
Revenues (b)	$ 800	$ 784	$ 1,789	$ 1,712
Costs and expenses:				
Cost of revenues (a)(b)	(413)	(427)	(958)	(935)
Selling, general and administrative expenses (a)(b)	(304)	(275)	(635)	(565)
Other income, net			3	
Restructuring costs		(12)		(12)
Amortization of intangible assets	(55)	(51)	(109)	(101)
Total costs and expenses	(772)	(765)	(1,699)	(1,613)
Operating income from continuing operations	28	19	90	99
Interest expense, net	(47)	(45)	(95)	(92)
Equity in the income of equity-method investees, net			1	
Minority interest expense			(2)	
Other loss, net	(2)		(3)	
(Loss) income from continuing operations before income taxes	(21)	(26)	(9)	7
Income tax expense	(13)	(1)	(23)	(16)
Loss from continuing operations	$ (34)	$ (27)	$ (32)	$ (9)
Loss from discontinued operations, net of taxes	(3)		(21)	
Net loss	$ (37)	$ (27)	$ (53)	$ (9)
Net loss per common share:				
Basic earnings per share:				
Loss from continuing operations	$ (0.23)	$ (0.19)	$ (0.22)	$ (0.06)
Loss from discontinued operations	(0.02)		(0.14)	
Net loss	$ (0.25)	$ (0.19)	$ (0.36)	$ (0.06)
Diluted earnings per share:				
Loss from continuing operations	$ (0.23)	$ (0.19)	$ (0.22)	$ (0.06)
Loss from discontinued operations	(0.02)		(0.14)	
Net loss	$ (0.25)	$ (0.19)	$ (0.36)	$ (0.06)
Weighted average common shares:				
Basic	147.9	145.9	147.5	145.4
Diluted	147.9	145.9	147.5	145.4
(a) Includes depreciation expense of:	$ (13)	$ (10)	$ (26)	$ (20)
(b) Includes the following income (expenses) resulting from				

transactions with related companies				
Revenues	$	$ 2	$ 1	$ 3
Cost of revenues	(1)		(1)	(1)
Selling, general and administrative expenses				(4)

See accompanying notes.

4

Table of Contents

Warner Music Group Corp.

Consolidated Statements of Cash Flows (Unaudited)

	Six Months Ended March 31, 2008	Six Months Ended March 31, 2007
	(in millions)	
Cash flows from operating activities		
Net loss	$ (53)	$ (9)
Loss from discontinued operations, net of tax	21	
Loss from continuing operations	(32)	(9)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	135	121
Deferred taxes	(15)	(22)
Non-cash interest expense	24	27
Non-cash stock-based compensation expense	4	5
Other non-cash items	(1)	
Equity in the income of equity-method investees	(1)	
Minority interest expense	2	
Changes in operating assets and liabilities:		
Accounts receivable	94	118
Inventories		(7)
Royalty advances	(38)	(28)
Accounts payable and accrued liabilities	(69)	(102)
Other balance sheet changes	(7)	4
Net cash provided by operating activities	96	107
Cash flows from investing activities		
Investments and acquisitions	(134)	(57)
Loans to third parties	(3)	(24)
Sales of short-term investments		18
Proceeds from the sale of buildings		7
Proceeds from the sale of investments	5	
Capital expenditures	(20)	(13)
Net cash used in investing activities	(152)	(69)
Cash flows from financing activities		
Debt repayments	(8)	(8)
Proceeds from the exercise of stock options		2
Dividends paid	(42)	(40)
Net cash used in financing activities	(50)	(46)
Effect of foreign currency exchange rate changes on cash	22	3
Net decrease in cash and equivalents	(84)	(5)
Cash and equivalents at beginning of period	333	367
Cash and equivalents at end of period	$ 249	$ 362

See accompanying notes.

Table of Contents

Warner Music Group Corp.

Consolidated Statement of Shareholders Deficit (Unaudited)

	Common Stock					
	Shares	(Value at $0.001 par)	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Shareholders Deficit
		(in millions, except number of common shares)				
Balance at September 30, 2007	149,524,737		$ 579	$ (614)	$ (1)	$ (36)
Comprehensive loss:						
Net loss				(53)		(53)
Foreign currency translation adjustment					18	18
Deferred losses on derivative financial instruments					(20)	(20)
Total comprehensive loss				(53)	(2)	(55)
Dividends				(19)		(19)
Impact of change in accounting (a)				3		3
Issuance of stock options and restricted shares of common stock	4,516,521		4			4
Balance at March 31, 2008	154,041,258		$ 583	$ (683)	$ (3)	$ (103)

(a) See Note 2, Basis of Presentation.

See accompanying notes.

Table of Contents

Warner Music Group Corp.

Notes to Consolidated Interim Financial Statements (Unaudited)

1. Description of Business

Warner Music Group Corp. (the Company or Parent) was formed by a private equity consortium of investors (the Investor Group) on November 21, 2003. The Company is the direct parent of WMG Holdings Corp. (Holdings), which is the direct parent of WMG Acquisition Corp. (Acquisition Corp.). Acquisition Corp. is one of the world s major music-based content companies 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 original Investor Group included affiliates of Thomas H. Lee Partners L.P. (THL), affiliates of Bain Capital Investors, LLC (Bain), affiliates of Providence Equity Partners, Inc. (Providence) and Music Capital Partners, L.P. (Music Capital). Music Capital s partnership agreement required that the Music Capital partnership dissolve and commence winding up by the second anniversary of the Company s May 2005 initial public offering. As a result, on May 7, 2007, Music Capital made a pro rata distribution of all shares of common stock of the Company held by it to its partners. The shares held by Music Capital had been subject to a stockholders agreement among Music Capital, THL, Bain and Providence and certain other parties. As a result of the distribution, the shares distributed by Music Capital ceased to be subject to the voting and other provisions of the stockholders agreement and Music Capital was no longer part of the Investor Group subject to the stockholders agreement.

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

Recorded Music Operations

The Company s Recorded Music business 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 the process 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 reissuances of previously released music and video titles, as well as in the licensing of recordings to and from third parties for various uses, including film and television soundtracks.

On May 31, 2006, the Company completed the acquisition of 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 (see Note 5). The Company also conducts its Recorded Music operations through a collection of additional record labels, including, among others, Asylum, Bad Boy, Cordless, East West, Elektra, Lava, Nonesuch, Reprise, Sire and Word.

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 WEA Corp., which markets and sells music and DVD products to retailers and wholesale distributors in the U.S.; ADA, which distributes the products of independent labels to retail and wholesale distributors in the U.S.; Ryko Distribution, which distributes music and DVD releases from Rykodisc, Ryko s record 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 Global, which provides ADA s distribution services to independent labels outside of the U.S. through a network of affiliated and non-affiliated distributors.

The Company plays an integral role in virtually all aspects of the music value chain from discovering and developing talent, to producing albums and promoting artists and their products. After an artist has entered into a contract with one of the Company s record labels, a master recording of the artist s music is created and replicated for sale to consumers both in the digital as well as the physical (primarily CD) format.

The Company s recorded music products are sold through multiple channels. Digital music content is generally sold through two primary channels: online and mobile. Digital recorded music products are sold to online digital retailers such as Apple s iTunes and mobile full-track download stores such as those operated by Verizon or Sprint. Both digital and physical recorded music are also sold to online physical retailers such as Amazon.com, barnesandnoble.com, bestbuy.com and walmart.com. In the U.S., WEA Corp., ADA, Ryko Distribution and Word market, sell and deliver physical product, either directly or through sub-distributors and wholesalers, to thousands of record stores, mass merchants and other retailers.

The sale of digital content is now integrated within all aspects of the Company s Recorded Music and Music Publishing businesses, including A&R, marketing, promotion and distribution. The Company believes existing and new digital businesses will be a significant source of growth for the next several years and will provide new opportunities to monetize its assets and create new revenue streams.

In addition, the Company s new media executives work closely with the A&R departments of its labels to ensure that while a record is being made, digital assets are also created with all of our distribution channels in mind, including subscription services such as Rhapsody and satellite radio, social networking sites such as MySpace and imeem, user-generated content sites such as YouTube, Internet portals, online video and music-centered destinations, such as Joost and Slacker. The Company also works side by side with its mobile and online partners to test new concepts.

As a music content company, the Company has assets beyond its recorded music and music publishing catalogs, such as its music video library, that it now has the opportunity to monetize through digital channels. As an owner of musical content, the Company believes it is well positioned to take advantage of growth in digital distribution and emerging technologies to maximize the value of its assets.

The proportion of digital revenues attributed to each distribution channel varies by region, and since digital music is in the early stages of growth, proportions may change as the roll-out of new technologies continues.

The Company is also diversifying its revenues beyond its traditional businesses by partnering with artists in other areas of their careers. The Company is building capabilities and platforms for exploiting a broader set of music-related rights to participate across the artist brands it helps create. Expansion of the Company s capabilities in this area have included strategic acquisitions and partnerships with companies involved in artist management, merchandising, strategic marketing and brand management, ticketing and touring, original programming and video entertainment. The Company believes enhancement of these capabilities will permit it to diversify revenue streams to better capitalize on the growth areas of the music industry, permit it to build stronger, long-term relationships with artists and more effectively connect artists and fans.

