

Warner Music Group Corp.
Form 10-Q
February 02, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2017

OR

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

Commission File Number 001-32502

Warner Music Group Corp.

(Exact name of Registrant as specified in its charter)

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

1633 Broadway

New York, NY 10019

(Address of principal executive offices)

(212) 275-2000

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

There is no public market for the Registrant's common stock. As of February 2, 2018 the number of shares of the Registrant's common stock, par value \$0.001 per share, outstanding was 1,055. All of the Registrant's common stock is owned by affiliates of Access Industries, Inc. The Registrant has filed all Exchange Act reports for the preceding 12 months.

WARNER MUSIC GROUP CORP.

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ITEM 1. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Warner Music Group Corp.

Consolidated Balance Sheets (Unaudited)

	December 31, 2017	September 30, 2017
	(in millions)	
Assets		
Current assets:		
Cash and equivalents	\$ 776	\$ 647
Accounts receivable, net of allowances of \$66 million and \$50 million	499	404
Inventories	38	39
Royalty advances expected to be recouped within one year	142	141
Prepaid and other current assets	47	44
Total current assets	1,502	1,275
Royalty advances expected to be recouped after one year	175	172
Property, plant and equipment, net	213	213
Goodwill	1,688	1,685
Intangible assets subject to amortization, net	2,045	2,090
Intangible assets not subject to amortization	117	117
Deferred tax assets, net	61	97
Other assets	74	69
Total assets	\$ 5,875	\$ 5,718
Liabilities and Equity		
Current liabilities:		
Accounts payable	\$ 166	\$ 208
Accrued royalties	1,406	1,263
Accrued liabilities	401	365
Accrued interest	25	41
Deferred revenue	201	197
Other current liabilities	35	26
Total current liabilities	2,234	2,100
Long-term debt	2,818	2,811
Deferred tax liabilities, net	196	190
Other noncurrent liabilities	306	309
Total liabilities	\$ 5,554	\$ 5,410
Equity:		
Common stock (\$0.001 par value; 10,000 shares authorized; 1,055 shares issued and outstanding)	\$ —	\$ —
Additional paid-in capital	1,128	1,128
Accumulated deficit	(650)	(654)
Accumulated other comprehensive loss, net	(171)	(181)

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Total Warner Music Group Corp. equity	307	293
Noncontrolling interest	14	15
Total equity	321	308
Total liabilities and equity	\$5,875	\$ 5,718

See accompanying notes

3

Warner Music Group Corp.

Consolidated Statements of Operations (Unaudited)

	Three Months Ended December 31, 2017 2016 (in millions)	
Revenue	\$1,045	\$917
Costs and expenses:		
Cost of revenue	(569)	(496)
Selling, general and administrative expenses (a)	(333)	(276)
Amortization expense	(53)	(51)
Total costs and expenses	(955)	(823)
Operating income	90	94
Loss on extinguishment of debt	(1)	(32)
Interest expense, net	(36)	(40)
Other income	4	19
Income before income taxes	57	41
Income tax expense	(52)	(17)
Net income	5	24
Less: Income attributable to noncontrolling interest	(1)	(2)
Net income attributable to Warner Music Group Corp.	\$4	\$22
(a) Includes depreciation expense of:	\$(12)	\$(12)

See accompanying notes

Warner Music Group Corp.

Consolidated Statements of Comprehensive Income (Loss) (Unaudited)

	Three Months Ended December 31, 2017 2016 (in millions)	
Net income	\$ 5	\$ 24
Other comprehensive income (loss), net of tax:		
Foreign currency adjustment	9	(37)
Deferred gains (losses) on derivative financial instruments	1	(2)
Other comprehensive income (loss), net of tax	10	(39)
Total comprehensive income (loss)	15	(15)
Less: Income attributable to noncontrolling interest	(1)	(2)
Comprehensive income (loss) attributable to Warner Music Group Corp.	\$ 14	\$(17)

See accompanying notes

Warner Music Group Corp.

Consolidated Statements of Cash Flows (Unaudited)

	Three Months Ended December 31, 2017 2016 (in millions)	
Cash flows from operating activities		
Net income	\$5	\$24
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	65	63
Unrealized losses/gains and remeasurement of foreign denominated loans	5	(17)
Deferred income taxes	42	(2)
Loss on extinguishment of debt	1	32
Net gain on investments	(7)	—
Non-cash interest expense	1	3
Equity-based compensation expense	18	10
Changes in operating assets and liabilities:		
Accounts receivable	(93)	(65)
Inventories	2	3
Royalty advances	(5)	1
Accounts payable and accrued liabilities	(23)	(12)
Royalty payables	141	112
Accrued interest	(16)	(10)
Deferred revenue	(3)	(1)
Other balance sheet changes	3	15
Net cash provided by operating activities	136	156
Cash flows from investing activities		
Acquisition of music publishing rights, net	(1)	(1)
Capital expenditures	(16)	(8)
Investments and acquisitions of businesses, net	(1)	(3)
Proceeds from the sale of investments	12	—
Net cash used in investing activities	(6)	(12)
Cash flows from financing activities		
Proceeds from issuance of Acquisition Corp. 4.125% Senior Secured Notes	—	380
Proceeds from issuance of Acquisition Corp. 4.875% Senior Secured Notes	—	250
Proceeds from issuance of Acquisition Corp. Senior Term Loan Facility	—	22
Repayment of Acquisition Corp. 6.00% Senior Secured Notes	—	(450)
Repayment of Acquisition Corp. 6.25% Senior Secured Notes	—	(173)
Repayment of Acquisition Corp. 5.625% Senior Secured Notes	—	(28)
Call premiums paid on early redemption of debt	—	(27)
Deferred financing costs paid	(1)	(12)
Distribution to noncontrolling interest holder	(2)	—

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Net cash used in financing activities	(3)	(38)
Effect of exchange rate changes on cash and equivalents	2	(10)
Net increase in cash and equivalents	129	96
Cash and equivalents at beginning of period	647	359
Cash and equivalents at end of period	\$776	\$455

See accompanying notes

Warner Music Group Corp.

Consolidated Statements of Equity (Unaudited)

	Common Stock Shares	Paid-in Value	Additional Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Warner Music Group Corp. Equity	Noncontrolling Interest	Total Equity
	(in millions, except share amounts)							
Balance at September 30, 2017	1,055	\$ —	\$ 1,128	\$ (654)	\$ (181)	\$ 293	\$ 15	\$ 308
Net income	—	—	—	4	—	4	1	5
Other comprehensive income, net								
of tax	—	—	—	—	10	10	—	10
Distribution to noncontrolling interest								
holders	—	—	—	—	—	—	(2)	(2)
Balance at December 31, 2017	1,055	\$ —	\$ 1,128	\$ (650)	\$ (171)	\$ 307	\$ 14	\$ 321

See accompanying notes

Warner Music Group Corp.

Notes to Consolidated Interim Financial Statements (Unaudited)

1. Description of Business

Warner Music Group Corp. (the “Company”) was formed on November 21, 2003. The Company is the direct parent of WMG Holdings Corp. (“Holdings”), which is the direct parent of WMG Acquisition Corp. (“Acquisition Corp.”). Acquisition Corp. is one of the world’s major music-based content companies.

Acquisition of Warner Music Group by Access Industries

Pursuant to an Agreement and Plan of Merger, dated as of May 6, 2011 (the “Merger Agreement”), by and among the Company, AI Entertainment Holdings LLC (formerly Airplanes Music LLC), a Delaware limited liability company (“Parent”) and an affiliate of Access Industries, Inc. (“Access”), and Airplanes Merger Sub, Inc., a Delaware corporation and a wholly owned subsidiary of Parent (“Merger Sub”), on July 20, 2011 (the “Merger Closing Date”), Merger Sub merged with and into the Company with the Company surviving as a wholly owned subsidiary of Parent (the “Merger”). In connection with the Merger, the Company delisted its common stock from the NYSE. The Company continues voluntarily to file with the SEC current and periodic reports that would be required to be filed with the SEC pursuant to Section 15(d) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”) as provided for in certain covenants contained in the agreements governing its outstanding indebtedness.

Recorded Music Operations

The Company’s Recorded Music business primarily consists of the discovery and development of artists and the related marketing, distribution and licensing of recorded music produced by such artists. The Company plays an integral role in virtually all aspects of the recorded music value chain from discovering and developing talent to producing music and promoting artists and their products.

In the United States, Recorded Music operations are conducted principally through the Company’s major record labels—Warner Bros. Records and Atlantic Records. The Company’s Recorded Music operations also include Rhino, a division that specializes in marketing the Company’s music catalog through compilations and reissues of previously released music and video titles. The Company also conducts its Recorded Music operations through a collection of additional record labels, including Asylum, Big Beat, Canvasback, East West, Elektra, Erato, FFRR, Fueled by Ramen, Nonesuch, Parlophone, Reprise, Roadrunner, Sire, Spinnin’, Warner Classics and Warner Music Nashville.

Outside the United States, Recorded Music activities are conducted in more than 50 countries through various subsidiaries, affiliates and non-affiliated licensees. Internationally, the Company engages in the same activities as in the United States: discovering and signing artists and distributing, marketing and selling their recorded music. In most cases, the Company also markets and distributes the music of those artists for whom the Company’s domestic record labels have international rights. In certain smaller markets, the Company licenses the right to distribute the Company’s records to non-affiliated third-party record labels. The Company’s international artist services operations include a network of concert promoters through which it provides resources to coordinate tours for the Company’s artists and other artists as well as management companies that guide artists with respect to their careers.

The Company’s Recorded Music distribution operations include Warner-Elektra-Atlantic Corporation (“WEA Corp.”), which markets and sells music and video products to retailers and wholesale distributors; Alternative Distribution

Alliance (“ADA”), which distributes the products of independent labels to retail and wholesale distributors; and various distribution centers and ventures operated internationally.

In addition to the Company’s Recorded Music products being sold in physical retail outlets, Recorded Music products are also sold in physical form to online physical retailers such as Amazon.com and bestbuy.com and in digital form to an expanded universe of digital partners, including digital streaming services such as Amazon, Apple Music, Deezer, Napster, Soundcloud, Spotify and YouTube, digital radio services such as iHeart Radio, Pandora and Sirius XM and digital download services such as Apple’s iTunes and Google Play.

The Company has integrated the exploitation of digital content into all aspects of its business, including artist and repertoire (“A&R”), marketing, promotion and distribution. The Company’s business development executives work closely with A&R departments to ensure that while music is being produced, digital assets are also created with all distribution channels in mind, including streaming services, social networking sites, online portals and music-centered destinations. The Company also works side by side with its online and mobile partners to test new concepts. The Company believes existing and new digital businesses will be a significant source of growth and will provide new opportunities to successfully monetize its assets and create new revenue streams. The proportion of digital revenues attributed to each distribution channel varies by region and proportions may change as the roll out of new technologies continues. As an owner of music 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 Company has diversified its revenues beyond its traditional businesses by entering into expanded-rights deals with recording artists in order to partner with artists in other aspects of their careers. Under these agreements, the Company provides services to and participates in artists’ activities outside the traditional recorded music business such as touring, merchandising and sponsorships. The Company has built artist services capabilities and platforms for exploiting this broader set of music-related rights and participating more widely in the monetization of the artist brands it helps create.

The Company believes that entering into expanded-rights deals and enhancing its artist services capabilities in areas such as concert promotion and management have permitted it to diversify revenue streams and capitalize on other revenue opportunities. This provides for improved long-term relationships with artists and allows the Company to more effectively connect artists and fans.

Music Publishing Operations

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

The Company’s Music Publishing operations are conducted principally through 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, its award-winning catalog includes over 70,000 songwriters and composers and a diverse range of genres including pop, rock, jazz, classical, country, R&B, hip-hop, rap, reggae, Latin, folk, blues, symphonic, soul, Broadway, techno, alternative and gospel. Warner/Chappell also administers the music and soundtracks of several third-party television and film producers and studios. The Company has an extensive production music library collectively branded as Warner/Chappell Production Music.