Table of Contents

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 garners a share of the revenues generated from use of the song.

The Company s Music Publishing operations include Warner/Chappell, its global Music Publishing company headquartered in 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., Hallmark Entertainment, Disney Music Publishing, New Line Cinema and Warner Bros. Studios. In 2007, the Company entered the production music library business with the acquisition of Non-Stop Music. Production music is a complementary alternative to licensing standards and contemporary hits for television, film and advertising producers.

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 unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Our business is seasonal, therefore, operating results for the three- and six-month periods ended March 31, 2008 are not necessarily indicative of the results that may be expected for the year ending September 30, 2008.

The consolidated balance sheet at September 30, 2007 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2007 (Registration No. 001-32502).

Basis of Consolidation

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

New Accounting Pronouncements

In October 2007, the Company adopted the provisions of FASB Statement No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes by prescribing application of a more likely than not threshold to the recognition and derecognition of uncertain tax positions. FIN 48 also prescribes guidance on measurement, classification, interest and penalties, accounting for interim periods, and disclosures. Upon adoption of FIN 48, the Company recorded a cumulative adjustment of $3 million, with a corresponding adjustment to the opening balance of accumulated deficit. As of the date of adoption, the Company had $1 million of unrecognized tax benefits, all of which would affect the effective tax rate if recognized. The Company classifies interest and penalties related to uncertain tax positions as a component of income tax expense. As of the date of adoption and March 31, 2008, the Company had accrued no material interest or penalties.

The Company and its subsidiaries file income tax returns in the U.S. and various foreign jurisdictions. The Internal Revenue Service has commenced an examination of the Company s U.S. income tax returns for the fiscal years ended September 30, 2004 through September 30, 2006.

In September 2006, the FASB issued FASB Statement No. 157, *Fair Value Measurements* (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value under U.S. GAAP and expands disclosures about fair value measurements. FAS 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The impact of this standard is not expected to be material to the Company s consolidated financial statements. The Company will adopt the provisions of FAS 157 in fiscal 2009.

In February 2007, the FASB issued FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, (* FAS 159 *)* including an Amendment of SFAS 115, which permits but does not require the Company to measure financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. The impact of this standard is not expected to be material to the Company s consolidated financial statements. The Company will adopt the provisions of FAS 159 in fiscal 2009.

3. Comprehensive Loss

Comprehensive loss consists of net loss and other gains and losses affecting equity that, under U.S. GAAP, are excluded from net loss. For the Company, the components of other comprehensive loss 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 changes to the minimum pension liability. The following summary sets forth the components of comprehensive loss, net of related taxes, for the three and six months ended March 31, 2008 and 2007 (in millions):

	Three Months Ended		**Six Months Ended**	
	March 31, 2008	**March 31, 2007**	**March 31, 2008**	**March 31, 2007**
Net loss	$ (37)	$ (27)	$ (53)	$ (9)
Foreign currency translation gains (losses) (a)	14		18	(6)
Derivative financial instruments losses	(15)	(6)	(20)	(7)

Comprehensive loss	$ (38)	$ (33)	$ (55)	$ (22)

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

Table of Contents

4. Net Loss Per Common Share

The Company computes net loss per common share in accordance with FASB Statement No. 128, *Earnings per Share* (FAS 128). Under the provisions of FAS 128, basic net loss per common share is computed by dividing the net loss applicable to common shares after preferred dividend requirements, if any, by the weighted average of common shares outstanding during the period. Diluted net loss per common share adjusts basic net loss 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 calculation of diluted net loss per common share excludes an adjustment to the weighted-average common shares outstanding for the potential dilution that would occur if the Company s stock options were exercised or the Company s restricted stock had vested. In the periods reported, the effect of the assumed exercise of any outstanding stock options and the assumed vesting of shares of restricted shares would have been antidilutive and accordingly, the following share amounts were excluded from the calculation of diluted net loss per share (in millions):

	Three Months Ended		Six Months Ended	
	March 31, 2008	March 31, 2007	March 31, 2008	March 31, 2007
Stock options	1.0	2.0	2.0	2.0
Restricted stock	1.0	3.0	1.0	4.0

5. Significant Acquisitions and Dispositions

Acquisition of Interest in Frank Sinatra Estate

The Company acquired a 50% interest in Frank Sinatra Enterprises, LLC (FSE) on November 19, 2007 for $50 million. FSE is a limited liability company established to administer licenses for use of Frank Sinatra s name and likeness and manage all aspects of his music, film and stage content. The transaction was accounted for under the purchase method of accounting, based on the provisions of FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* and the results of operations of FSE have been included in the Company s results of operations from the date of the acquisition. The purchase price has been preliminarily allocated to the underlying net assets acquired in proportion to the estimated fair value, principally as follows: recorded music catalog, $33 million; trademarks, $10 million; and goodwill $7 million.

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 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, $39 million; tangible assets, $36 million; and tangible liabilities, $33 million.

In connection with the signing of the initial agreement in December 2006, the Company 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.

Discontinued Operations

During the six months ended March 31, 2008, the Company determined that it would shut down the operations of Bulldog Entertainment, an entertainment services company. As a result of this triggering event, the Company performed an impairment test at December 31, 2007 and determined that an $18 million impairment charge was necessary to adjust the assets to fair market value, based on the discounted value of future cash flows. The Company shut down these operations in January 2008 and as such Bulldog Entertainment is reported as a discontinued operation in the consolidated financial statements of the Company. In the six months ended March 31, 2008, the Company recorded a loss related to its discontinued operation of $21 million, which included costs to shut down the operations and an impairment charge related to goodwill of $18 million.

Table of Contents

6. Inventories

Inventories consist of the following (in millions):

	March 31, 2008 (unaudited)	September 30, 2007 (audited)
Compact discs, cassettes and other music-related products	$ 60	$ 56
Published sheet music and song books	1	2
	$ 61	$ 58

7. Goodwill and Intangible Assets

Goodwill

The following analysis details the changes in goodwill for each reportable segment during the six months ended March 31, 2008 (in millions):

	Recorded Music	Music Publishing	Total
Balance at September 30, 2007 (audited)	**$ 474**	**$ 591**	**$ 1,065**
Acquisitions (a)	18		18
Disposition (b)	(18)		(18)
Other adjustments (c)	9		9
Balance at March 31, 2008 (unaudited)	**$ 483**	**$ 591**	**$ 1,074**

(a) Acquisitions include $8 million of goodwill acquired as part of an investment in FSE as more fully described in Note 5, as well as $9 million related to the acquisition during the quarter ended March 31, 2008 of a tour, production, promotion, and booking company.

(b) Disposition relates to the impairment and discontinued operation of Bulldog Entertainment as more fully described in Note 5.

(c) Other represents foreign currency translation adjustments.

Table of Contents

Other Intangible Assets

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

	September 30, 2007 (audited)	Acquisitions (a)	Other (b)	March 31, 2008 (unaudited)
Intangible assets subject to amortization:				
Recorded music catalog	$ 1,319	44	9	$ 1,372
Music publishing copyrights	916	17	39	972
Artist contracts	66	7	2	75
Trademarks	11	10		21
Other intangible assets	6			6
	2,318	78	50	2,446
Accumulated amortization	(686)			(795)
Total net intangible assets subject to amortization	1,632			1,651
Intangible assets not subject to amortization:				
Trademarks and brands	100			100
Total net other intangible assets	$ 1,732			$ 1,751

(a) The acquisitions primarily relate to $33 million of music catalog and $10 million of trademarks acquired in the connection with the investment in FSE as more fully described in Note 5.

(b) Other represents foreign currency translation adjustments.

8. Restructuring Costs

Realignment Plan for Fiscal Year 2007

In the second quarter of 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 included 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 was also designed to improve the operating effectiveness of the Company s current businesses and to realign its 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 plan consisted 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 continued to shift resources from the physical sales channels to efforts focused on digital distribution and emerging technologies and other new revenue streams. Part of the plan also resulted in the outsourcing of some back-office functions as a cost-savings measure.

The changes described above were implemented in fiscal year 2007. The Company incurred substantially all of the costs associated with the realignment plan in fiscal year 2007. This included approximately $50 million of restructuring costs and $13 million of implementation costs. In connection with the plan, the Company reduced headcount by approximately 400 employees. The Company expects that the majority of any cost savings will be offset by new business initiatives in areas related to digital distribution and video. Restructuring costs consist of the following (in millions):

	Employee Terminations	Other Exit Costs	Total
Liability as of September 30, 2007	**$ 16**	**$ 1**	**$ 17**
Cash paid during the six months ended March 31, 2008	(10)		(10)
Liability as of March 31, 2008	**$ 6**	**$ 1**	**$ 7**

Acquisition-Related Restructuring Costs

As of March 31, 2008, the Company had approximately $19 million of liabilities for Acquisition-related restructuring costs. These relate to restructuring efforts implemented in fiscal 2005 following 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 costs by the end of fiscal year 2008. Restructuring costs consist of the following (in millions):

Table of Contents

	Employee Terminations	Other Exit Costs	Total
Liability as of September 30, 2007	**$ 3**	**$ 19**	**$ 22**
Cash paid during the six months ended March 31, 2008	(1)		(1)
Non-cash reductions during the six months ended March 31, 2008 (a)		(2)	(2)
Liability as of March 31, 2008	**$ 2**	**$ 17**	**$ 19**

(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, co-publisher and other contracts.