2. Summary of Significant Accounting Policies

Interim Financial Statements

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("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 notes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three month period ended December 31, 2017 are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2018.

The consolidated balance sheet at September 30, 2017 has been derived from the audited consolidated financial statements at that date but does not include all of the information and notes required by U.S. GAAP for complete financial statements.

For further information, refer to the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2017 (File No. 001-32502).

Basis of Consolidation

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

Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 810, Consolidation (“ASC 810”), requires the Company first evaluate its investments to determine if any investments qualify as a variable interest entity (“VIE”). A VIE is consolidated if the Company is deemed to be the primary beneficiary of the VIE, which is the party involved with the VIE that has both (i) the power to control the most significant activities of the VIE and (ii) either the obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE. If an entity is not deemed to be a VIE, the Company consolidates the entity if the Company has a controlling voting interest.

The Company maintains a 52-53 week fiscal year ending on the last Friday in each reporting period. As such, all references to December 31, 2017 and December 31, 2016 relate to the periods ended December 29, 2017 and December 30, 2016, respectively. For convenience purposes, the Company continues to date its financial statements as of December 31. The fiscal year ended September 30, 2017 ended on September 29, 2017.

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

Income Taxes

At the end of each interim period, the Company makes its best estimate of the effective tax rate expected to be applicable for the full fiscal year and uses that rate to provide for income taxes on a current year-to-date basis before discrete items. If a reliable estimate of the annual effective tax rate cannot be made, which could be caused by the significant variability in rates when marginal earnings are expected for the year, a discrete tax rate is calculated for the period.

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the “Tax Act”). In accordance with ASC Topic 740, Income Taxes (“ASC 740”) the Company recorded the impacts in the period of enactment. Furthermore, the SEC has provided guidance under Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (“SAB 118”) that allows companies, for one year following the enactment date, to consider the impact of the Tax Act as “provisional” when a company can make a reasonable estimate but does not have the necessary information available, prepared or analyzed in reasonable detail to finalize its accounting for the impact of the Tax Act. A company may need to reflect adjustments to its provisional amounts upon obtaining, preparing or analyzing additional information about facts and circumstances that existed at the period of enactment.

New Accounting Pronouncements

In October 2017, the Company adopted ASU 2016-09, Compensation - Stock Compensation (“ASU 2016-09”). This ASU provides amended guidance which simplifies the accounting for share-based payment transactions involving multiple aspects of the accounting for share-based transactions, including income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The adoption of ASU 2016-09 did not have any effect on the Company’s consolidated financial statements and footnote disclosures as of December 31, 2017.

In May 2014, the FASB issued guidance codified in ASC 606, Revenue from Contracts with Customers (“ASC 606”), which replaces the guidance in former ASC 605, Revenue Recognition and ASC 928-605, Entertainment – Music. The amendment was the result of a joint effort by the FASB and the International Accounting Standards Board to improve financial reporting by creating common revenue recognition guidance for U.S. GAAP and international financial reporting standards (“IFRS”). The joint project clarifies the principles for recognizing revenue and develops a common revenue standard for U.S. GAAP and IFRS. ASC 606 is effective for annual periods beginning after

December 15, 2017, and interim periods within those years. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The update may be applied using one of two methods: retrospective application to each prior reporting period presented, or retrospective application with the cumulative effect of initially applying the update recognized at the date of initial application. The Company currently plans to adopt this ASU under the modified retrospective method and is evaluating the impact of the adoption of this standard on its financial statements and disclosures.

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities (“ASU 2016-01”). This ASU will require that equity investments are measured at fair value with changes in fair value recognized in net income. The Company may elect to measure equity investments that do not have a readily determinable fair value at cost minus impairment, if any, plus or minus changes resulting from observable price. ASU 2016-01 will be effective for annual periods beginning after December 15, 2017, and interim periods within those years. Earlier adoption is permitted. The adoption of this standard is not expected to have a significant impact on the Company’s financial statements, other than disclosure.

In February 2016, the FASB issued ASU 2016-02, Leases (“ASU 2016-02”). This ASU establishes a right-of-use (“ROU”) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the statement of operations. ASU 2016-02 will be effective for annual periods beginning after December 15, 2018, and interim periods within those years. Earlier adoption is permitted. The Company is evaluating the impact of the adoption of this standard on its financial statements and disclosures.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments (“ASU 2016-15”). This ASU provides specific guidance of how certain cash receipts and cash payments should be presented and classified in the statement of cash flows. ASU 2016-15 is effective for annual periods beginning after December 15, 2017, and interim periods within those years. Early adoption is permitted. The adoption of this standard is not expected to have a significant impact on the Company’s financial statements, other than presentation.

In October 2016, the FASB issued ASU 2016-16, Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory (“ASU 2016-16”). This ASU requires the recognition of current and deferred income taxes for intra-entity asset transfers when the transaction occurs. ASU 2016-16 is effective for annual periods beginning after December 15, 2017, and interim periods within those years. Early adoption is permitted using the modified retrospective approach with a cumulative-effect to opening retained earnings in the period of adoption. The Company does not plan to early adopt this standard and the impact upon the required adoption date is not known or reasonably estimable.

In August 2017, the FASB issued ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities (“ASU 2017-12”). This ASU improves certain aspects of the hedge accounting model including making more risk management strategies eligible for hedge accounting and simplifying the assessment of hedge effectiveness. ASU 2017-12 is effective for all annual periods beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted and requires a prospective adoption with a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year of adoption for existing hedging relationships. The Company is evaluating the impact of the adoption of this standard on its financial statements and disclosures.

3. Comprehensive Income (Loss)

Comprehensive income (loss), which is reported in the accompanying consolidated statements of equity, consists of net income (loss) and other gains and losses affecting equity that, under U.S. GAAP, are excluded from net income (loss). For the Company, the components of other comprehensive income (loss) primarily consist of foreign currency translation gains and losses and minimum pension liabilities. The following summary sets forth the changes in the components of accumulated other comprehensive loss, net of related taxes of \$7 million:

	Foreign Minimum Currency Pension Translation Liability Gain (Loss) Adjustment (in millions)	Deferred Losses On Derivative Financial Instruments	Accumulated Other Comprehensive Loss, net
Balance at September 30, 2017	\$ (171) \$ (10)	\$ —	\$ (181)

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Other comprehensive income	9	—	1	10
Amounts reclassified from accumulated other comprehensive income	—	—	—	—
Balance at December 31, 2017	\$ (162)	\$ (10)	\$ 1	\$ (171)

(a) Includes historical foreign currency translation related to certain intra-entity transactions that are no longer considered of a long-term investment nature.

4. Goodwill and Intangible Assets

Goodwill

The following analysis details the changes in goodwill for each reportable segment:

	Recorded Music		Total
	Music	Publishing	
	(in millions)		
Balance at September 30, 2017	\$1,221	\$ 464	\$1,685
Acquisitions	—	—	—
Divestitures	—	—	—
Other adjustments (a)	3	—	3
Balance at December 31, 2017	\$1,224	\$ 464	\$1,688

(a) Other adjustments during the three months ended December 31, 2017 represent foreign currency movements. The Company performs its annual goodwill impairment test in accordance with ASC 350, Intangibles—Goodwill and other (“ASC 350”) during the fourth quarter of each fiscal year as of July 1. The Company may conduct an earlier review if events or circumstances occur that would suggest the carrying value of the Company’s goodwill may not be recoverable. No indicators of impairment were identified during the current period that required the Company to perform an interim assessment or recoverability test.

At December 31, 2017 and September 30, 2017, the goodwill and intangible balances presented include the preliminary purchase accounting allocation resulting from the acquisition of Spinnin’ Records on September 7, 2017. The acquisition of Spinnin’ Records was accounted for as a business combination under ASC 805, which requires the acquisition method of accounting. At September 30, 2017, the Company performed a preliminary purchase allocation under the acquisition method of accounting, which is subject to revision based on final determinations of fair value and allocations of purchase price to the identifiable assets and liabilities acquired. At December 31, 2017, the Company has not made any adjustments to the preliminary allocation recorded at September 30, 2017.

Intangible Assets

Intangible assets consist of the following:

	Weighted	December	September
	Average	31,	30,
	Useful Life	2017	2017
		(in millions)	
Intangible assets subject to amortization:			
Recorded music catalog	10 years	\$901	\$ 898
Music publishing copyrights	27 years	1,540	1,534

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Artist and songwriter contracts	13 years	906	904
Trademarks	6 years	14	14
Other intangible assets	7 years	10	10
Total gross intangible asset subject to amortization		3,371	3,360
Accumulated amortization		(1,326)	(1,270)
Total net intangible assets subject to amortization		2,045	2,090
Intangible assets not subject to amortization:			
Trademarks and tradenames	Indefinite	117	117
Total net intangible assets		\$2,162	\$ 2,207

5. Debt

Debt Capitalization

Long-term debt consists of the following:

	December 31, 2017	September 30, 2017
	(in millions)	
Revolving Credit Facility—Acquisition Corp. (a)	\$—	\$ —
Senior Term Loan Facility due 2023—Acquisition Corp. (b)	991	990
5.625% Senior Secured Notes due 2022—Acquisition Corp. (c)	246	246
5.00% Senior Secured Notes due 2023—Acquisition Corp. (d)	297	297
4.125% Senior Secured Notes due 2024— Acquisition Corp. (e)	407	402
4.875% Senior Secured Notes due 2024— Acquisition Corp. (f)	247	246
6.75% Senior Notes due 2022—Acquisition Corp. (g)	630	630
Total debt (h)	\$2,818	\$ 2,811

- (a) Reflects \$150 million of commitments under the Revolving Credit Facility, less letters of credit outstanding of approximately \$12 million at both December 31, 2017 and September 30, 2017. There were no loans outstanding under the Revolving Credit Facility at December 31, 2017 or September 30, 2017. On January 31, 2018, Acquisition Corp. entered into a new revolving credit facility that replaced our then existing revolving credit facility in its entirety. See Note 12 of our Consolidated Financial Statements for further discussion.
- (b) Principal amount of \$1.006 billion at both December 31, 2017 and September 30, 2017 less unamortized discount of \$5 million and \$6 million and unamortized deferred financing costs of \$10 million and \$10 million at December 31, 2017 and September 30, 2017, respectively.
- (c) Principal amount of \$248 million less unamortized deferred financing costs of \$2 million at December 31, 2017 and September 30, 2017, respectively.
- (d) Principal amount of \$300 million less unamortized deferred financing costs of \$3 million at both December 31, 2017 and September 30, 2017, respectively.
- (e) Face amount of €345 million. Above amounts represent the dollar equivalent of such notes at December 31, 2017 and September 30, 2017. Principal amount of \$412 million and \$407 million at December 31, 2017 and September 30, 2017, respectively, less unamortized deferred financing costs of \$5 million at both December 31, 2017 and September 30, 2017.
- (f) Principal amount of \$250 million at both December 31, 2017 and September 30, 2017 less unamortized deferred financing costs of \$3 million and \$4 million at December 31, 2017 and September 30, 2017, respectively.
- (g) Principal amount of \$635 million less unamortized deferred financing costs of \$5 million at both December 31, 2017 and September 30, 2017, respectively.
- (h) Principal amount of debt of \$2.851 billion and \$2.846 billion less unamortized discount of \$5 million and \$6 million and unamortized deferred financing costs of \$28 million and \$29 million at December 31, 2017 and September 30, 2017, respectively.

December 2017 Senior Term Loan Credit Agreement Amendment

On December 6, 2017, Acquisition Corp. entered into an amendment (the “December 2017 Senior Term Loan Credit Agreement Amendment”) to the Senior Term Loan Credit Agreement, dated November 1, 2012, among Acquisition Corp., the guarantors party thereto, the lenders party thereto and Credit Suisse AG, as administrative agent, governing Acquisition Corp.’s senior secured term loan facility with Credit Suisse AG, as administrative agent, and the other financial institutions and lenders from time to time party thereto, to, among other things, reduce the pricing terms of its outstanding term loans, change certain incurrence thresholds governing the ability to incur debt and liens, change certain EBITDA add-backs and increase the thresholds below which the excess cash flow sweep is triggered. The Company recorded a loss on extinguishment of debt of approximately \$1 million, which represented the discount and unamortized deferred financing costs related to the debt of the lenders that was fully repaid.

New Revolving Credit Agreement

On January 31, 2018, Acquisition Corp. entered into a new revolving credit facility that replaced our then existing revolving credit facility in its entirety, and references to “Revolving Credit Facility” below in this Note 5 are to our new revolving credit facility. See Note 12 of our Consolidated Financial Statements for further discussion.

Interest Rates

The loans under the Revolving Credit Facility bear interest at Acquisition Corp.'s election at a rate equal to (i) the rate for deposits in the borrowing currency in the London interbank market (adjusted for maximum reserves) for the applicable interest period ("Revolving LIBOR") subject to a zero floor, plus 1.75% per annum, or (ii) the base rate, which is the highest of (x) the corporate base rate established by the administrative agent from time to time, (y) 0.50% in excess of the overnight federal funds rate and (z) the one-month Revolving LIBOR plus 1.0% per annum, plus, in each case, 0.75% per annum. If there is a payment default at any time, then the interest rate applicable to overdue principal will be the rate otherwise applicable to such loan plus 2.0% per annum. Default interest will also be payable on other overdue amounts at a rate of 2.0% per annum above the amount that would apply to an alternative base rate loan.

The loans under the Senior Term Loan Facility bear interest at Acquisition Corp.'s election at a rate equal to (i) the rate for deposits in U.S. dollars in the London interbank market (adjusted for maximum reserves) for the applicable interest period ("Term Loan LIBOR") subject to a zero floor, plus 2.25% per annum, or (ii) the base rate, which is the highest of (x) the corporate base rate established by the administrative agent as its prime rate in effect at its principal office in New York City from time to time, (y) 0.50% in excess of the overnight federal funds rate and (z) one-month Term Loan LIBOR, plus 1.00% per annum, plus, in each case, 1.25% per annum. If there is a payment default at any time, then the interest rate applicable to overdue principal and interest will be the rate otherwise applicable to such loan plus 2.0% per annum. Default interest will also be payable on other overdue amounts at a rate of 2.0% per annum above the amount that would apply to an alternative base rate loan.

Maturity of Senior Term Loan Facility

The loans outstanding under the Senior Term Loan Facility mature on November 1, 2023, subject, in certain circumstances, to a springing maturity inside the maturity of certain of Acquisition Corp.'s other indebtedness.

Maturity of Revolving Credit Facility

The maturity date of the Revolving Credit Facility is January 31, 2023.

Maturities of Senior Notes and Senior Secured Notes

As of December 31, 2017, there are no scheduled maturities of notes until 2022, when \$883 million is scheduled to mature. Thereafter, \$962 million is scheduled to mature.

Interest Expense, net

Total interest expense, net, was \$36 million and \$40 million for the three months ended December 31, 2017 and December 31, 2016, respectively. The weighted-average interest rate of the Company's total debt was 4.9% at December 31, 2017, September 30, 2017, and December 31, 2016.

6. 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 the pricing of digital music downloads. On February 28, 2006, the Antitrust Division of the U.S. Department of Justice served us with a Civil Investigative Demand, also seeking information relating to the pricing of digitally downloaded music. Both investigations were ultimately closed, but subsequent to the announcements of the investigations, more than thirty putative class action lawsuits were filed concerning the pricing of digital music downloads. The lawsuits were consolidated in the Southern District of New York. The consolidated amended complaint, filed on April 13, 2007, alleges conspiracy among record companies to delay the release of their content for digital distribution, inflate their pricing of CDs and fix prices for digital downloads. The complaint seeks unspecified compensatory, statutory and treble damages. On October 9, 2008, the District Court issued an order dismissing the case as to all defendants, including us. However, on January 13, 2010, the Second Circuit vacated the judgment of the District Court and remanded the case for further proceedings and on January 10, 2011, the U.S. Supreme Court denied the defendants' petition for Certiorari.

Upon remand to the District Court, all defendants, including the Company, filed a renewed motion to dismiss challenging, among other things, plaintiffs' state law claims and standing to bring certain claims. The renewed motion was based mainly on arguments made in defendants' original motion to dismiss, but not addressed by the District Court. On July 18, 2011, the District Court granted defendants' motion in part, and denied it in part. Notably, all claims on behalf of the CD-purchaser class were dismissed with prejudice. However, a wide variety of state and federal claims remain for the class of Internet download purchasers. On March 19, 2014, plaintiffs filed a motion for class certification. Plaintiffs filed an operative consolidated amended complaint on September 25, 2015. The Company filed its answer to the fourth amended complaint on October 9, 2015, and filed an amended answer on November 3, 2015. A mediation took place on February 22, 2016, but the parties were unable to reach a resolution. On July 18, 2017, the District Court denied plaintiffs' motion for class certification. On August 1, 2017, plaintiffs filed a petition with the Second Circuit seeking permission to appeal the district court's order denying class certification. On August 11, 2017, defendants filed their opposition to plaintiffs' petition. On December 8, 2017, the Second Circuit denied plaintiffs' request for leave to appeal the District Court's order denying their motion for class certification. The parties are attempting to resolve the matter and have informed the District Court that they expect to file a dismissal in February 2018.

Sirius XM

On September 11, 2013, the Company joined with Capitol Records, LLC, Sony Music Entertainment, UMG Recordings, Inc. and ABKCO Music & Records, Inc. in a lawsuit brought in California Superior Court against Sirius XM Radio Inc., alleging copyright infringement for Sirius XM's use of pre-1972 sound recordings under California law. A nation-wide settlement was reached on June 17, 2015 pursuant to which Sirius XM paid the plaintiffs, in the aggregate, \$210 million on July 29, 2015 and the plaintiffs dismissed their lawsuit with prejudice. The settlement resolves all past claims as to Sirius XM's use of pre-1972 recordings owned or controlled by the plaintiffs and enables Sirius XM, without any additional payment, to reproduce, perform and broadcast such recordings in the United States through December 31, 2017. The allocation of the settlement proceeds among the plaintiffs was determined and the settlement proceeds were distributed accordingly. This resulted in a cash distribution to the Company of \$33 million of which \$28 million was recognized in revenue during the 2016 fiscal year and \$4 million was recognized in revenue during the 2017 fiscal year. The balance of \$1 million was recognized in the first quarter of the 2018 fiscal year. The Company is sharing its allocation of the settlement proceeds with its artists on the same basis as statutory revenue from Sirius XM is shared, i.e., the artist share of our allocation will be paid to artists by SoundExchange.

As part of the settlement, plaintiffs agreed to negotiate in good faith to grant Sirius XM a license to publicly perform the plaintiffs' pre-1972 sound recordings for the five-year period running from January 1, 2018 to December 31, 2022. Pursuant to the settlement, if the parties are unable to reach an agreement on license terms, the royalty rate for each license will be determined by binding arbitration on a willing buyer/willing seller standard. On December 21, 2017, Sirius XM commenced an arbitration through JAMS to determine the rate for the five-year period.

Other Matters

In addition to the matters discussed above, the Company is involved in various litigation and regulatory proceedings arising in the normal course of business. Where it is determined, in consultation with counsel based on litigation and settlement risks, that a loss is probable and estimable in a given matter, the Company establishes an accrual. In the currently pending proceedings, the amount of accrual is not material. An estimate of the reasonably possible loss or range of loss in excess of the amounts already accrued cannot be made at this time due to various factors typical in contested proceedings, including (1) the results of ongoing discovery; (2) uncertain damage theories and demands; (3) a less than complete factual record; (4) uncertainty concerning legal theories and their resolution by courts or regulators; and (5) the unpredictable nature of the opposing party and its demands. However, the Company cannot predict with certainty the outcome of any litigation or the potential for future litigation. As such, the Company

continuously monitors these proceedings as they develop and adjusts any accrual or disclosure as needed. Regardless of the outcome, litigation could have an adverse impact on the Company, including the Company's brand value, because of defense costs, diversion of management resources and other factors and it could have a material effect on the Company's results of operations for a given reporting period.

7. Income Taxes

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act. The Tax Act contains significant revisions to U.S. corporate income tax provisions, including, but not limited to, a reduction of the U.S. corporate statutory tax rate from 35% to 21%, a one-time transition tax on accumulated foreign earnings, an income inclusion of global intangible low-taxed income ("GILTI"), and a new minimum tax, base erosion anti-abuse tax ("BEAT"). In accordance with ASC 740, the Company recorded the effects of the Tax Act during the three months ended December 31, 2017, the period of enactment.

The reduction in U.S. corporate statutory tax rate from 35% to 21% is effective January 1, 2018. The Tax Act requires companies with a fiscal year that begins before and ends after the effective date of the rate change to calculate a blended tax rate based

on the pro rata number of days in the fiscal year before and after the effective date. As a result, for the fiscal year ending September 30, 2018, the Company's statutory income tax rate will be 24.5%. For the fiscal year ending September 30, 2019, the Company will be subject to the U.S. corporate statutory tax rate will be 21%.

The reduction of the U.S. corporate statutory rate requires the Company to adjust its U.S. deferred tax assets and liabilities using the newly enacted tax rate of 21%. As a result, the Company recorded a provisional U.S. income tax expense of \$27 million for the reduction of its net U.S. deferred tax assets as a discrete item for the three months ended December 31, 2017. Since the Company has a fiscal year ending September 30, 2018, and has applied an annual effective tax rate in calculating its income tax provision for the three months ended December 31, 2017, the impact of the U.S. corporate statutory tax rate change will not be finalized until September 30, 2018. Furthermore, the Company has a provisional deferred tax liability of approximately \$4 million, after the impact of the newly enacted tax rate, associated with unremitted earnings due to the uncertainty of the treatment of future distributions under the Tax Act.

The one-time transition tax on accumulated foreign earnings ("Transition Tax") would be imposed at a rate of 15.5% for cash and cash equivalents and 8% for illiquid assets. The Company reasonably estimates that there is no income tax impact related to the Transition Tax and recorded no income tax liability for the three months ended December 31, 2017 due to an estimated overall deficit in accumulated foreign earnings. This estimate is provisional since the Company has not obtained and analyzed information necessary to finalize its accounting for the impact of the Transition Tax. The final impacts of the Transition Tax may differ from the estimate due to changes in interpretations of the Tax Act and updates or changes to the information that the Company has used to estimate the transition impact, including, but not limited to, the impacts from changes to foreign earnings estimates, foreign exchange rates, and cash positions of foreign subsidiaries.

GILTI and BEAT are effective for the Company for the fiscal year ended September 30, 2019. For the period of enactment, the Company has elected not to adjust its deferred taxes for the impact of GILTI and will consider the impact of GILTI in the specific period in which it occurs.

For the three months ended December 31, 2017, the Company recorded an income tax expense of \$52 million. The income tax expense for the three months ended December 31, 2017 is greater than the expected income tax expense at the blended statutory tax rate of 24.5% primarily due to a U.S. income tax expense of \$27 million arising from a reduction in net U.S. deferred tax assets due to the change in the U.S. statutory tax rate, foreign income taxed at rates higher than the U.S. statutory tax rate, income withholding taxes, foreign losses with no tax benefit and an increase in uncertain tax positions.

For the three months ended December 31, 2016, the Company recorded income tax expense of \$17 million. The income tax expense for the three months ended December 31, 2016 is higher than the expected income tax expense at the statutory tax rate of 35% primarily due to income withholding taxes, state income taxes, foreign losses with no tax benefit and an increase in uncertain tax positions, partially offset by a reduction in a valuation allowance.