9. Debt

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

	March 31, 2008 (unaudited)	September 30, 2007 (audited)
Senior secured credit facility:		
Term loan (a)	$ 1,388	$ 1,396
7.375% U.S. dollar-denominated Senior Subordinated Notes due 2014 Acquisition Corp.	465	465
8.125% Sterling-denominated Senior Subordinated Notes due 2014 Acquisition Corp. (b)	201	202
9.5% Senior Discount Notes due 2014 Holdings (c)	220	210
Other	1	
Total debt	2,275	2,273
Less current portion	(17)	(17)
Total long-term debt	$ 2,258	$ 2,256

(a) Decrease in debt is a result of quarterly principal amortization payments of our term loans under our senior secured credit facility.

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

(c) Change represents the accrual of interest on the discount notes in the form of an increase in the accreted value of the discount notes.

Restricted Net Assets

The Company is a holding company that conducts substantially all its business operations through its 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 the 8.125% Sterling-denominated Senior Subordinated Notes due 2014 issued by Acquisition Corp. (collectively, the Acquisition Corp. Senior Subordinated Notes) and the indenture for the 9.5% Senior Discount Notes due 2014 issued by Holdings (the 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, 2008 and 2007 (in millions):

	Three Months Ended		Six Months Ended	
	March 31, 2008	March 31, 2007	March 31, 2008	March 31, 2007
Recorded Music	$	$ 2	$ 2	$ 4
Music Publishing		(1)		(1)
Corporate expenses	1	1	2	2
Total	$ 1	$ 2	$ 4	$ 5

During the three months ended March 31, 2008, the Company awarded 4,475,000 stock options and 4,546,312 shares of restricted stock to its employees. During the six months ended March 31, 2008, the Company awarded 6,112,010 stock options and 4,546,312 shares of restricted stock to its employees.

11. Shareholders Deficit

Return of Capital and Dividends Paid

On February 6, 2008, 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 on February 29, 2008 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 September 4, 2007, 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 on October 24, 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.

Dividend Policy

The Company has discontinued its previous policy of paying a regular quarterly dividend. On February 29, 2008, the Company paid its final quarterly dividend of $0.13 per share under the now discontinued policy. The Company currently intends to retain future earnings to build cash on the balance sheet and invest in its business, particularly in A&R. Any future determination to pay dividends will be 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.

Vesting of Restricted Stock

During the six months ended March 31, 2008, 1,797,437 shares of restricted stock was purchased by or awarded to certain employees vested.

12. Commitments and Contingencies

Pricing of Digital Music Downloads

On December 20, 2005 and February 3, 2006, the Attorney General of the State of New York served the Company with requests for information in connection with an industry-wide investigation as to whether the practices of industry participants concerning the pricing of digital music downloads violate Section 1 of the Sherman Act, New York State General Business Law §§ 340 et seq., New York Executive Law §63(12), and related statutes. On February 28, 2006, the Antitrust Division of the U.S. Department of Justice served the Company with a request for information in the form of a Civil Investigative Demand as to whether its activities relating to the pricing of digitally downloaded music violate Section 1 of the Sherman Act. 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. All defendants, including the Company, filed a motion to dismiss the consolidated amended complaint on July 30, 2007. The Court heard an argument on this motion on March 25, 2008 and reserved decision. 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). Similar Statements of Objections were also issued to Apple Inc. and each of the other major recorded music companies. The Statement of Objections targeted Apple Inc. s practice of applying certain territorial restrictions in relation to its iTunes stores in the European Economic Area (EEA). The EC alleged that these restrictions arose, 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 might lead to a distortion of competition, infringing Article 81 of the EC Treaty. We submitted that our practices had not infringed Article 81 of the EC Treaty and presented arguments to that effect in our response. On January 9, 2008, the EC announced that its proceedings had clarified that it was not the agreements between Apple and the major record companies which determined how the iTunes store was organized in Europe and that, consequently, it did not intend to take further action in the case. On March 27, 2008, the EC sent a letter to the Company formally confirming that the case has been closed.

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, 2008, 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 through the fourth quarter of fiscal year 2008. As of March 31, 2008, the Company had interest rate swap agreements to hedge a total notional debt amount of $897 million. For the six months ended March 31, 2008, the Company recorded deferred losses in comprehensive income of $24 million as well as $3 million of deferred net gains in comprehensive income related to foreign currency hedging.

Table of Contents

14. Segment Information

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

The accounting policies of the Company s business segments are the same as those described in the summary of significant accounting policies included elsewhere herein. The Company accounts for intersegment sales at fair value as if the sales were to third parties. While intercompany transactions are treated like third-party transactions to determine segment performance, the revenues (and corresponding expenses recognized by the segment that is counterparty to the transaction) are eliminated in consolidation, therefore, do not themselves impact its consolidated results. All income statement categories exclude the results of discontinued operations. Segment information consists of the following (in millions):

Three Months Ended	**Recorded Music**	**Music Publishing**	**Corporate expenses and eliminations**	**Total**
March 31, 2008				
Revenues	$ 652	$ 155	$ (7)	**$ 800**
OIBDA	70	54	(28)	**96**
Depreciation of property, plant and equipment	(10)	(1)	(2)	**(13)**
Amortization of intangible assets	(38)	(17)		**(55)**
Operating income (loss) from continuing operations	$ 22	$ 36	$ (30)	**$ 28**
March 31, 2007				
Revenues	$ 648	$ 143	$ (7)	**$ 784**
OIBDA	55	53	(28)	**80**
Depreciation of property, plant and equipment	(6)	(1)	(3)	**(10)**
Amortization of intangible assets	(36)	(14)	(1)	**(51)**
Operating income (loss) from continuing operations	$ 13	$ 38	$ (32)	**$ 19**

Six Months Ended	**Recorded Music**	**Music Publishing**	**Corporate expenses and eliminations**	**Total**
March 31, 2008				
Revenues	$ 1,502	$ 299	$ (12)	**$ 1,789**
OIBDA	206	75	(56)	**225**
Depreciation of property, plant and equipment	(19)	(2)	(5)	**(26)**
Amortization of intangible assets	(76)	(33)		**(109)**
Operating income (loss) from continuing operations	$ 111	$ 40	$ (61)	**$ 90**
March 31, 2007				
Revenues	$ 1,448	$ 276	$ (12)	**$ 1,712**
OIBDA	196	72	(48)	**220**
Depreciation of property, plant and equipment	(12)	(2)	(6)	**(20)**
Amortization of intangible assets	(72)	(29)		**(101)**
Operating income (loss) from continuing operations	$ 112	$ 41	$ (54)	**$ 99**

16

Table of Contents

15. Additional Financial Information

Cash Interest and Taxes

The Company made interest payments of approximately $80 million and $73 million during the six months ended March 31, 2008 and 2007, respectively. The Company paid approximately $36 million and $37 million of income and withholding taxes in the six months ended March 31, 2008 and 2007, respectively. The Company received $3 million and $6 million of income tax refunds in the six months ended March 31, 2008 and 2007, respectively.

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.

Table of Contents

WARNER MUSIC GROUP CORP.

Supplementary Information

Consolidating Balance Sheet (unaudited)

March 31, 2008

	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	$ 98	$	$ 151	$	$ 249
Accounts receivable, net			482		482
Inventories			61		61
Royalty advances expected to be recouped within one year			200		200
Deferred tax assets			49		49
Other current assets			30		30
Total current assets	98		973		1,071
Royalty advances expected to be recouped after one year			242		242
Investments in and advances (from) to consolidated subsidiaries	(201)	15		186	
Investments			182		182
Property, plant and equipment, net			128		128
Goodwill			1,074		1,074
Intangible assets subject to amortization, net			1,651		1,651
Intangible assets not subject to amortization			100		100
Other assets		4	80		84
Total assets	$ (103)	$ 19	$ 4,430	$ 186	$ 4,532
Liabilities and shareholders (deficit) equity:					
Current liabilities:					
Accounts payable	$	$	$ 214	$	$ 214
Accrued royalties			1,268		1,268
Taxes and other withholdings	2		24		26
Dividends payable	1				1
Current portion of long-term debt			17		17
Other current liabilities			358		358
Total current liabilities	3		1,881		1,884
Long-term debt		220	2,038		2,258
Deferred tax liabilities, net			250		250
Other noncurrent liabilities	(3)		246		243
Total liabilities		220	4,415		4,635
Shareholders (deficit) equity	(103)	(201)	15	186	(103)

Total liabilities and shareholders (deficit) equity	$ (103)	$ 19	$ 4,430	$ 186	$ 4,532

Table of Contents

WARNER MUSIC GROUP CORP.