The Company has determined that it is reasonably possible that the gross unrecognized tax benefits as of December 31, 2017 could decrease by up to approximately \$3 million related to various ongoing audits and settlement discussions in various foreign jurisdictions during the next twelve months.

8. Derivative Financial Instruments

The Company uses derivative financial instruments, primarily foreign currency forward exchange contracts, for the purpose of managing foreign currency exchange risk by reducing the effects of fluctuations in foreign currency exchange rates.

The Company enters into foreign currency forward exchange contracts primarily to hedge the risk that unremitted or future royalties and license fees owed to its domestic companies for the sale, or anticipated sale, of U.S.-copyrighted products abroad may be adversely affected by changes in foreign currency exchange rates. The Company focuses on managing the level of exposure to the risk of foreign currency exchange rate fluctuations on its major currencies, which include the Euro, British pound sterling, Japanese yen, Canadian dollar, Swedish krona and Australian dollar. The foreign currency forward exchange contracts related to royalties are designated and qualify as cash flow hedges under the criteria prescribed in ASC 815, Derivatives and Hedging. The Company records these contracts at fair value on its balance sheet and gains or losses on these contracts are deferred in equity (as a component of comprehensive loss). These deferred gains and losses are recognized in income in the period in which the related royalties and license fees being hedged are received and recognized in income. However, to the extent that any of these contracts are not considered to be perfectly effective in offsetting the change in the value of the royalties and license fees being hedged, any changes in fair value relating to the ineffective portion of these contracts are immediately recognized in the statement of operations.

The Company may at times choose to hedge foreign currency risk associated with financing transactions such as third-party debt and other balance sheet items. The foreign currency forward exchange contracts related to balance sheet items denominated in foreign currency are reviewed on a contract-by-contract basis and are designated accordingly. If these foreign currency forward exchange contracts do not qualify for hedge accounting, then the Company records these contracts at fair value on its balance sheet and the related gains and losses are immediately recognized in the statement of operations where there is an equal and offsetting entry related to the underlying exposure.

The fair value of foreign currency forward exchange contracts is determined by using observable market transactions of spot and forward rates (i.e., Level 2 inputs) which is discussed further in Note 11. Additionally, netting provisions are provided for in existing International Swap and Derivative Association Inc. agreements in situations where the Company executes multiple contracts with the same counterparty. As a result, net assets or liabilities resulting from foreign exchange derivatives subject to these netting agreements are classified within other current assets or other current liabilities in the Company's consolidated balance sheets.

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

As of December 31, 2017, the Company had outstanding hedge contracts for the sale of \$220 million and the purchase of \$131 million of foreign currencies at fixed rates that will be settled by September 2018. As of December 31, 2017, the Company had \$1 million of unrealized deferred income in comprehensive income related to foreign exchange hedging. As of September 30, 2017, the Company had no outstanding hedge contracts and no deferred gains or losses in comprehensive loss related to foreign exchange hedging.

The following is a summary of amounts recorded in the Consolidated Balance Sheet pertaining to the Company's use of foreign currency derivatives at December 31, 2017 and September 30, 2017:

	December 31, 2017	September 30, 2017
	(a)	(a)
	(in millions)	
Other current assets	\$ —	\$ —
Other current liabilities	1	—

(a) Includes \$1 million and \$2 million of foreign exchange derivative contracts in asset and liability positions, respectively.

9. Segment Information

As discussed more fully in Note 1, based on the nature of its products and services, the Company classifies its business interests into two fundamental operations: Recorded Music and Music Publishing, which also represent

reportable segments of the Company. 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 and non-cash amortization of intangible assets (“OIBDA”). The Company has supplemented its analysis of OIBDA results by segment with an analysis of operating income (loss) by segment.

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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, and therefore, do not themselves impact consolidated results.

Three Months Ended	Record Music	Music Publishing	Corporate expenses and eliminations	Total
	(in millions)			
December 31, 2017				
Revenues	\$904	\$ 143	\$ (2)	\$1,045
Operating income (loss)	129	(1)	(38)	90
Amortization of intangible assets	36	17	—	53
Depreciation of property, plant and equipment	8	1	3	12
OIBDA	173	17	(35)	155
December 31, 2016				
Revenues	\$797	\$ 124	\$ (4)	\$917
Operating income (loss)	123	(2)	(27)	94
Amortization of intangible assets	35	16	—	51
Depreciation of property, plant and equipment	7	2	3	12
OIBDA	165	16	(24)	157

10. Additional Financial Information

Cash Interest and Taxes

The Company made interest payments of approximately \$51 million and \$47 million during the three months ended December 31, 2017 and December 31, 2016, respectively. The Company paid approximately \$8 million of income and withholding taxes during the three months ended December 31, 2017 and paid approximately \$9 million of income and withholding taxes during the three months ended December 31, 2016.

11. Fair Value Measurements

ASC 820, Fair Value Measurement, defines fair value as the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that asset or liability. The fair value should be calculated based on assumptions that market participants would use in pricing the asset or liability, not on assumptions specific to the entity.

In addition to defining fair value, ASC 820 expands the disclosure requirements around fair value and establishes a fair value hierarchy for valuation inputs. The hierarchy prioritizes the inputs into three levels based on the extent to which inputs used in measuring fair value are observable in the market. Each fair value measurement is reported in one of the three levels which is determined by the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

Level 1—inputs are based upon unadjusted quoted prices for identical instruments traded in active markets.

Level 2—inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3—inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques that include option pricing models, discounted cash flow models and similar techniques.

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In accordance with the fair value hierarchy, described above, the following table shows the fair value of the Company's financial instruments that are required to be measured at fair value as of December 31, 2017 and September 30, 2017.

	Fair Value Measurements as of December 31, 2017			
	(Level 1)	(Level 2)	(Level 3)	Total
	(in millions)			
Other Current Assets:				
Foreign Currency Forward Exchange Contracts (a)	\$ —	\$ —	\$ —	\$ —
Other Current Liabilities:				
Foreign Currency Forward Exchange Contracts (a)	—	(1)	—	(1)
Other Current Liabilities:				
Contractual Obligations (b)	—	—	—	—
Other Non-Current Liabilities:				
Contractual Obligations (b)	—	—	(5)	(5)
Total	\$ —	\$ (1)	\$ (5)	\$ (6)

	Fair Value Measurements as of September 30, 2017			
	(Level 1)	(Level 2)	(Level 3)	Total
	(in millions)			
Other Current Liabilities:				
Contractual Obligations (b)	—	—	—	—
Other Non-Current Liabilities:				
Contractual Obligations (b)	—	—	(5)	(5)
Total	\$ —	\$ —	\$ (5)	\$ (5)

(a) The fair value of the foreign currency forward exchange contracts is based on dealer quotes of market forward rates and reflects the amount that the Company would receive or pay at their maturity dates for contracts involving the same currencies and maturity dates.

(b) This represents purchase obligations and contingent consideration related to the Company's various acquisitions. This is based on a discounted cash flow approach and it is adjusted to fair value on a recurring basis and any adjustments are included as a component of operating income in the statement of operations. These amounts were mainly calculated using unobservable inputs such as future earnings performance of the Company's various acquisitions and the expected timing of the payment.

The following table reconciles the beginning and ending balances of net assets and liabilities classified as Level 3:

	Total (in millions)
Balance at September 30, 2017	(5)
Additions	—
Reductions	—

Payments	—
Balance at December 31, 2017	\$ (5)

The majority of the Company's non-financial instruments, which include goodwill, intangible assets, inventories, and property, plant, and equipment, are not required to be re-measured to fair value on a recurring basis. These assets are evaluated for impairment if certain triggering events occur. If such evaluation indicates that impairment exists, the asset is written down to its fair value. In addition, an impairment analysis is performed at least annually for goodwill and indefinite-lived intangible assets.

Fair Value of Debt

Based on the level of interest rates prevailing at December 31, 2017, the fair value of the Company's debt was \$2.932 billion. Based on the level of interest rates prevailing at September 30, 2017, the fair value of the Company's debt was \$2.936 billion. The fair value of the Company's debt instruments are determined using quoted market prices from less active markets or by using quoted market prices for instruments with identical terms and maturities; both approaches are considered a Level 2 measurement.

12. Subsequent Events

Special Cash Dividend

On January 8, 2018, our Board of Directors approved a special cash dividend of \$125 million which was paid on January 12, 2018 to stockholders of record as of January 11, 2018.

New Revolving Credit Agreement

On January 31, 2018, the Company entered into a new revolving credit agreement (the “Revolving Credit Agreement”) for its Revolving Credit Facility, and terminated its existing revolving credit agreement (the “Old Revolving Credit Agreement”). The Revolving Credit Agreement differs from the Old Revolving Credit Agreement in that it, among other things, reduces the interest rate margin applicable to the loans, extends the maturity date thereunder, provides for the option to increase the commitments under the Company’s then existing revolving credit agreement, provides for greater flexibility to amend and extend the Company’s then existing revolving credit agreement and create additional tranches thereunder, provides for greater flexibility over future amendments, increases the springing financial maintenance covenant to 4.75:1.00 and provides that the covenant shall not be tested unless at the end of a fiscal quarter the outstanding amount of loans and drawings under letters of credit which have not been reimbursed exceeds \$54 million and aligns the other negative covenants with those of the Senior Term Loan Credit Agreement.

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. Acquisition Corp. has issued and outstanding the 5.625% Senior Secured Notes due 2022, the 5.00% Senior Secured Notes due 2023, the 4.125% Senior Secured Notes due 2024, the 4.875% Senior Secured Notes due 2024 and the 6.75% Senior Notes due 2022 (together, the “Acquisition Corp. Notes”).

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

The Company and Holdings are holding companies that conduct substantially all of their business operations through Acquisition Corp. Accordingly, the ability of the Company and Holdings to obtain funds from their subsidiaries is restricted by the indentures for the Acquisition Corp. Notes and the credit agreements for the Acquisition Corp. Senior Credit Facilities, including the Revolving Credit Facility and Senior Term Loan Facility.

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Consolidating Balance Sheet (Unaudited)

December 31, 2017

	WMG Acquisition Corp. (issuer) (in millions)	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Elimination	WMG Acquisition Corp. Consolidated	Warner Music Group Holdings Corp.	Warner Music Group Corp. Eliminations	Warner Music Group Corp. Consolidated
Assets:								
Current assets:								
Cash and equivalents	\$—	\$ 435	\$ 341	\$ —	\$ 776	\$ —	\$ —	\$ 776
Accounts receivable, net	—	247	252	—	499	—	—	499
Inventories	—	13	25	—	38	—	—	38
Royalty advances expected to be recouped within one year	—	86	56	—	142	—	—	142
Prepaid and other current assets	—	14	33	—	47	—	—	47
Total current assets	—	795	707	—	1,502	—	—	1,502
Due from (to) parent companies	500	(4)	(496)	—	—	—	—	—
Investments in and advances to consolidated subsidiaries	2,644	1,453	—	(4,097)	—	391	391	(782)
Royalty advances expected to be recouped after one year	—	106	69	—	175	—	—	175
Property, plant and equipment, net	—	139	74	—	213	—	—	213
Goodwill	—	1,368	320	—	1,688	—	—	1,688
Intangible assets subject to amortization, net	—	1,006	1,039	—	2,045	—	—	2,045
Intangible assets not subject to amortization	—	71	46	—	117	—	—	117
Deferred tax assets, net	—	53	8	—	61	—	—	61
Other assets	7	47	20	—	74	—	—	74
Total assets	\$3,151	\$ 5,034	\$ 1,787	\$ (4,097)	\$ 5,875	\$ 391	\$ 391	\$ (782)
Liabilities and Deficit:								
Current liabilities:								
Accounts payable	\$—	\$ 87	\$ 79	\$ —	\$ 166	\$ —	\$ —	\$ 166
Accrued royalties	—	791	615	—	1,406	—	—	1,406
Accrued liabilities	—	175	226	—	401	—	—	401
Accrued interest	25	—	—	—	25	—	—	25
Deferred revenue	—	148	53	—	201	—	—	201
Other current liabilities	—	4	31	—	35	—	—	35