Supplementary Information

Consolidating Balance Sheet (audited)

September 30, 2007

	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp.	Eliminations	Warner Music Group Corp. Consolidated
			(in millions)		
Assets:					
Current assets:					
Cash and equivalents	$ 74	$	$ 259	$	$ 333
Due (to) from affiliates	(2)		2		
Accounts receivable, net			555		555
Inventories			58		58
Royalty advances expected to be recouped within one year			176		176
Deferred tax assets			40		40
Other current assets			33		33
Total current assets	72		1,123		1,195
Royalty advances expected to be recouped after one year			216		216
Investments in and advances (from) to consolidated subsidiaries	(85)	121		(36)	
Investments			146		146
Property, plant and equipment			133		133
Goodwill			1,047		1,047
Intangible assets subject to amortization			1,632		1,632
Intangible assets not subject to amortization			100		100
Assets of discontinued operations			18		18
Other assets		4	81		85
Total assets	$ (13)	$ 125	$ 4,496	$ (36)	$ 4,572
Liabilities and Shareholders (Deficit) Equity:					
Current liabilities:					
Accounts payable	$	$	$ 225	$	$ 225
Accrued royalties			1,226		1,226
Taxes and other withholdings	2		31		33
Dividends payable	23				23
Current portion of long-term debt			17		17
Other current liabilities			358		358
Total current liabilities	25		1,857		1,882
Long-term debt		210	2,046		2,256
Dividends payable	1				1
Deferred tax liabilities, net			244		244
Other noncurrent liabilities	(3)		228		225

Total liabilities	23	210	4,375		4,608
Shareholders (deficit) equity	(36)	(85)	121	(36)	(36)
Total liabilities and shareholders (deficit) equity	$ (13)	$ 125	$ 4,496	$ (36)	$ 4,572

Table of Contents

WARNER MUSIC GROUP CORP.

Supplementary Information

Consolidating Statements of Operations (unaudited)

For The Three Months Ended March 31, 2008 and 2007

	Three months ended March 31, 2008				
	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	Warner Music Group Corp. Consolidated
Revenues	$	$	$ 800	$	$ 800
Costs and expenses:					
Cost of revenues			(413)		(413)
Selling, general and administrative expenses			(304)		(304)
Amortization of intangible assets			(55)		(55)
Total costs and expenses			(772)		(772)
Operating income from continuing operations			28		28
Interest expense, net		(5)	(42)		(47)
Equity in the (losses) income of consolidated subsidiaries	(37)	(32)		69	
Other loss, net			(2)		(2)
(Loss) income from continuing operations before income taxes	(37)	(37)	(16)	69	(21)
Income tax expense			(13)		(13)
(Loss) income from continuing operations	$ (37)	$ (37)	$ (29)	$ 69	$ (34)
Loss from discontinued operations, net of taxes			(3)		(3)
Net (loss) income	$ (37)	$ (37)	$ (32)	$ 69	$ (37)

	Three months ended March 31, 2007				
	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	Warner Music Group Corp. Consolidated
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 asset			(51)		(51)
Total costs and expenses			(765)		(765)

Operating income from continuing operations						19			19
Interest expense, net	1		(4)		(42)				(45)
Equity in the (losses) income of consolidated subsidiaries	(28)		(24)				52		
(Loss) income from continuing operations before income taxes	(27)		(28)		(23)		52		(26)
Income tax expense					(1)				(1)
(Loss) income from continuing operations	$ (27)	$	(28)	$	(24)	$	52	$	(27)
Loss from discontinued operations, net of taxes									
Net (loss) income	$ (27)	$	(28)	$	(24)	$	52	$	(27)

Table of Contents

WARNER MUSIC GROUP CORP.

Supplementary Information

Consolidating Statements of Operations (unaudited)

For The Six Months Ended March 31, 2008 and 2007

	Six months ended March 31, 2008				
	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	Warner Music Group Corp. Consolidated
Revenues	$	$	$ 1,789	$	$ 1,789
Costs and expenses:					
Cost of revenues			(958)		(958)
Selling, general and administrative expenses			(635)		(635)
Other income, net			3		3
Amortization of intangible assets			(109)		(109)
Total costs and expenses			(1,699)		(1,699)
Operating income from continuing operations			90		90
Interest expense, net		(10)	(85)		(95)
Minority interest expense			(2)		(2)
Equity in the (losses) income of equity method investees	(53)	(43)	1	96	1
Other loss, net			(3)		(3)
(Loss) income from continuing operations before income taxes	(53)	(53)	1	96	(9)
Income tax expense			(23)		(23)
(Loss) income from continuing operations	$ (53)	$ (53)	$ (22)	$ 96	$ (32)
Loss from discontinued operations, net of taxes			(21)		(21)
Net (loss) income	$ (53)	$ (53)	$ (43)	$ 96	$ (53)

	Six months ended March 31, 2007				
	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp.	Eliminations	Warner Music Group Corp. Consolidated
					(in millions)
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 from continuing operations			99		99
Interest expense, net	1	(9)	(84)		(92)
Equity in the (losses) income of consolidated subsidiaries	(10)	(1)		11	
(Loss) income from continuing operations before income taxes	(9)	(10)	15	11	7
Income tax expense			(16)		(16)
(Loss) income from continuing operations	$ (9)	$ (10)	$ (1)	$ 11	$ (9)
Loss from discontinued operations, net of taxes					
Net (loss) income	$ (9)	$ (10)	$ (1)	$ 11	$ (9)

Table of Contents

WARNER MUSIC GROUP CORP.

Supplementary Information

Consolidating Statement of Cash Flows (unaudited)

For The Six Months Ended March 31, 2008

	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	Consolidated
Cash flows from operating activities:					
Net (loss) income	$ (53)	$ (53)	$ (43)	$ 96	$ (53)
Loss from discontinued operations, net of tax			21		21
(Loss) income from continued operations	(53)	(53)	(22)	96	(32)
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:					
Depreciation and amortization			135		135
Deferred taxes			(15)		(15)
Non-cash interest expense		10	14		24
Non-cash stock compensation expense			4		4
Other non-cash items			(1)		(1)
Equity in the income of equity-method investees			(1)		(1)
Equity in the loss (income) of consolidated subs	53	43		(96)	
Minority interest			2		2
Changes in operating assets and liabilities:					
Accounts receivable			94		94
Royalty advances			(38)		(38)
Inventories					
Accounts payable and accrued liabilities			(69)		(69)
Other balance sheet changes	(5)		(2)		(7)
Net cash (used in) provided by operating activities	(5)		101		96
Cash flows from investing activities:					
Loans to third parties			(3)		(3)
Investments and acquisitions			(134)		(134)
Proceeds from the sale of shares			5		5
Capital expenditures			(20)		(20)
Net cash (used in) provided by investing activities			(152)		(152)
Cash flows from financing activities:					
Quarterly debt repayments			(8)		(8)
Increase in intercompany	3		(3)		
Return of capital and dividends paid	(42)	(68)	(68)	136	(42)
Return of capital received	68	68		(136)	
Net cash provided by (used in) financing activities	29		(79)		(50)
Effect of foreign currency exchange rate changes on cash			22		22

Net increase (decrease) in cash and equivalents	24	(108)	(84)
Cash and equivalents at beginning of period	74	259	333
Cash and equivalents at end of period	$ 98	$ 151	$ 249

Table of Contents

WARNER MUSIC GROUP CORP.

Supplementary Information

Consolidating Statement of Cash Flows (unaudited)

For The Six Months Ended March 31, 2007

	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	Consolidated
Cash flows from operating activities:					
Net (loss) income	$ (9)	$ (10)	$ (1)	$ 11	$ (9)
Loss from discontinued operations, net of tax					
(Loss) income from continued operations	(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 losses (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	1		106		107
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	18		(87)		(69)
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	41		(87)		(46)
			3		3

Effect of foreign currency exchange rate changes on cash							
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	$ 101	$	$	261	$	$	362

24

Table of Contents

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

You should read the following discussion of our results of operations and financial condition with the unaudited interim financial statements included elsewhere in this Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2008 (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 the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements other than statements of historical facts included in this Quarterly Report, including, without limitation, statements regarding our future financial position, business strategy, budgets, projected costs, cost savings, industry trends and plans and objectives of management for future operations, are forward-looking statements. In addition, forward-looking statements generally can be identified by the use of forward-looking terminology such as may, will, expect, intend, estimate, anticipate, believe or continue or the negative thereof or variations thereon or similar te 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 capitalize on the growth areas of the music industry, to effectively deploy our capital including the level and success of future A&R investments, 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, the success of strategic actions we are taking to accelerate our transformation as we redefine our role in the music industry, our success in limiting piracy, our ability to compete in the highly competitive markets in which we operate, the growth of the music industry and the effect of our and the music industry s efforts to combat piracy on the industry, our intentions with respect to our dividend policy, our ability to fund our future capital needs and the effect of litigation on us. Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to have been correct.

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

- the impact of our substantial leverage on our ability to raise additional capital to fund our operations, on our ability to react to changes in the economy or our industry and on our ability to meet our obligations under our indebtedness;
- the continued decline in the global recorded music industry and the rate of overall decline in the music industry;
- our ability to continue to identify, sign and retain desirable talent at manageable costs;
- the threat posed to our business by piracy of music by means of home CD-R activity, Internet peer-to-peer file-sharing and sideloading of unauthorized content;
- the significant threat posed to our business and the music industry by organized industrial piracy;
- the popular demand for particular recording artists and/or songwriters and albums and the timely completion of albums by major recording artists and/or songwriters;

the diversity and quality of our portfolio of songwriters;

the diversity and quality of our album releases;

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

our involvement in intellectual property litigation;

the possible downward pressure on our pricing and profit margins;

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 businesses;

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 and the Department of Justice;

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;

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

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. was formed by the Investor Group on November 21, 2003. The Company is the direct parent of Holdings, which is the direct parent of Acquisition Corp. Acquisition Corp is one of the world s major music companies and the successor to the interests of the Recorded Music and Music Publishing businesses of Time Warner. Effective March 1, 2004, Acquisition Corp acquired such interests from Time Warner for approximately $2.6 billion. The original Investor Group included affiliates of THL, affiliates of Bain, affiliates of Providence and Music Capital. Music Capital s partnership agreement required that the Music Capital partnership dissolve and commence winding up by the second anniversary of the Company s May 2005 initial public offering. As a result, on May 7, 2007, Music Capital made a pro rata distribution of all shares of common stock of the Company held by it to its partners. The shares held by Music Capital had been subject to a stockholders agreement among Music Capital, THL, Bain and Providence and certain other parties. As a result of the distribution, the shares distributed by Music Capital ceased to be subject to the voting and other provisions of the stockholders agreement and Music Capital was no longer part of the Investor Group subject to the stockholders agreement.

The Company 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.

Table of Contents

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 month ended March 31, 2008 and 2007. 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, 2008 and 2007, as well as a discussion of our financial condition and liquidity as of March 31, 2008. 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.

Use of OIBDA

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

Use of Constant Currency

As exchange rates are an important factor in understanding period to period comparisons, we believe the presentation of results on a constant-currency basis in addition to reported results helps improve the ability to understand our operating results and evaluate our performance in comparison to prior periods. Constant-currency information compares results between periods as if exchange rates had remained constant period-over-period. We use results on a constant-currency basis as one measure to evaluate our performance. We calculate constant-currency by translating prior-year results at current year foreign currency exchange rates. We generally refer to such amounts calculated on a constant-currency basis as excluding the impact of foreign currency exchange rates . These results should be considered in addition to, not as a substitute for, results reported in accordance with GAAP. Results on a constant-currency basis, as we present them, may not be comparable to similarly titled measures used by other companies and is not a measure of performance presented in accordance with 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 months ended March 31, 2008 are not necessarily indicative of the results that may be expected for fiscal year ending September 30, 2008.

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 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, a division that specializes in marketing our music catalog through compilations and reissuances of previously released music and video titles, as well as in the licensing of recordings to and from third parties for various uses, including film and television soundtracks.

On May 31, 2006, the Company completed the acquisition of Ryko, a leading independent, integrated music and entertainment company. On January 29, 2007, the Company acquired a majority interest in Roadrunner, which includes Roadrunner Records, one of the leading hard rock and heavy metal labels. We also conduct our Recorded Music operations through a collection of additional record labels, including, among others, Asylum, Bad Boy, Cordless, East West, Elektra, Lava, Nonesuch, Reprise, Sire and Word.

Outside the U.S., our recorded music activities are conducted in more than 50 countries through WMI and its various subsidiaries, affiliates and non-affiliated licensees. WMI engages in the same activities as our U.S. labels: discovering and signing

artists and distributing, marketing and selling their recorded music. In most cases, WMI also markets and distributes the records of those artists for whom our 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 WEA Corp, which markets and sells music and DVD products to retailers and wholesale distributors in the U.S.; ADA, which distributes the products of independent labels to retail and wholesale distributors in the U.S.; Ryko Distribution, which distributes music and DVD releases from Rykodisc, Ryko s record 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 the ADA U.K., which provides ADA s distribution services outside of the U.S. through a network of affiliated and non-affiliated distributors.

We play an integral role in virtually all aspects of the music value chain from discovering and developing talent, to producing albums and promoting artists and their products. After an artist has entered into a contract with one of our record labels, a master recording of the artist s music is created and replicated for sale to consumers both in the digital as well as the physical (primarily CD) format.

Our recorded music products are sold through multiple channels. Digital music content is generally sold through two primary channels: online and mobile. Digital recorded music products are sold to online digital retailers such as Apple s iTunes and mobile full-track download stores such as those operated by Verizon or Sprint. Both digital and physical recorded music are also sold to online physical retailers such as Amazon.com, barnesandnoble.com, bestbuy.com and walmart.com. In the U.S., WEA Corp., ADA, Ryko Distribution and Word market, sell and deliver physical product, either directly or through sub-distributors and wholesalers, to thousands of record stores, mass merchants and other retailers.

The sale of digital content is now integrated within all aspects of our Recorded Music and Music Publishing businesses, including A&R, marketing, promotion and distribution. We believe existing and new digital businesses will be a significant source of growth for the next several years and will provide new opportunities to monetize its assets and create new revenue streams.

In addition, our new media executives work closely with the A&R departments of our labels to ensure that while a record is being made, digital assets are also created with all of our distribution channels in mind, including subscription services such as Rhapsody and satellite radio, social networking sites such as MySpace and imeem, user-generated content sites such as YouTube, Internet portals, online video and music-centered destinations, such as Joost and Slacker. We also work side by side with its mobile and online partners to test new concepts.

As a music content company, we have assets beyond our recorded music and music publishing catalogs, such as our music video library, that we now has the opportunity to monetize through digital channels. As an owner of musical content, we believe we are well positioned to take advantage of growth in digital distribution and emerging technologies to maximize the value of our assets.

The proportion of digital revenues attributed to each distribution channel varies by region, and since digital music is in the early stages of growth, proportions may change as the roll-out of new technologies continues.

We are also diversifying our revenues beyond our traditional businesses by partnering with artists in other areas of their careers. We are building capabilities and platforms for exploiting a broader set of music-related rights to participate across the artist brands we help create. Expansion of our capabilities in this area have included strategic acquisitions and partnerships with companies involved in artist management, merchandising, strategic marketing and brand management, ticketing and touring, original programming and video entertainment. We believe enhancement of these capabilities will permit us to diversify revenue streams to better capitalize on the growth areas of the music industry, permit us to build stronger, long-term relationships with artists and more effectively connect artists and fans.

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., Hallmark Entertainment, Disney Music Publishing, New Line Cinema and Warner Bros. Studios. In 2007, we entered the production music library business with the acquisition of Non-Stop Music. Production music is a complementary alternative to licensing standards and contemporary hits for television, film and advertising producers.

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.

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

Realignment Plan for Fiscal Year 2007

In the second quarter of 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 included 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 was 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 plan consisted 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 continued 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 also resulted in the outsourcing of some back-office functions as a cost-savings measure.

Table of Contents

The changes described above were implemented in fiscal year 2007. The Company incurred substantially all of the costs associated with the realignment plan in fiscal year 2007. This included approximately $50 million of restructuring costs and $13 million of implementation costs, primarily all of which were paid in cash. In connection with the plan, the Company reduced headcount by approximately 400 employees. The Company expects that the majority of any cost savings will be offset by new business initiatives in areas related to digital distribution and video.

Table of Contents

RESULTS OF OPERATIONS

Three Months Ended March 31, 2008 Compared to Three Months Ended March 31, 2007

Consolidated Historical Results

Revenues

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

	Three Months Ended March 31,		*2008 vs 2007*	
	2008	**2007**	**$ Change**	**% Change**
Revenue by Type				
Physical sales	$ 447	$ 489	$ (42)	-9%
Digital	155	105	50	48%
Licensing	50	54	(4)	-7%
Total Recorded Music	**652**	**648**	**4**	**1%**
Mechanical	57	58	(1)	-2%
Performance	61	53	8	15%
Synchronization	21	21		
Digital	9	6	3	50%
Other	7	5	2	40%
Total Music Publishing	**155**	**143**	**12**	**8%**
Intersegment elimination	(7)	(7)		
Total Revenue	**$ 800**	**$ 784**	**$ 16**	**2%**
Revenue by Geographical Location				
U.S. Recorded Music	$ 297	$ 358	$ (61)	-17%
U.S. Publishing	64	61	3	5%
Total U.S.	**361**	**419**	**(58)**	**-14%**
International Recorded Music	355	290	65	22%
International Publishing	91	82	9	11%
Total International	**446**	**372**	**74**	**20%**
Intersegment eliminations	(7)	(7)		
Total Revenue	**$ 800**	**$ 784**	**$ 16**	**2%**

Total Revenue

Total revenues increased by $16 million, or 2%, to $800 million, from $784 million for the three months ended March 31, 2007. Excluding the favorable impact of foreign currency exchange rates, total revenues decreased $30 million or 4%. Recorded Music and Music Publishing revenues comprised 81% and 19% of the total revenues for the three months ended March 31, 2008, respectively, compared to 83% and 17% for the three months ended March 31, 2007, respectively. U.S. and international revenues comprised 45% and 55% of total revenues for the three months ended March 31, 2008, compared to 53% and 47% for the three months ended March 31, 2007, respectively.

Total digital revenues increased by $53 million, or 48%, to $164 million from $111 million for the three months ended March 31, 2007. Excluding the favorable impact of foreign currency exchange rates, total digital sales increased by $50 million. Total digital revenue represented

21% and 14% of consolidated revenues for the three months ended March 31, 2008 and March 31, 2007, respectively. Total digital revenues for the three months ended March 31, 2008 were comprised of U.S. revenues of $105 million, or 64% of total digital revenues, and international revenues of $59 million, or 36% of total digital revenues. Total digital revenues for the three months ended March 31, 2007 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.