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Total current liabilities	25	1,205	1,004	—	2,234	—	—	—	2,234
Long-term debt	2,818	—	—	—	2,818	—	—	—	2,818
Deferred tax liabilities, net	—	—	196	—	196	—	—	—	196
Other noncurrent liabilities	1	195	110	—	306	—	—	—	306
Total liabilities	2,844	1,400	1,310	—	5,554	—	—	—	5,554
Total Warner Music Group Corp. equity	307	3,630	467	(4,097)	307	391	391	(782)	307
Noncontrolling interest	—	4	10	—	14	—	—	—	14
Total equity	307	3,634	477	(4,097)	321	391	391	(782)	321
Total liabilities and equity	\$3,151	\$ 5,034	\$ 1,787	\$ (4,097)	\$ 5,875	\$ 391	\$ 391	\$ (782)	\$ 5,875

Consolidating Balance Sheet

September 30, 2017

	WMG Acquisition Corp. (issuer) (in millions)	Non- Guarantor Subsidiaries	Guarantor Subsidiaries	Elimination	WMG Acquisition Corp. Consolidated	Warner Music Group Holdings Corp.	Warner Music Group Corp. Elimination	Warner Music Group Corp. Consolidated
Assets:								
Current assets:								
Cash and equivalents	\$—	\$ 347	\$ 300	\$—	\$ 647	\$—	\$—	\$ 647
Accounts receivable, net	—	214	190	—	404	—	—	404
Inventories	—	12	27	—	39	—	—	39
Royalty advances expected to be recouped within one year	—	89	52	—	141	—	—	141
Prepaid and other current assets	—	15	29	—	44	—	—	44
Total current assets	—	677	598	—	1,275	—	—	1,275
Due from (to) parent companies	418	96	(514)	—	—	—	—	—
Investments in and advances to consolidated subsidiaries	2,721	1,312	—	(4,033)	—	377	377	(754)
Royalty advances expected to be recouped after one year	—	109	63	—	172	—	—	172
Property, plant and equipment, net	—	139	74	—	213	—	—	213
Goodwill	—	1,368	317	—	1,685	—	—	1,685
Intangible assets subject to amortization, net	—	1,029	1,061	—	2,090	—	—	2,090
Intangible assets not subject to amortization	—	71	46	—	117	—	—	117
Deferred tax assets, net	—	89	8	—	97	—	—	97
Other assets	7	45	17	—	69	—	—	69
Total assets	\$3,146	\$ 4,935	\$ 1,670	\$ (4,033)	\$ 5,718	\$ 377	\$ 377	\$ (754)
Liabilities and Deficit:								
Current liabilities:								
Accounts payable	\$—	\$ 135	\$ 73	\$—	\$ 208	\$—	\$—	\$ 208
Accrued royalties	—	732	531	—	1,263	—	—	1,263
Accrued liabilities	—	144	221	—	365	—	—	365
Accrued interest	41	—	—	—	41	—	—	41
Deferred revenue	—	125	72	—	197	—	—	197
Other current liabilities	—	3	23	—	26	—	—	26

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Total current liabilities	41	1,139	920	—	2,100	—	—	—	2,100
Long-term debt	2,811	—	—	—	2,811	—	—	—	2,811
Deferred tax liabilities, net	—	—	190	—	190	—	—	—	190
Other noncurrent liabilities	1	196	112	—	309	—	—	—	309
Total liabilities	2,853	1,335	1,222	—	5,410	—	—	—	5,410
Total Warner Music Group Corp. equity	293	3,596	437	(4,033)	293	377	377	(754)	293
Noncontrolling interest	—	4	11	—	15	—	—	—	15
Total equity	293	3,600	448	(4,033)	308	377	377	(754)	308
Total liabilities and equity	\$3,146	\$ 4,935	\$ 1,670	\$ (4,033)	\$ 5,718	\$ 377	\$ 377	\$ (754)	\$ 5,718

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Consolidating Statement of Operations (Unaudited)

For The Three Months Ended December 31, 2017

	WMG Acquisition				Warner Music Group				
	Corp. (issuer)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Corp. Consolidated	Holdings Corp.	Group Corp.	Eliminations	Warner Music Group Corp. Consolidated
	(in millions)								
Revenues	\$—	\$ 547	\$ 621	\$ (123)	\$ 1,045	\$ —	\$ —	\$ —	\$ 1,045
Costs and expenses:									
Cost of revenue	—	(257)	(393)	81	(569)	—	—	—	(569)
Selling, general and administrative expenses	—	(235)	(138)	40	(333)	—	—	—	(333)
Amortization of intangible assets	—	(24)	(29)	—	(53)	—	—	—	(53)
Total costs and expenses	—	(516)	(560)	121	(955)	—	—	—	(955)
Operating income	—	31	61	(2)	90	—	—	—	90
Loss on extinguishment of debt	(1)	—	—	—	(1)	—	—	—	(1)
Interest expense, net	(29)	1	(8)	—	(36)	—	—	—	(36)
Equity gains (losses) from equity method investments	90	44	—	(133)	1	4	4	(8)	1
Other income, net	(4)	9	(2)	—	3	—	—	—	3
Income before income taxes	56	85	51	(135)	57	4	4	(8)	57
Income tax (expense) benefit	(52)	(51)	(10)	61	(52)	—	—	—	(52)
Net income	4	34	41	(74)	5	4	4	(8)	5
Less: income attributable to noncontrolling interest	—	—	(1)	—	(1)	—	—	—	(1)
Net income (loss) attributable to Warner Music Group Corp.	\$4	\$ 34	\$ 40	\$ (74)	\$ 4	\$ 4	\$ 4	\$ (8)	\$ 4

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Consolidating Statement of Operations (Unaudited)

For The Three Months Ended December 31, 2016

	WMG Acquisition Corp. (issuer)				Warner Music Group Corp.				
	Non-Guarantor Subsidiaries	Guarantor Subsidiaries	Eliminations	Consolidated	Non-Guarantor Subsidiaries	Guarantor Subsidiaries	Eliminations	Consolidated	
	(in millions)				(in millions)				
Revenues	\$ —	\$ 490	\$ 521	\$ (94)	\$ 917	\$ —	\$ —	\$ —	\$ 917
Costs and expenses:									
Cost of revenue	—	(220)	(341)	65	(496)	—	—	—	(496)
Selling, general and administrative expenses	(1)	(176)	(128)	29	(276)	—	—	—	(276)
Amortization of intangible assets	—	(25)	(26)	—	(51)	—	—	—	(51)
Total costs and expenses	(1)	(421)	(495)	94	(823)	—	—	—	(823)
Operating (loss) income	(1)	69	26	—	94	—	—	—	94
Loss on extinguishment of debt	(32)	—	—	—	(32)	—	—	—	(32)
Interest (expense) income, net	(23)	1	(18)	—	(40)	—	—	—	(40)
Equity gains (losses) from equity method investments	83	40	—	(123)	—	22	22	(44)	—
Other income, net	12	3	4	—	19	—	—	—	19
Income before income taxes	39	113	12	(123)	41	22	22	(44)	41
Income tax (expense) benefit	(17)	(18)	(9)	27	(17)	—	—	—	(17)
Net income	22	95	3	(96)	24	22	22	(44)	24
Less: income attributable to noncontrolling interest	—	—	(2)	—	(2)	—	—	—	(2)
Net income attributable to Warner Music Group Corp.	\$ 22	\$ 95	\$ 1	\$ (96)	\$ 22	\$ 22	\$ 22	\$ (44)	\$ 22

Consolidating Statement of Comprehensive Income (Unaudited)

For The Three Months Ended December 31, 2017

	WMG Acquisition Corp. Guarantor (issued Subsidiaries (in millions))				Non-Guarantor Subsidiaries Eliminations				WMG Acquisition Corp. Consolidated		Warner Music Group Corp. Eliminations		Warner Music Group Corp. Consolidated	
Net income	\$4	\$ 34	\$ 41	\$ (74)	\$ 5	\$ 4	\$ 4	\$ (8)	\$ 5					
Other comprehensive income, net of tax:														
Foreign currency adjustment	9	—	(9)	9	9	9	9	(18)	9					
Deferred gains (losses) on derivative financial instruments	1	—	(1)	1	1	1	1	(2)	1					
Other comprehensive income, net of tax:	10	—	(10)	10	10	10	10	(20)	10					
Total comprehensive income (loss)	14	34	31	(64)	15	14	14	(28)	15					
Less: income attributable to noncontrolling interest	—	—	(1)	—	(1)	—	—	—	(1)					
Comprehensive income attributable to Warner Music Group Corp.	\$ 14	\$ 34	\$ 30	\$ (64)	\$ 14	\$ 14	\$ 14	\$ (28)	\$ 14					

Consolidating Statement of Comprehensive Income (Unaudited)

For The Three Months Ended December 31, 2016

	WMG Acquisition		Non-Guarantor Subsidiaries		Elimination		WMG Acquisition Corp. Consolidated	Warner Music Group Corp.	Warner Music Group Corp. Elimination	Warner Music Group Corp. Consolidated
	(issuer)	Subsidiaries	Subsidiaries	Elimination	Consolidated	Corp.	Corp.	Elimination	Consolidated	
	(in millions)									
Net income	\$22	\$ 95	\$ 3	\$ (96)	\$ 24	\$ 22	\$ 22	\$ (44)	\$ 24	
Other comprehensive (loss) income, net of tax:										
Foreign currency adjustment	(37)	—	37	(37)	(37)	(37)	(37)	74	(37)	
Deferred losses on derivative financial instruments	(2)	(2)	—	2	(2)	(2)	(2)	4	(2)	
Other comprehensive (loss) income, net of tax:	(39)	(2)	37	(35)	(39)	(39)	(39)	78	(39)	
Total comprehensive (loss) income	(17)	93	40	(131)	(15)	(17)	(17)	34	(15)	
Less: income attributable to noncontrolling interest	—	—	(2)	—	(2)	—	—	—	(2)	
Comprehensive (loss) income attributable to Warner Music Group Corp.	\$(17)	\$ 93	\$ 38	\$ (131)	\$(17)	\$(17)	\$(17)	\$ 34	\$(17)	

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Consolidating Statement of Cash Flows (Unaudited)

For The Three Months Ended December 31, 2017

	WMG Acquisition Corp. (issuer) (in millions)				Warner Music Group Corp. Eliminations				Warner Music Group Corp. Consolidated	
	WMG Acquisition Corp. (issuer)	Non-Guarantor Subsidiaries	Guarantor Subsidiaries	Eliminations	WMG Acquisition Corp. Consolidated	WMG Holding Corp.	Warner Music Group Corp.	Eliminations	Warner Music Group Corp. Consolidated	
Cash flows from operating activities										
Net income	\$4	\$ 34	\$ 41	\$ (74)	\$ 5	\$ 4	\$ 4	\$ (8)	\$ 5	
Adjustments to reconcile net income to net cash provided by operating activities:										
Depreciation and amortization	—	32	33	—	65	—	—	—	65	
Unrealized losses/gains and remeasurement of foreign denominated loans										
Deferred income taxes	6	1	(2)	—	5	—	—	—	5	
Loss on extinguishment of debt	—	—	42	—	42	—	—	—	42	
Net gain on investments	1	—	—	—	1	—	—	—	1	
Non-cash interest expense	—	(7)	—	—	(7)	—	—	—	(7)	
Equity-based compensation expense	1	—	—	—	1	—	—	—	1	
Equity (gains) losses, including distributions	—	18	—	—	18	—	—	—	18	
Changes in operating assets and liabilities:	(90)	(43)	—	133	—	(4)	(4)	8	—	
Accounts receivable	—	(33)	(60)	—	(93)	—	—	—	(93)	
Inventories	—	—	2	—	2	—	—	—	2	
Royalty advances	—	5	(10)	—	(5)	—	—	—	(5)	
Accounts payable and accrued liabilities	—	65	(29)	(59)	(23)	—	—	—	(23)	
Royalty payables	—	59	82	—	141	—	—	—	141	
Accrued interest	(16)	—	—	—	(16)	—	—	—	(16)	
Deferred revenue	—	17	(20)	—	(3)	—	—	—	(3)	
Other balance sheet changes	-	37	(34)	—	3	—	—	—	3	
Net cash provided by operating activities	(94)	185	45	—	136	—	—	—	136	
Cash flows from investing activities										
	—	—	(1)	—	(1)	—	—	—	(1)	