Recorded Music revenues increased by $4 million from $648 million for the three months ended March 31, 2007. Excluding the favorable impact of foreign currency exchange rates, total Recorded Music revenues decreased $30 million or 4%, for the three months ended March 31, 2008. This performance was tempered by the ongoing transition in the recorded music industry, which is characterized by a shift in consumption patterns from physical sales to new forms of digital music and the continued impact of digital piracy. The decrease was primarily attributable to a decrease of $67 million in physical sales and $10 million in licensing revenues, partially offset by an increase in digital sales of $47 million. The decrease in physical sales was driven by the timing of releases and declines in the physical business, which are not currently being fully offset by growth in the digital business, though digital performance was quite strong. In addition, U.S. retailers are more actively managing their inventory levels in response to the tougher economy and credit markets as well as the changing underlying demand for physical recorded music product. The increase in digital revenues

reflects continued growth and development of new distribution channels and continued proliferation of digital as a preferred means of consumption, digital marketing efforts and the release of a number of popular tracks and ringtones that sold a significant number of units in the quarter. In both the U.S. and internationally, online is now a larger share of our business than mobile.

Music Publishing revenues increased to $155 million for the three months ended March 31, 2008 as compared to $143 million for the three months ended March 31, 2007. Excluding the favorable impact of foreign currency exchange rates, total Music Publishing revenues remained constant year over year.

Revenue by Geographical Location

U.S. revenues decreased by $58 million, or 14%, due to a decrease of $87 million in physical sales. Period-over-period differences in the U.S. Recorded Music business were due to the timing of releases and declines in the physical business, which are not currently being fully offset by growth in the digital business, though digital performance was quite strong. In addition, U.S. retailers are more actively managing their inventory levels in response to the tougher economy and credit markets as well as the changing underlying demand for physical recorded music product. This was offset by an increase of $24 million in digital revenues which was due primarily to the continued growth of digital distribution channels, digital marketing efforts and the release of a number of popular tracks and ringtones that sold a significant number of units in the quarter.

International revenues increased by $74 million, or 20%, from $372 million for the three months ended March 31, 2008. Excluding the favorable impact of foreign currency exchange rates, total international revenues increased $28 million, or 7%, for the three months ended March 31, 2008. This increase was primarily related to an increase of $20 million in physical sales and an increase of $23 million in digital revenues. The increase in physical sales primarily relates to a larger number of top-selling albums in international territories, primarily in Asia and Europe. The increase in digital revenues reflects continued growth and development of new distribution channels and continued proliferation of digital as a preferred means of consumption and digital marketing efforts. Offsetting these increases were decreases of $12 million of licensing revenues and $3 million of international Music Publishing revenues. The decrease in international Music Publishing revenues primarily relates to a decrease in mechanical revenue.

Cost of revenues

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

	Three Months Ended March 31,		*2008 vs 2007*	
	2008	**2007**	**$ Change**	**% Change**
Artist and repertoire costs	$ 268	$ 260	$ 8	3%
Product costs	121	149	(28)	-19%
Licensing costs	24	18	6	33%
Total cost of revenues	**$ 413**	**$ 427**	**$ (14)**	**-3%**

Our cost of revenues decreased by $14 million, or 3%, from $427 million for the three months ended March 31, 2007. Excluding the impact of foreign currency exchange rates, our cost of revenues decreased $41 million, or 9%, for the three months ended March 31, 2008. Expressed as a percent of revenues, cost of revenues was 52% and 54% for the three months ended March 31, 2008 and 2007, respectively.

Artist and repertoire costs increased as a percentage of revenues from 33% in the three months ended March 31, 2007 to 34% in the three months ended March 31, 2008 driven primarily by higher copyright royalty rates on digital products sold in the quarter compared with those in the prior year period.

Product costs decreased from 19% of revenues in the three months ended March 31, 2007 to 15% of revenues in the three months ended March 31, 2008. The decrease was largely due to a change in product mix, from physical to digital.

Table of Contents

Selling, general and administrative expenses

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

	Three Months Ended March 31,		*2008 vs 2007*	
	2008	**2007**	**$ Change**	**% Change**
General and administrative expense (1)	$ 148	$ 130	$ 18	14%
Selling and marketing expense	132	130	2	2%
Distribution expense	24	15	9	60%
Total selling, general and administrative expense	**$ 304**	**$ 275**	**$ 29**	**11%**

(1) Includes depreciation expense of $13 million and $10 million for the three months ended March 31, 2008, and 2007, respectively.
Selling, general and administrative expenses increased by $29 million, or 11%, to $304 million for the three months ended March 31, 2008. Excluding the impact of foreign currency exchange rates, selling, general and administrative expenses increased $18 million, or 6%, for the three months ended March 31, 2008. Expressed as a percent of revenues, selling, general and administrative expenses were 38% and 35% for the three months ended March 31, 2008 and 2007, respectively.

General and administrative costs increased by $18 million compared to the three months ended March 31, 2007. The increase in general and administrative costs reflects recent acquisitions and various upgrades to our IT infrastructure, including financial reporting systems.

Distribution costs increased by $9 million compared to the three months ended March 31, 2007. The increase in distribution costs primarily reflects a change in bad debt expense from the prior year.

Reconciliation of Consolidated Historical OIBDA to Operating Income and Net Loss

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

	Three Months Ended March 31,		*2008 vs 2007*	
	2008	**2007**	**$ Change**	**% Change**
OIBDA	$ 96	$ 80	$ 16	20%
Depreciation expense	(13)	(10)	(3)	30%
Amortization expense	(55)	(51)	(4)	8%
Operating income from continuing operations	**28**	**19**	**9**	**47%**
Interest expense, net	(47)	(45)	(2)	4%
Other expense, net	(2)		(2)	
Loss from continuing operations before income taxes	**(21)**	**(26)**	**5**	**-19%**
Income tax expense	(13)	(1)	(12)	1200%
Loss from continuing operations	**(34)**	**(27)**	**(7)**	**26%**
Loss from discontinued operations, net of taxes	(3)		(3)	
Net Loss	**$ (37)**	**$ (27)**	**$ (10)**	**37%**

OIBDA

Our OIBDA increased by $16 million to $96 million for the three months ended March 31, 2008 as compared to $80 million for the three months ended March 31, 2007. Excluding the impact of foreign currency exchange rates, OIBDA increased $8 million, or 9%, for the three months ended March 31, 2008. Expressed as a percentage of revenues, total OIBDA margin was 12% for the three months ended March 31, 2008 as compared to 10% for the three months ended March 31, 2007. The increase in OIBDA primarily relates to the change in product mix for the quarter and $12 million of restructuring costs incurred in the prior-year quarter.

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

Table of Contents

Depreciation expense

Our depreciation expense increased by $3 million, or 30%, to $13 million for three months ended March 31, 2008. The increase primarily relates to additional depreciation related to new assets resulting from higher capital spending along with acquisitions and investments in IT infrastructure.

Amortization expense

Amortization expense for the three months ended March 31, 2008 increased by $4 million, or 8%, to $55 million. Excluding the impact of foreign currency exchange rates, amortization expense increased by $3 million, which relates to additional amortization associated with recent acquisitions of certain recorded music catalog assets, including Roadrunner and Frank Sinatra Enterprises, and the acquisition of various music publishing copyrights.

Operating income from continuing operations

Our operating income from continuing operations increased $9 million, to $28 million for the three months ended March 31, 2008 as compared to $19 million for the prior year. The increase in operating income was primarily a result of the $12 million in restructuring costs incurred in the prior-year quarter.

Interest expense, net

Our interest expense, net, increased $2 million to $47 million for the three months ended March 31, 2008 as compared to $45 million for the three months ended March 31, 2007. This was the result of the fluctuations in interest income earned on our cash balances.

See Financial Condition and Liquidity for more information.

Other expense, net

Other expense, net for the three months ended March 31, 2008 reflects currency exchange movements associated with inter-company receivables and payables that are short term in nature and realized gains and losses on certain foreign currency hedging activities.

Income tax expense

Income tax expense was $13 million for the three months ended March 31, 2008 compared to $1 million for the three months ended March 31, 2007. The increase in tax expense is primarily related to an increase in income earned by our foreign affiliates compared to the prior-year quarter. There is no tax benefit realized from any related U.S. losses as a full valuation allowance exists.

Loss from continuing operations

Our loss from continuing operations increased by $7 million, to a loss of $34 million for the three months ended March 31, 2008 as compared to loss of $27 million for the three months ended March 31, 2007. The increase in the loss from continuing operations is primarily the result of an increase in income tax expense.

Loss from discontinued operations

We recorded a loss from discontinued operations related to the decision to shut down the operations of Bulldog Entertainment (Bulldog), an entertainment services company. In connection with shutting down the operations of Bulldog, the Company incurred a loss related to the impairment of goodwill recorded at the time of the initial acquisition. The loss from discontinued operations includes severance and other costs incurred in order to shut down the operations of Bulldog during the three months ended March 31, 2008.

Net loss

Our net loss increased by $10 million, to a net loss of $37 million for the three months ended March 31, 2008 as compared to net loss of $27 million for the three months ended March 31, 2007. The increase in the net loss is primarily the result of an increase in income tax expense.