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Acquisition of music publishing rights, net									
Capital expenditures	—	(13)	(3)	—	(16)	—	—	—	(16)
Investments and acquisitions of businesses, net	—	(1)	—	—	(1)	—	—	—	(1)
Proceeds from the sale of investments	—	12	—	—	12	—	—	—	12
Advances from issuer	95	—	—	(95)	—	—	—	—	—
Net cash used in investing activities	95	(2)	(4)	(95)	(6)	—	—	—	(6)
Cash flows from financing activities									
Proceeds from issuance of Acquisition Corp. 4.125% Senior Secured Notes	—	—	—	—	—	—	—	—	—
Proceeds from issuance of Acquisition Corp. 4.875% Senior Secured Notes	—	—	—	—	—	—	—	—	—
Proceeds from issuance of Acquisition Corp. Senior Term Loan Facility	—	—	—	—	—	—	—	—	—
Repayment of Acquisition Corp. 6.00% Senior Secured Notes	—	—	—	—	—	—	—	—	—
Repayment of Acquisition Corp. 6.25% Senior Secured Notes	—	—	—	—	—	—	—	—	—
Repayment of Acquisition Corp. 5.625% Senior Secured Notes	—	—	—	—	—	—	—	—	—
Call premiums paid on early redemption of debt	—	—	—	—	—	—	—	—	—
Deferred financing costs paid	(1)	—	—	—	(1)	—	—	—	(1)
Distribution to noncontrolling interest holder	—	—	(2)	—	(2)	—	—	—	(2)
Change in due to (from) issuer	—	(95)	—	95	—	—	—	—	—
Net cash used in financing activities	(1)	(95)	(2)	95	(3)	—	—	—	(3)
Effect of exchange rate changes on cash and equivalents	—	—	2	—	2	—	—	—	2
Net increase in cash and equivalents	—	88	41	—	129	—	—	—	129
Cash and equivalents at beginning of period	—	347	300	—	647	—	—	—	647
Cash and equivalents at end of period	\$—	\$ 435	\$ 341	\$ —	\$ 776	\$ —	\$ —	\$ —	\$ 776

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Consolidating Statement of Cash Flows (Unaudited)

For The Nine Months Ended December 31, 2016

	WMG Acquisition Corp. (issuer) (in millions)	Non- Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Elimination	WMG Acquisition Corp. Consolidated	Warner Music Group Corp. Holdings Corp.	Warner Music Group Corp. Elimination	Warner Music Group Corp. Consolidated
Cash flows from operating activities								
Net income	\$22	\$ 95	\$ 3	\$ (96)	\$ 24	\$ 22	\$ 22	\$ (44) \$ 24
Adjustments to reconcile net income to net cash provided by operating activities:								
Depreciation and amortization	—	35	28	—	63	—	—	63
Unrealized (gains)/losses and remeasurement of foreign denominated loans	(21)	(9)	13	—	(17)	—	—	(17)
Deferred income taxes	—	—	(2)	—	(2)	—	—	(2)
Loss on extinguishment of debt	32	—	—	—	32	—	—	32
Non-cash interest expense	3	—	—	—	3	—	—	3
Non-cash stock-based compensation expenses	—	10	—	—	10	—	—	10
Equity (gains) losses, including distributions	(83)	(40)	—	123	—	(22)	(22)	44
Changes in operating assets and liabilities:								
Accounts receivable	—	(19)	(46)	—	(65)	—	—	(65)
Inventories	—	2	1	—	3	—	—	3
Royalty advances	—	7	(6)	—	1	—	—	1
Accounts payable and accrued liabilities	—	6	9	(27)	(12)	—	—	(12)
Royalty payables	—	40	72	—	112	—	—	112
Accrued interest	(10)	—	—	—	(10)	—	—	(10)
Deferred revenue	—	(33)	32	—	(1)	—	—	(1)
Other balance sheet changes	—	12	3	—	15	—	—	15
Net cash provided by (used in) operating activities	(57)	106	107	—	156	—	—	156
Cash flows from investing activities								
Acquisition of music publishing rights, net	—	—	(1)	—	(1)	—	—	(1)

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Capital expenditures	—	(6)	(2)	—	(8)	—	—	—	(8)
Investments and acquisitions of businesses, net	—	(3)	—	—	(3)	—	—	—	(3)
Advances to issuer	95	—	—	(95)	—	—	—	—	—
Net cash (used in) provided by investing activities	95	(9)	(3)	(95)	(12)	—	—	—	(12)
Cash flows from financing activities									
Proceeds from issuance of Acquisition Corp. 4.125% Senior Secured Notes	380	—	—	—	380	—	—	—	380
Proceeds from issuance of Acquisition Corp. 4.875% Senior Secured Notes	250	—	—	—	250	—	—	—	250
Proceeds from issuance of Acquisition Corp. Senior Term Loan Facility	22	—	—	—	22	—	—	—	22
Repayment of Acquisition Corp. 6.00% Senior Secured Notes	(450)	—	—	—	(450)	—	—	—	(450)
Repayment of Acquisition Corp. 6.25% Senior Secured Notes	(173)	—	—	—	(173)	—	—	—	(173)
Repayment of Acquisition Corp. 5.625% Senior Secured Notes	(28)	—	—	—	(28)	—	—	—	(28)
Financing costs paid	(27)	—	—	—	(27)	—	—	—	(27)
Deferred financing costs paid	(12)	—	—	—	(12)	—	—	—	(12)
Change in due to (from) issuer	—	(95)	—	95	—	—	—	—	—
Net cash provided by (used in) financing activities	(38)	(95)	—	95	(38)	—	—	—	(38)
Effect of exchange rate changes on cash and equivalents	—	—	(10)	—	(10)	—	—	—	(10)
Net increase (decrease) in cash and equivalents	—	2	94	—	96	—	—	—	96
Cash and equivalents at beginning of period	—	180	179	—	359	—	—	—	359
Cash and equivalents at end of period	\$—	\$ 182	\$ 273	\$ —	\$ 455	\$ —	\$ —	\$ —	\$ 455

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 December 31, 2017 (the "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, 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 variations thereon or similar terminology. Such statements include, among others, our ability to compete in the highly competitive markets in which we operate, statements regarding our ability to develop talent and attract future talent, our ability to reduce future capital expenditures, our ability to monetize our music-based content, including through new distribution channels and formats to capitalize on the growth areas of the music industry, our ability to effectively deploy our capital, the development of digital music and the effect of digital distribution channels on our business, including whether we will be able to achieve higher margins from digital sales, the success of strategic actions we are taking to accelerate our transformation as we redefine our role in the music industry, the effectiveness of our ongoing efforts to reduce overhead expenditures and manage our variable and fixed cost structure and our ability to generate expected cost savings from such efforts, our success in limiting piracy, the growth of the music industry and the effect of our and the music industry's efforts to combat piracy on the industry, our intention to pay dividends or repurchase or retire our outstanding debt or notes in open market purchases, privately or otherwise, the impact on us of potential strategic transactions, 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 failure of the digital portion of the global recorded music industry to grow or grow at a significant rate to offset declines in the physical portion of the global recorded music industry;
- downward pressure on our pricing and our profit margins and reductions in shelf space;
- our ability to identify, sign and retain artists and songwriters and the existence or absence of superstar releases;
- threats to our business associated with digital piracy;
- 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;
- the impact of legitimate channels for digital distribution of our creative content;
- our dependence on a limited number of digital music services for the online sale of our music recordings and their ability to significantly influence the pricing structure for online music stores;
- our involvement in intellectual property litigation;

our ability to continue to enforce our intellectual property rights in digital environments;
the ability to develop a successful business model applicable to a digital environment and to enter into artist services and expanded-rights deals with recording artists in order to broaden our revenue streams in growing segments of the music business;

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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;

significant fluctuations in our operations, cash flows and valuation of our common stock from period to period;

our inability to compete successfully in the highly competitive markets in which we operate;

trends, developments or other events in some foreign countries in which we operate;

local economic conditions in the countries in which we operate;

our failure to attract and retain our executive officers and other key personnel;

the impact of rates on other income streams that may be set by arbitration proceedings on our business;

an impairment in the carrying value of goodwill or other intangible and long-lived assets;

unfavorable currency exchange rate fluctuations;

our failure to have full control and ability to direct the operations we conduct through joint ventures;

legislation limiting the terms by which an individual can be bound under a “personal services” contract;

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

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;

the impact of, and risks inherent in, acquisitions or business combinations;

risks inherent to our outsourcing of information technology (“IT”) infrastructure and certain finance and accounting functions;

our ability to maintain the security of information relating to our customers, employees and vendors and our music-based content;

the fact that we have engaged in substantial restructuring activities in the past, and may need to implement further restructurings in the future and our restructuring efforts may not be successful or generate expected cost-savings;

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 ability to generate sufficient cash to service all of our indebtedness, and the risk that we may be forced to take other actions to satisfy our obligations under our indebtedness, which may not be successful;

the fact that our debt agreements contain restrictions that limit our flexibility in operating our business;

our indebtedness levels, and the fact that we may be able to incur substantially more indebtedness, which may increase the risks created by our substantial indebtedness;

the significant amount of cash required to service our indebtedness and the ability to generate cash or refinance indebtedness as it becomes due depends on many factors, some of which are beyond our control;

risks of downgrade, suspension or withdrawal of the rating assigned by a rating agency to us could impact our cost of capital;

risks relating to Access, which, together with its affiliates, indirectly owns all of our outstanding capital stock, and controls our company and may have conflicts of interest with the holders of our debt or us in the future. Access may also enter into, or cause us to enter into, strategic transactions that could change the nature or structure of our business, capital structure or credit profile;

risks related to evolving regulations concerning data privacy, which might result in increased regulation and different industry standards;

changes in law and government regulations, including as a result of the Tax Cuts and Jobs Act; and risks related to other factors discussed under “Risk Factors” of this Quarterly Report and in our Annual Report on Form 10-K for the fiscal year ended September 30, 2017.

There may be other factors not presently known to us or which we currently consider to be immaterial that could cause our actual results to differ materially from those projected in any forward-looking statements we make. You should read carefully the “Risk Factors” section of this Quarterly Report to better understand the risks and uncertainties inherent in our business and underlying any 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 update or revise forward-looking statements to reflect events or circumstances after the date made or to reflect the occurrence of unanticipated events.

INTRODUCTION

Warner Music Group Corp. (the “Company”) was formed on November 21, 2003. The Company is the direct parent of WMG Holdings Corp. (“Holdings”), which is the direct parent of WMG Acquisition Corp. (“Acquisition Corp.”). Acquisition Corp. is one of the world’s major music-based content companies.

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

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

Overview. This section provides a general description of our business, as well as a discussion of factors 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 months ended December 31, 2017 and December 31, 2016. 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 three months ended December 31, 2017 and December 31, 2016 as well as a discussion of our financial condition and liquidity as of December 31, 2017. The discussion of our financial condition and liquidity includes a summary of the key debt covenant 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 and non-cash amortization of intangible assets (“OIBDA”). We consider OIBDA to be an important indicator of the operational strengths and performance of our businesses. 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 and other non-operating income (loss). Accordingly, OIBDA should be considered in addition to, not as a substitute for, operating income (loss), net income (loss) attributable to Warner Music Group Corp. and other measures of financial performance reported in accordance with U.S. GAAP. In addition, our definition of OIBDA may differ from similarly titled measures used by other companies. A reconciliation of consolidated OIBDA to operating income (loss) and net income (loss) attributable to Warner Music Group Corp. is provided in our “Results of Operations.”

Use of Constant Currency

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

OVERVIEW

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

Recorded Music Operations

Our Recorded Music business primarily consists of the discovery and development of artists and the related marketing, distribution and licensing of recorded music produced by such artists. We play an integral role in virtually all aspects of the recorded music value chain from discovering and developing talent to producing music and marketing and promoting artists and their products.

In the United States, our Recorded Music operations are conducted principally through our major record labels—Warner Bros. Records and Atlantic Records. Our Recorded Music operations also include Rhino, a division that specializes in marketing our music catalog through compilations and reissues of previously released music and video titles. We also conduct our Recorded Music operations through a collection of additional record labels, including, Asylum, Big Beat, Canvasback, East West, Elektra, Erato, FFRR, Fueled by Ramen, Nonesuch, Parlophone, Reprise, Roadrunner, Sire, Spinnin’, Warner Classics and Warner Music Nashville.

Outside the United States, our Recorded Music activities are conducted in more than 50 countries through various subsidiaries, affiliates and non-affiliated licensees. Internationally, we engage in the same activities as in the United States: discovering and signing artists and distributing, marketing and selling their recorded music. In most cases, we also market and distribute the music of those artists for whom our domestic record labels have international rights. In certain smaller markets, we license the right to distribute our records to non-affiliated third-party record labels. Our international artist services operations include a network of concert promoters through which we provide resources to coordinate tours for our artists and other artists as well as management companies that guide artists with respect to their careers.

Our Recorded Music distribution operations include Warner-Elektra-Atlantic Corporation (“WEA Corp.”), which markets and sells music and video products to retailers and wholesale distributors; Alternative Distribution Alliance (“ADA”), which distributes the products of independent labels to retail and wholesale distributors; various distribution centers and ventures operated internationally.

In addition to our Recorded Music products being sold in physical retail outlets, our Recorded Music products are also sold in physical form to online physical retailers such as Amazon.com, barnesandnoble.com and bestbuy.com and in

digital form to an expanded universe of digital partners, including digital download services such as Apple's iTunes and Google Play, digital streaming services such as Amazon, Apple Music, Deezer, Napster, Soundcloud, Spotify and YouTube, and digital radio services such as iHeart Radio, Pandora and Sirius XM.

We have integrated the exploitation of digital content into all aspects of our business, including artist and repertoire ("A&R"), marketing, promotion and distribution. Our business development executives work closely with A&R departments to ensure that while music is being produced, digital assets are also created with all distribution channels in mind, including streaming services, social networking sites, online portals and music-centered destinations. We also work side-by-side with our online and mobile partners to test new concepts. We believe existing and new digital businesses will be a significant source of growth and will provide new opportunities to successfully monetize our assets and create new revenue streams. The proportion of digital revenues attributed to each distribution channel varies by region and proportions may change as the roll out of new technologies continues. As an owner of music 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.

We have diversified our revenues beyond our traditional businesses by entering into expanded-rights deals with recording artists in order to partner with artists in other aspects of their careers. Under these agreements, we provide services to and participate in artists' activities outside the traditional recorded music business such as touring, merchandising and sponsorships. We have built artist services capabilities and platforms for exploiting this broader set of music-related rights and participating more widely in the monetization of the artist brands we help create. We believe that entering into expanded-rights deals and enhancing our artist services capabilities in areas such as concert promotion and management has permitted us to diversify revenue streams and capitalize on other revenue opportunities. This provides for improved long-term relationships with artists and allows us to more effectively connect artists and fans.

Recorded Music revenues are derived from four main sources:

- **Digital:** the rightsholder receives revenues with respect to digital streaming and digital download services;
- **Physical:** the rightsholder receives revenues with respect to sales of physical products such as CDs, vinyl and DVDs;
- **Artist services and expanded-rights:** the rightsholder receives revenues with respect to artist services businesses and our participation in expanded-rights associated with our artists, including sponsorship, fan clubs, artist websites, merchandising, touring, concert promotion, ticketing and artist and brand management; and
- **Licensing:** the rightsholder receives royalties or fees for the right to use sound recordings in combination with visual images such as in films or television programs, television commercials and videogames; the rightsholder also receives royalties if sound recordings are performed publicly through broadcast of music on television, radio and cable, and in public spaces such as shops, workplaces, restaurants, bars and clubs.

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

- **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; and (iii) creating master recordings in the studio;
- **Product costs**—the costs to manufacture, package and distribute products to wholesale and retail distribution outlets, the royalty costs associated with distributing products of independent labels to wholesale and retail distribution outlets, as well as the costs related to our artist services business;
- **Selling and marketing expenses**—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 expenses**—the costs associated with general overhead and other administrative expenses.

Music Publishing Operations

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

Our Music Publishing operations are conducted principally through 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 70,000 songwriters and composers and a diverse range of genres including pop, rock, jazz, classical, country, R&B, hip-hop, rap, reggae, Latin, folk, blues, symphonic, soul, Broadway, techno, alternative and gospel. Warner/Chappell also administers the music and soundtracks of several third-party television and film producers and studios. We have an extensive production music library collectively branded as Warner/Chappell Production Music.

Music Publishing revenues are derived from five main sources:

• **Performance:** the rightsholder receives revenues if the composition is performed publicly through broadcast of music on television, radio and cable, live performance at a concert or other venue (e.g., arena concerts and nightclubs), and performance of music in staged theatrical productions;

• **Digital:** the rightsholder receives revenues with respect to compositions embodied in recordings sold in digital download services, digital streaming services and digital performance;

• **Mechanical:** the rightsholder receives revenues with respect to compositions embodied in recordings sold in any physical format or configuration such as CDs, vinyl and DVDs;

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♣Synchronization: the rightsholder receives revenues for the right to use the composition in combination with visual images such as in films or television programs, television commercials and videogames as well as from other uses such as in toys or novelty items and merchandise; and

♣Other: the rightsholder receives revenues for use in printed sheet music and other uses.

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

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

♣Selling and marketing, general overhead and other administrative expenses—the costs associated with selling and marketing, general overhead and other administrative expenses.

Factors Affecting Results of Operations and Comparability

Acquisition of Spinnin' Records

On September 7, 2017, we acquired Spinnin' Records, one of the world's most successful and important dance and electronic music companies. Based in the Netherlands, over the past two decades the label has signed and nurtured a fantastic roster of pioneering recording artists, as well as built prominent music publishing and artist management arms.

Other Business Models to Drive Incremental Revenue

Artist Services and Expanded-Rights Deals

As another means to offset declines in physical revenues and download revenues in Recorded Music, for many years we have signed recording artists to expanded-rights deals. Under our expanded-rights deals, we participate in the recording artist's revenue streams, other than from recorded music sales, such as touring, merchandising and sponsorships. Artist services and expanded-rights Recorded Music revenue, which includes revenue from expanded-rights deals as well as revenue from our artist services business, represented approximately 10% of our total revenue during the three months ended December 31, 2017. Artist services and expanded-rights revenue will fluctuate from period to period depending upon touring schedules, among other things. Margins for the various artist services and expanded-rights revenue streams can vary significantly. The overall impact on margins will, therefore, depend on the composition of the various revenue streams in any particular period. For instance, participation in revenue from touring under our expanded-rights deals typically flows straight through to operating income with little associated cost. Revenue from some of our artist services businesses such as our management business and revenue from participation in touring and sponsorships under our expanded-rights deals are all high margin, while merchandising revenue under our expanded-rights deals and revenue from some of our artist services businesses such as our concert promotion businesses tend to be lower margin than our traditional revenue streams in Recorded Music.

RESULTS OF OPERATIONS

Three Months Ended December 31, 2017 Compared with Three Months Ended December 31, 2016

Consolidated Results

Revenues

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

	For the Three Months Ended		2017 vs. 2016		
	December 31, 2017	2016	\$ Change	% Change	
Revenue by Type					
Digital	\$ 481	\$ 402	\$79	20	%
Physical	223	227	(4)	-2	%
Total Digital and Physical	704	629	75	12	%
Artist services and expanded-rights	105	90	15	17	%
Licensing	95	78	17	22	%
Total Recorded Music	904	797	107	13	%
Performance	43	37	6	16	%
Digital	53	43	10	23	%
Mechanical	18	16	2	13	%
Synchronization	27	26	1	4	%
Other	2	2	—	—	%
Total Music Publishing	143	124	19	15	%
Intersegment eliminations	(2)	(4)	2	-50	%
Total Revenue	\$ 1,045	\$ 917	\$128	14	%
Revenue by Geographical Location					
U.S. Recorded Music	\$ 370	\$ 345	\$25	7	%
U.S. Music Publishing	63	51	12	24	%
Total U.S.	433	396	37	9	%
International Recorded Music	534	452	82	18	%
International Music Publishing	80	73	7	10	%
Total International	614	525	89	17	%
Intersegment eliminations	(2)	(4)	2	-50	%
Total Revenue	\$ 1,045	\$ 917	\$128	14	%

Total Revenue

Total revenue increased by \$128 million, or 14%, to \$1,045 million for the three months ended December 31, 2017 from \$917 million for the three months ended December 31, 2016. Prior to intersegment eliminations, Recorded Music and Music Publishing revenues represented 86% and 14% of total revenue for the three months ended December 31, 2017, respectively, and 87% and 13% of total revenue for the three months ended December 31, 2016, respectively. Prior to intersegment eliminations, U.S. and international revenues represented 41% and 59% of total

revenue for the three months ended December 31, 2017 and 43% and 57% of total revenue for the three months ended December 31, 2016, respectively.

Total digital revenue after intersegment eliminations increased by \$89 million, or 20%, to \$533 million for the three months ended December 31, 2017 from \$444 million for the three months ended December 31, 2016. Total digital revenue represented 51% and 48% of consolidated revenue for the three months ended December 31, 2017 and December 31, 2016, respectively. Prior to intersegment eliminations, total digital revenue for the three months ended December 31, 2017 was comprised of U.S. revenue of \$279 million and international revenue of \$255 million, or 52% and 48% of total digital revenue, respectively. Prior to intersegment eliminations, total digital revenue for the three months ended December 31, 2016 was comprised of U.S. revenue of \$251 million and international revenue of \$194 million, or 56% and 44% of total digital revenue, respectively.

Recorded Music revenue increased by \$107 million, or 13%, to \$904 million for the three months ended December 31, 2017 from \$797 million for the three months ended December 31, 2016. U.S. Recorded Music revenues were \$370 million and \$345 million, or 41% and 43%, of consolidated Recorded Music revenues for the three months ended December 31, 2017 and December 31, 2016, respectively. International Recorded Music revenues were \$534 million and \$452 million, or 59% and 57%, of consolidated Recorded Music revenues for the three months ended December 31, 2017 and December 31, 2016, respectively.

The overall increase in Recorded Music revenue was driven by increases in digital revenue, licensing revenue, and artist services and expanded-rights revenue, partially offset by a slight decrease in physical revenue. Digital revenue increased by \$79 million as a result of the continued success from Ed Sheeran and the continued growth in streaming services. Revenue from streaming services grew by \$93 million to \$404 million for the three months ended December 31, 2017 from \$311 million for the three months ended December 31, 2016 and was partially offset by digital download and other digital declines of \$14 million to \$77 million for the three months ended December 31, 2017 from \$91 million for the three months ended December 31, 2016. Licensing revenue increased by \$17 million primarily due to higher broadcast fee income and increased synchronization activity. Artist services and expanded-rights revenue increased by \$15 million primarily due to merchandise revenue and ticket sales generated from successful U.S. artists and successful tours in France and Japan, partially offset by a decrease in touring revenue in Italy due to strong concert promotion revenue in the prior year. Physical revenue decreased by \$4 million primarily due to the continued shift from physical revenue to digital revenue and strong catalog sales in the prior year, partially offset by the favorable impact of foreign currency exchange rates of \$9 million and a successful new release in Japan.