Business Segment Results

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

	Three Months Ended March 31,		2008 vs 2007	
	2008	2007	$ Change	% Change
Recorded Music				
Revenue	$ 652	$ 648	$ 4	1%
OIBDA	70	55	15	27%
Operating income from continuing operations	$ 22	$ 13	$ 9	69%
Music Publishing				
Revenue	$ 155	$ 143	$ 12	8%
OIBDA	54	53	1	2%
Operating income from continuing operations	$ 36	$ 38	$ (2)	-5%
Corporate expenses and eliminations				
Revenue	$ (7)	$ (7)	$	
OIBDA	(28)	(28)		
Operating loss from continuing operations	$ (30)	$ (32)	$ 2	-6%
Total				
Revenue	$ 800	$ 784	$ 16	2%
OIBDA	96	80	16	20%
Operating income from continuing operations	$ 28	$ 19	$ 9	47%

Recorded Music

Revenues

Recorded Music revenues increased by $4 million, or 1%, to $652 million for the three months ended March 31, 2008 from $648 million for the three months ended March 31, 2007. Excluding the impact of foreign currency exchange rates, total Recorded Music revenues decreased $30 million, or 4% for the three months ended March 31, 2008. Recorded Music revenues represented 81% of consolidated revenues, prior to corporate and revenue eliminations, for each of the three months ended March 31, 2008 and 2007. International Recorded Music revenues were $355 million and $290 million, or 54% and 45% of consolidated Recorded Music revenues for the three months ended March 31, 2008 and 2007, respectively.

The decrease in Recorded Music revenues, excluding the impact of foreign currency exchange rates, was primarily attributable to a decrease in physical sales of $67 million, or 13% for the three months ended March 31, 2008. The decrease in physical sales was driven by the timing of releases and declines in the physical business, which are not currently being fully offset by growth in the digital business, though digital performance was quite strong. In addition, U.S. retailers are more actively managing their inventory levels in response to the tougher economy and credit markets as well as the changing underlying demand for physical recorded music product. The decreases to Recorded Music physical revenues were partially offset by the increases in digital revenues of $47 million, or 44%. The increase in digital revenue reflects the continued growth and development of new distribution channels and the continued proliferation of digital as a preferred means of consumption, digital marketing efforts and the release of a number of popular tracks and ringtones that sold a significant number of units in the quarter. The increase was comprised of an increase in U.S. digital sales of $24 million and an increase in international digital sales of $23 million. Digital sales comprised approximately 24% of Recorded Music revenues for the three months ended March 31, 2008, up from 16% of Recorded Music revenues in the three months ended March 31, 2007 which is reflective of the shifting of the market to digital media from physical media. This was offset in part by revenue from new business initiatives including touring, artist management, and merchandise sales.

OIBDA and Operating income from continuing operations

Recorded Music OIBDA was $70 million for the three months ended March 31, 2008 as compared to $55 million for the three months ended March 31, 2007. Recorded Music operating income from continuing operations included the following (in millions):

	Three Months Ended March 31,		2008 vs 2007	
	2008	2007	$ Change	% Change
OIBDA	$ 70	$ 55	$ 15	27%
Depreciation and amortization	(48)	(42)	(6)	14%
Operating income from continuing operations	**$ 22**	**$ 13**	**$ 9**	**69%**

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

	Three Months Ended March 31,		2008 vs 2007	
	2008	2007	$ Change	% Change
Artist and repertoire costs	$ 189	$ 189	$	
Product costs	121	149	(28)	-19%
Licensing	24	18	6	33%
Total cost of revenues	**$ 334**	**$ 356**	**$ (22)**	**-6%**

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

	Three Months Ended March 31,		2008 vs 2007	
	2008	2007	$ Change	% Change
General and administrative expense (1)	$ 107	$ 90	$ 17	19%
Selling and marketing expense	127	127		
Distribution expense	24	15	9	60%
Total selling, general and administrative expense	**$ 258**	**$ 232**	**$ 26**	**11%**

(1) Includes depreciation expense of $10 million and $6 million for the three months ended March 31, 2008 and 2007, respectively.

Recorded Music operating income from continuing operations increased by $9 million, or 69% due to the increases in OIBDA described below.

Recorded Music OIBDA increased by $15 million, or 27%, to $70 million for the three months ended March 31, 2008 compared to $55 million for the three months ended March 31, 2007. Expressed as a percentage of Recorded Music revenues, Recorded Music OIBDA was 11% and 8% for the three months ended March 31, 2008 and 2007, respectively. Excluding the impact of foreign currency exchange rates, OIBDA increased by $10 million due primarily to $11 million of restructuring costs incurred in the prior year quarter and the change in product mix for the quarter.

Cost of revenues

Recorded Music cost of revenues expenses decreased $22 million, or 6% for the three months ended March 31, 2008. Excluding the impact of foreign currency exchange rates, Recorded Music cost of revenues decreased by $40 million, or 11%. This was composed of a decrease in product costs of $23 million and a decrease in artist and repertoire costs of $21 million, offset by an increased licensing expense of $4 million. As a percentage of sales, products costs decreased by 2% due primarily to the increase in digital sales and decrease in physical sales and artist and repertoire costs decreased by 2% due primarily to a change in product mix, as the prior-year quarter reflected higher costs related to profit-sharing arrangements. Product costs and artist and repertoire costs decreased in line with the decrease in physical sales and reflected changes in product mix, including increased digital revenues and lower artist and copyright royalty rates.

Selling, general and administrative costs

Recorded Music selling, general and administrative costs increased $26 million, or 11%, for the three months ended March 31, 2008. Excluding the impact of foreign currency exchange rates, selling, general and administrative costs increased by $15 million, or 6%. This increase was primarily the result of an increase in distribution costs as previously described and an increase in general and administrative costs associated with several recent acquisitions and reflects various investments in IT infrastructure. These increases were offset in part by a decrease in marketing costs due to continued cost management efforts and timing of releases.

Table of Contents

Music Publishing

Revenues

Music Publishing revenues increased 8% to $155 million for the three months ended March 31, 2008 as compared to $143 million for the three months ended March 31, 2007. Excluding the favorable impact of foreign currency exchange rates, total Music Publishing revenues were flat year-over-year.

Excluding the impact of foreign currency exchange rates, mechanical and synchronization revenue decreased by $6 million and $1 million, respectively. Mechanical revenue decreased as a result of continued industry-wide declines in physical sales. Excluding the impact of foreign currency exchange rates, performance revenue increased by $2 million and digital revenues increased $3 million as the transition in the recorded music industry continues.

Digital sales represented 6% and 4% of Music Publishing revenues for the three months ended March 31, 2008 and 2007, respectively. Music Publishing revenues represented 19% and 18% of consolidated revenues, prior to corporate and revenue eliminations, for the three months ended March 31, 2008 and 2007, respectively.

OIBDA and Operating income from continuing operations

Music Publishing operating income from continuing operations decreased to $36 million for the three months ended March 31, 2008 as compared to $38 million for the three months ended March 31, 2007. Music Publishing operating income from continuing operations includes the following (in millions):

	Three Months Ended March 31,		*2008 vs 2007*	
	2008	**2007**	**$ Change**	**% Change**
OIBDA	$ 54	$ 53	$ 1	2%
Depreciation and amortization	(18)	(15)	(3)	20%
Operating income	**$ 36**	**$ 38**	**$ (2)**	**-5%**

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

	Three Months Ended March 31,		*2008 vs 2007*	
	2008	**2007**	**$ Change**	**% Change**
Artist and repertoire costs	$ 86	$ 77	$ 9	12%
Total cost of revenues	**$ 86**	**$ 77**	**$ 9**	**12%**

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

	Three Months Ended March 31,		*2008 vs 2007*	
	2008	**2007**	**$ Change**	**% Change**
General and administrative expense (1)	$ 16	$ 14	$ 2	14%
Total selling, general and administrative expense	**$ 16**	**$ 14**	**$ 2**	**14%**

(1) Includes depreciation expense of $1 million for the three months ended March 31, 2008 and 2007, respectively.

Music Publishing operating income from continuing operations decreased by $2 million due to the increase in OIBDA described below offset by an increase in amortization.

Music Publishing OIBDA increased $1 million to $54 million for the three months ended March 31, 2008 as compared to $53 million for the three months ended March 31, 2007. Expressed as a percentage of Music Publishing revenues, Music Publishing OIBDA was 35% and 37% for the three months ended March 31, 2008 and 2007, respectively. Excluding a $1 million favorable impact of foreign currency exchange rates, Music Publishing OIBDA was flat year-over-year.

Cost of revenues

Excluding the impact of foreign currency exchange rates, Music Publishing artist and repertoire costs decreased by $1 million, which was primarily related to the change in revenue mix discussed above as different royalty rates apply to the different revenue streams.

Table of Contents

Selling, general and administrative expenses

Excluding the impact of foreign currency exchange rates, Music Publishing selling, general and administrative costs increased by $1 million. This increase was the result of an increase in general and administrative costs related primarily to a newly acquired business.

Corporate Expenses and Eliminations

Corporate expenses before depreciation and amortization expense remained flat year over year and were $28 million for both the three months ended March 31, 2008 and March 31, 2007.

Table of Contents

Six Months Ended March 31, 2008 Compared to Six Months Ended March 31, 2007

Consolidated Historical Results

Revenues

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

	Six Months Ended March 31,		2008 vs 2007	
	2008	2007	$ Change	% Change
Revenue by Type				
Physical sales	$ 1,107	$ 1,133	$ (26)	-2%
Digital	287	198	89	45%
Licensing	108	117	(9)	-8%
Total Recorded Music	**$ 1,502**	**$ 1,448**	**$ 54**	**4%**
Mechanical	117	117		
Performance	111	100	11	11%
Synchronization	41	39	2	5%
Digital	18	13	5	38%
Other	12	7	5	71%
Total Music Publishing	**$ 299**	**$ 276**	**$ 23**	**8%**
Intersegment elimination	(12)	(12)		
Total Revenue	**$ 1,789**	**$ 1,712**	**$ 77**	**4%**
Revenue by Geographical Location				
U.S. Recorded Music	$ 697	720	$ (23)	-3%
U.S. Publishing	111	105	6	6%
Total U.S.	**$ 808**	**$ 825**	**$ (17)**	**-2%**
International Recorded Music	805	728	77	11%
International Publishing	188	171	17	10%
Total International	**$ 993**	**$ 899**	**$ 94**	**10%**
Intersegment eliminations	(12)	(12)		
Total Revenue	**$ 1,789**	**$ 1,712**	**$ 77**	**4%**

Total Revenue

Total revenues increased by $77 million, or 4%, to $1,789 million, from $1,712 million for the six months ended March 31, 2007. Excluding the favorable impact of foreign currency exchange rates, total revenues decreased $23 million or 1%. Recorded Music and Music Publishing revenues comprised 84% and 16% of total revenues for the six months ended March 31, 2008, respectively, compared to 85% and 15% for the six months ended March 31, 2007, respectively. U.S and international revenues comprised 45% and 55% of total revenues for the six months ended March 31, 2008, respectively, compared to 48% and 52% for the six months ended March 31, 2007, respectively.

Total digital revenues increased by $94 million, or 45% to $305 million, from $211 million for the six months ended March 31, 2007. Excluding the favorable impact of foreign currency exchange rates, total digital sales increased by $88 million or 41%. Total digital revenue represented 17% and 12% of consolidated revenues for the six months ended March 31, 2008 and March 31, 2007, respectively. Total digital revenues for the six months ended March 31, 2008 were comprised of U.S. revenues of $200 million, or 66% of total digital revenues, and international

revenues of $105 million, or 34% of total digital revenues. Total digital revenues for the six months ended March 31, 2007 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. Total digital revenues for the six months ended March 31, 2008 also included $1 million of intersegment eliminations.

Recorded Music revenues increased by $54 million, or 4%, from $1,448 million for the six months ended March 31, 2007. Excluding the favorable impact of foreign currency exchange rates, total Recorded Music revenues decreased $24 million or 2%, for the six months ended March 31, 2008. The decrease was primarily attributable to the decrease of $87 million in physical sales and $20 million in licensing revenues, offset by an increase in digital sales of $83 million. The decrease in physical sales was driven by the timing of releases and declines in the physical business, which are not currently being fully offset for by growth in the digital business,

though digital performance was quite strong. In addition, U.S. retailers are more actively managing their inventory levels in response to the tougher economy and credit markets as well as the changing underlying demand for physical recorded music product. The decrease in licensing revenues is primarily due to the signing of several significant licensing deals in the prior-year quarter. This was offset in part by revenue from new business initiatives including touring, artist management, and merchandise sales. The increase in digital revenues reflects continued growth and development of new distribution channels and continued proliferation of digital as a preferred means of consumption and digital marketing efforts, as well as a rate increase on revenue from satellite radio services in the U.S.

Music Publishing revenues increased to $299 million for the six months ended March 31, 2008 as compared to $276 million for the six months ended March 31, 2007. Excluding the favorable impact of foreign currency exchange rates, total Music Publishing revenues remained constant year over year.

Revenue by Geographical Location

U.S. revenues decreased by $17 million, or 2%, due to a decrease of $59 million in physical sales and $16 million in licensing revenues. Period-over-period differences in the U.S. Recorded Music business were due to the timing of releases and declines in the physical business, which are not currently being fully offset by growth in the digital business, though digital performance was quite strong. In addition, U.S. retailers are more actively managing their inventory levels in response to the tougher economy and credit markets as well as the changing underlying demand for physical recorded music product. The decrease in U.S. licensing revenues is primarily due to the signing of several significant licensing deals in the prior-year period. This was offset by an increase in Recorded Music digital revenue of $52 million which was driven by continued growth of digital distribution channels and digital marketing efforts, the release of a number of popular tracks and ringtones that sold a significant number of units during the six-month period, as well as a rate increase on revenue from satellite radio services in the U.S. In addition, there was an increase in U.S. Music Publishing revenues of $6 million.

International revenues increased by $94 million, or 10%, from $899 million for the six months ended March 31, 2007. Excluding the favorable impact of foreign currency exchange rates, total international revenues decreased $7 million, or 1%, from the six months ended March 31, 2007. This decrease was primarily related to the decrease in international physical sales of $28 million, which was offset in part by an increase of $31 million in international digital sales as well as revenues from new businesses such as touring and artist management. In addition, Music Publishing revenues decreased by $6 million and licensing revenue decreased by $4 million. The international physical sales decrease was driven by the overall industry decline in physical sales and weaker international markets. In addition, the prior-year six-month period reflected significant sales of several successful international releases, primarily in Japan. The declines were primarily experienced in the first fiscal quarter with offsetting increases occurring in the second fiscal quarter. International Music Publishing revenues decreased primarily due to a decrease in mechanical revenue. The increase in digital revenues reflects continued growth and development of new distribution channels and continued proliferation of digital as a preferred means of consumption and digital marketing efforts.

Cost of revenues

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

	Six Months Ended March 31,		*2008 vs 2007*	
	2008	**2007**	**$ Change**	**% Change**
Artist and repertoire costs	$ 612	$ 593	$ 19	3%
Product costs	303	305	(2)	-1%
Licensing costs	43	37	6	16%
Total cost of revenues	**$ 958**	**$ 935**	**$ 23**	**2%**

Our cost of revenues increased by $23 million, or 2%, from $935 million for the six months ended March 31, 2007. Excluding the impact of foreign currency exchange rates, our cost of revenues decreased $37 million, or 4%, for the six months ended March 31, 2008. Expressed as a percent of revenues, cost of revenues was 54% and 55% for the six months ended March 31, 2008 and 2007, respectively.

Artist and repertoire costs decreased as a percentage of revenues from 35% in the six months ended March 31, 2007 to 34% in the six months ended March 31, 2008 driven primarily by lower royalty rates on products sold in the current year period compared with those in the prior year period .

Product costs decreased from 18% of revenues in the six months ended March 31, 2007 to 17% of revenues in the six months ended March 31, 2008, however excluding the impact of foreign currency exchange rates, product costs increased by 1% from 16% of revenues.

Table of Contents

Selling, general and administrative expenses

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

	Six Months Ended March 31,		*2008 vs 2007*	
	2008	2007	$ Change	% Change
General and administrative expense (1)	$ 298	$ 249	$ 49	20%
Selling and marketing expense	293	284	9	3%
Distribution expense	44	32	12	38%
Total selling, general and administrative expense	**$ 635**	**$ 565**	**$ 70**	**12%**

(1) Includes depreciation expense of $26 million and $20 million for the three months ended March 31, 2008, and 2007, respectively.
Selling, general and administrative expenses increased by $70 million, or 12%, to $635 million for the six months ended March 31, 2008. Excluding the impact of foreign currency exchange rates, selling, general and administrative expenses increased $45 million, or 8%, for the six months ended March 31, 2008. Expressed as a percent of revenues, selling, general and administrative expenses were 35% and 33% for the six months ended March 31, 2008 and 2007, respectively.

General and administrative costs increased by $49 million or $41 million, excluding the impact of foreign currency compared to the six months ended March 31, 2007. The increase in general and administrative costs reflects various upgrades to our IT infrastructure, including financial reporting systems, as well as an increase related to recent acquisitions.

Distribution costs increased by $12 million compared to the six months ended March 31, 2007. The increase in distribution costs reflects additional costs related to new business activities, international physical distribution costs and a change in bad debt expense from the prior year.

Other income

Other income of $3 million for the six months ended March 31, 2008 relates primarily to our share of a contingent payment related to the settlement with Kazaa recorded in the prior-year quarter. We previously announced the settlement of a copyright infringement lawsuit with Kazaa and recorded an estimate of amounts we expected to receive. Our share of the settlement amount, including the contingent payment, was received in the first quarter of the fiscal year.

Reconciliation of Consolidated Historical OIBDA to Operating Income and Net Income (Loss)

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 (loss) for purposes of the discussion that follows (in millions):

	Six Months Ended March 31,		*2008 vs 2007*	
	2008	2007	$ Change	% Change
OIBDA	$ 225	$ 220	$ 5	2%
Depreciation expense	(26)	(20)	(6)	30%
Amortization expense	(109)	(101)	(8)	8%
Operating income from continuing operations	**$ 90**	**$ 99**	**$ (9)**	**-9%**
Interest expense, net	(95)	(92)	(3)	3%
Equity in the income of equity-method investees net				