Music Publishing revenues increased by \$19 million, or 15%, to \$143 million for the three months ended December 31, 2017 from \$124 million for the three months ended December 31, 2016. U.S. Music Publishing revenues were \$63 million and \$51 million, or 44% and 41%, of consolidated Music Publishing revenues for the three months ended December 31, 2017 and December 31, 2016, respectively. International Music Publishing revenues were \$80 million and \$73 million, or 56% and 59%, of consolidated Music Publishing revenues for the three months ended December 31, 2017 and December 31, 2016, respectively.

The overall increase in Music Publishing revenue was mainly driven by increases in digital revenue of \$10 million, performance revenue of \$6 million, mechanical revenue of \$2 million, and synchronization revenue of \$1 million. The increase in digital revenue was due to an increase in streaming revenue of \$10 million driven by the continued growth in streaming services. Performance revenue increased by \$6 million due to increased market share and timing of distributions.

Revenue by Geographical Location

U.S. revenue increased by \$37 million, or 9%, to \$433 million for the three months ended December 31, 2017 from \$396 million for the three months ended December 31, 2016. U.S. Recorded Music revenue increased by \$25 million, or 7%. The primary driver was the increase in U.S. Recorded Music digital revenue, which increased by \$22 million driven by the continued success of Ed Sheeran and the continued growth in streaming services. Streaming revenue increased by \$33 million, partially offset by an \$11 million decline in digital download and other digital revenue. Digital revenue for the three months ended December 31, 2016 included the impact of the Pandora distribution of \$18 million. U.S. Recorded Music artist services and expanded-rights revenue increased by \$6 million primarily due to merchandise revenue and ticket sales generated from successful U.S. artists. U.S. Recorded Music licensing revenue increased by \$4 million primarily due to increased synchronization activity. These increases were partially offset by a decline in U.S. physical revenue of \$7 million due to the shift from physical revenue to digital revenue and strong catalog sales in the prior year quarter. U.S. Music Publishing revenue increased by \$12 million, or 24%, to \$63 million for the three months ended December 31, 2017 from \$51 million for the three months ended December 31, 2016. This was primarily driven by the increase in U.S. Music Publishing digital revenue of \$6 million due to

increases in streaming revenue of \$7 million due to continued growth in streaming services, partially offset by declines in digital download revenue of \$1 million. U.S. performance revenue increased by \$3 million due to increased market share and timing of distributions. U.S. synchronization revenue increased by \$2 million due to increased television and commercial income.

International revenue increased by \$89 million, or 17%, to \$614 million for the three months ended December 31, 2017 from \$525 million for the three months ended December 31, 2016. Excluding the favorable impact of foreign currency exchange rates, International revenue increased by \$57 million or 10%. International Recorded Music revenue increased \$82 million primarily due to increases in digital revenue of \$57 million, licensing revenue of \$13 million, artist services and expanded-rights revenue of \$9 million, and physical revenue of \$3 million. International Recorded Music digital revenue increased due to a \$60 million increase in streaming revenue, partially offset by a \$3 million decline in digital download revenue. The increase in International Recorded Music streaming revenue was due to the continued success of Ed Sheeran and the continued growth in streaming services internationally. International Recorded Music licensing revenue increased due to higher broadcast fee income and the favorable impact of foreign currency exchange rates. International artist services and expanded-rights revenue increased due to strong concert promotion revenue in France and Japan and increases in merchandise revenue in the U.K. and Japan, partially offset by successful tours in Italy in the prior year quarter with no comparative tours in the current year. International Recorded Music physical revenue increased due to the favorable impact of foreign currency exchange rates of \$9 million, offset by the continued shift from physical revenue to digital revenue. International Music Publishing revenue increased by \$7 million, or 10%, to \$80 million for the three months ended December 31, 2017 from \$73 million for the three months ended December 31, 2016. This was primarily driven by the increase in International Music Publishing digital revenue of \$4 million due to an increase in streaming revenue of \$3 million. The increase was also attributable to an increase in performance revenue of \$3 million due to increased market share and timing of distributions.

Cost of revenues

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

	For the Three Months Ended		2017 vs. 2016		
	December 31, 2017	2016	\$ Change	% Change	
Artist and repertoire costs	\$ 374	\$ 323	\$51	16	%
Product costs	195	173	22	13	%
Total cost of revenues	\$ 569	\$ 496	\$73	15	%

Total cost of revenues increased by \$73 million to \$569 million for the three months ended December 31, 2017 from \$496 million for the three months ended December 31, 2016. Expressed as a percentage of revenues, cost of revenues remained flat at 54% for the three months ended December 31, 2017 and December 31, 2016.

Artist and repertoire costs increased by \$51 million, to \$374 million for the three months ended December 31, 2017 from \$323 million for the three months ended December 31, 2016. Artist and repertoire costs as a percentage of revenue increased to 36% for the three months ended December 31, 2017 from 35% for the three months ended December 31, 2016. The increase was due to the mix in revenue, specifically licensing revenue mix and higher artist related costs and investment.

Product costs increased by \$22 million, to \$195 million for the three months ended December 31, 2017 from \$173 million for the three months ended December 31, 2016. Product costs as a percentage of revenue remained flat at 19% for the three months ended December 31, 2017 and December 31, 2016.

Selling, general and administrative expenses

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

	For the Three Months Ended		2017 vs. 2016		
	December 31, 2017	2016	\$ Change	% Change	
General and administrative expense (1)	\$ 185	\$ 148	\$37	25	%
Selling and marketing expense	128	111	17	15	%
Distribution expense	20	17	3	18	%
Total selling, general and administrative expense	\$ 333	\$ 276	\$57	21	%

(1) Includes depreciation expense of \$12 million for both the three months ended December 31, 2017 and December 31, 2016.

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Total selling, general and administrative expense increased by \$57 million, or 21%, to \$333 million for the three months ended December 31, 2017 from \$276 million for the three months ended December 31, 2016. Expressed as a percentage of revenue, selling, general and administrative expense increased to 32% for the three months ended December 31, 2017 from 30% for the three months ended December 31, 2016.

General and administrative expense increased by \$37 million, or 25%, to \$185 million for the three months ended December 31, 2017 from \$148 million for the three months ended December 31, 2016. The increase in general and administrative expense was due to an increase in expense associated with our Senior Management Free Cash Flow Plan which is associated with the increase in the fair value of our equity. The increase was also due to increases in other employee related compensation expense, severance and restructuring costs, and an increase in facilities cost due to overlap in terms on the lease of our new Los Angeles headquarters with our existing office leases. Expressed as a percentage of revenue, general and administrative expense increased to 18% for the three months ended December 31, 2017 from 16% for the three months ended December 31, 2016.

Selling and marketing expense increased by \$17 million, or 15%, to \$128 million for the three months ended December 31, 2017 from \$111 million for the three months ended December 31, 2016. The increase in selling and marketing expense was primarily due to increased variable marketing expense on higher revenue in the quarter. Expressed as a percentage of revenue, selling and marketing expense remained flat at 12% for the three months ended December 31, 2017 and December 31, 2016.

Distribution expense increased by \$3 million, or 18%, to \$20 million for the three months ended December 31, 2017 from \$17 million for the three months ended December 31, 2016. Expressed as a percentage of revenue, distribution expense remained flat at 2% for the three months ended December 31, 2017 and December 31, 2016.

Reconciliation of Net Income Attributable to Warner Music Group Corp. and Operating Income to Consolidated OIBDA

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

	For the Three Months Ended		2017 vs. 2016		
	December 31, 2017	2016	\$ Change	% Change	
Net income attributable to Warner Music Group Corp.	\$ 4	\$ 22	\$(18)	-82	%
Income attributable to noncontrolling interest	1	2	(1)	-50	%
Net income	5	24	(19)	-79	%
Income tax expense	52	17	35	—	%
Income before income taxes	57	41	16	39	%
Other income, net	(4)	(19)	15	-79	%
Interest expense, net	36	40	(4)	-10	%
Loss on extinguishment of debt	1	32	(31)	-97	%
Operating income	90	94	(4)	-4	%
Amortization expense	53	51	2	4	%
Depreciation expense	12	12	—	—	%
OIBDA	\$ 155	\$ 157	\$(2)	-1	%

OIBDA

OIBDA decreased by \$2 million, or 1%, to \$155 million for the three months ended December 31, 2017 as compared to \$157 million for the three months ended December 31, 2016 as a result of higher general and administrative expenses and higher artist and repertoire costs. Expressed as a percentage of total revenue, OIBDA decreased to 15% for the three months ended December 31, 2017 from 17% for the three months ended December 31, 2016.

Depreciation expense

Our depreciation expense remained flat at \$12 million for the three months ended December 31, 2017 and December 31, 2016.

Amortization expense

Our amortization expense increased by \$2 million, or 4%, to \$53 million for the three months ended December 31, 2017 from \$51 million for the three months ended December 31, 2016, due to the impact of foreign currency exchange rates of \$2 million.

Operating income

Our operating income decreased by \$4 million to \$90 million for the three months ended December 31, 2017 from \$94 million for the three months ended December 31, 2016. The decrease in operating income was due to higher general and administrative expenses and higher cost of revenues, as noted above.

Loss on extinguishment of debt

We recorded a loss on extinguishment of debt in the amount of \$1 million for the three months ended December 31, 2017 related to the December 2017 Senior Term Loan Credit Agreement Amendment. We recorded a loss on extinguishment of debt in the amount of \$32 million for the three months ended December 31, 2016 which represents the premium paid on early redemption and unamortized deferred financing costs related to the refinancing transaction that occurred during the three months ended December 31, 2016.

Interest expense, net

Our interest expense, net, decreased by \$4 million, or 10%, to \$36 million for the three months ended December 31, 2017 from \$40 million for the three months ended December 31, 2016 due to lower interest rates as a result of refinancing transactions.

Other income, net

Other income, net, for the current quarter primarily includes an \$8 million gain on the sale of investments and currency exchange gains on our intercompany loans of \$2 million, partially offset by foreign currency losses on our Euro denominated debt of \$6 million and derivative liabilities of \$1 million. This compares to currency exchange gains on our Euro denominated debt of \$21 million and gains on our derivative assets of \$11 million, partially offset by currency exchange losses on our intercompany loans of \$13 million in the prior year quarter.

Income tax (expense)

Our income tax expense increased by \$35 million to \$52 million for the three months ended December 31, 2017 compared to \$17 million of income tax expense for the three months ended December 31, 2016. The change of \$35 million in income tax expense primarily relates to U.S. tax expense of \$27 million for the reduction of our net U.S. deferred tax assets as a result of the change in the U.S. corporate statutory tax rate pursuant to the Tax Act and U.S. tax expense included in the three months ended December 31, 2017 as compared to the three months ended December 31, 2016 in which the U.S. tax expense was offset by a valuation allowance release.

Our assessment of the final impacts of the Tax Act is dependent on, among other things, future changes in interpretations of the Tax Act, any legislative action to address questions that arise because of the Tax Act, and any changes in accounting standards for income taxes with respect to the Tax Act.

Net income

Net income decreased by \$19 million to \$5 million for the three months ended December 31, 2017 from \$24 million for the three months ended December 31, 2016 as a result of the factors described above.

Noncontrolling interest

Income attributable to noncontrolling interest was \$1 million for the three months ended December 31, 2017 and \$2 million for the three months ended December 31, 2016.

Business Segment Results

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

	For the Three Months Ended		2017 vs. 2016		
	December 31, 2017	2016	\$ Change	% Change	
Recorded Music					
Revenue	\$ 904	\$ 797	\$107	13	%
Operating income	129	123	6	5	%
OIBDA	173				