Warner Music Group Corp.
Form 10-Q
February 05, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2008

OR

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

Commission File Number 001-32502

Warner Music Group Corp.

(Exact name of Registrant as specified in its charter)

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

75 Rockefeller Plaza

New York, NY 10019

(Address of principal executive offices)

(212) 275-2000

(Registrant s telephone number, including area code)

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

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

Large accelerated filer ¨	Accelerated filer x
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of February 4, 2009, the number of shares of the Registrant s common stock, par value $0.001 per share, outstanding was 154,462,885.

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WARNER MUSIC GROUP CORP.

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ITEM 1. FINANCIAL STATEMENTS

Warner Music Group Corp.

Consolidated Balance Sheets

	December 31, 2008 (unaudited)	September 30, 2008 (audited)
	(in millions)	
Assets		
Current assets:		
Cash and equivalents	$ 549	$ 411
Accounts receivable, less allowances of $193 and $159 million	543	538
Inventories	57	57
Royalty advances expected to be recouped within one year	176	174
Deferred tax assets	32	30
Other current assets	38	38
Total current assets	1,395	1,248
Royalty advances expected to be recouped after one year	215	212
Investments	49	155
Property, plant and equipment, net	108	117
Goodwill	1,087	1,085
Intangible assets subject to amortization, net	1,442	1,539
Intangible assets not subject to amortization	100	100
Other assets	69	70
Total assets	$ 4,465	$ 4,526
Liabilities and Shareholders Deficit		
Current liabilities:		
Accounts payable	$ 191	$ 219
Accrued royalties	1,198	1,189
Taxes and other withholdings	24	16
Current portion of long-term debt	17	17
Deferred income	135	117
Other current liabilities	242	313
Total current liabilities	1,807	1,871
Long-term debt	2,206	2,242
Deferred tax liabilities	235	237
Other noncurrent liabilities	258	262
Total liabilities	4,506	4,612
Commitments and Contingencies (See Note 11)		
Shareholders deficit:		
Common stock ($0.001 par value; 500,000,000 shares authorized; 154,462,885 and 154,012,885 shares issued and outstanding)		
Additional paid-in capital	592	590
Accumulated deficit	(663)	(686)
Accumulated other comprehensive income, net	30	10
Total shareholders deficit	(41)	(86)

Total liabilities and shareholders deficit	$ 4,465	$ 4,526

See accompanying notes.

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Warner Music Group Corp.

Consolidated Statements of Operations (Unaudited)

	Three Months Ended December 31, 2008	Three Months Ended December 31, 2007
	(in millions, except per share amounts)	
Revenues	$ 878	$ 989
Costs and expenses:		
Cost of revenues	(484)	(545)
Selling, general and administrative expenses (a)	(295)	(331)
Other income		3
Amortization of intangible assets	(58)	(54)
Total costs and expenses	(837)	(927)
Operating income	41	62
Interest expense, net	(44)	(48)
Minority interest income (expense)	7	(2)
Gain on sale of equity investment	36	
Gain on foreign exchange transaction	9	
Impairment of equity investment	(10)	
Other expense, net		
Income from continuing operations before income taxes	39	12
Income tax expense	(16)	(10)
Income from continuing operations	23	2
Loss from discontinued operations		(18)
Net income (loss)	$ 23	$ (16)
Net income (loss) per common share:		
Basic earnings per share:		
Income from continuing operations	$ 0.15	$ 0.01
Loss from discontinued operations		(0.12)
Net income (loss)	$ 0.15	$ (0.11)
Diluted earnings per share:		
Income from continuing operations	$ 0.15	$ 0.01
Loss from discontinued operations		(0.12)
Net income (loss)	$ 0.15	$ (0.11)
Weighted average common shares:		
Basic	149.2	147.2
Diluted	149.9	147.2
(a) Includes depreciation expense of:	$ (8)	$ (13)

See accompanying notes.

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Warner Music Group Corp.

Consolidated Statements of Cash Flows (Unaudited)

	Three Months Ended December 31, 2008	Three Months Ended December 31, 2007
	(in millions)	
Cash flows from operating activities		
Net income (loss)	$ 23	$ (16)
Loss from discontinued operations		18
Income from continuing operations	23	2
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	66	67
Deferred taxes		(11)
Gain on sale of equity investment	(36)	
Gain on foreign exchange transaction	(9)	
Impairment of equity investment	10	
Non-cash interest expense	11	12
Non-cash stock-based compensation expense	2	3
Minority interest (income) expense	(7)	2
Other non-cash items	(1)	(2)
Changes in operating assets and liabilities:		
Accounts receivable	(22)	(96)
Inventories	(3)	(2)
Royalty advances	(26)	(46)
Accounts payable and accrued liabilities	40	28
Other balance sheet changes	(5)	7
Net cash provided by (used in) operating activities	43	(36)
Cash flows from investing activities		
Repayments of loans to third parties	3	
Investments and acquisitions of businesses	(5)	(106)
Acquisition of publishing rights	(2)	(11)
Proceeds from the sale of investments	124	5
Capital expenditures	(3)	(7)
Net cash provided by (used in) investing activities	117	(119)
Cash flows from financing activities		
Debt repayments	(4)	(4)
Dividends paid		(20)
Net cash used in financing activities	(4)	(24)
Effect of foreign currency exchange rate changes on cash	(18)	6
Net increase (decrease) in cash and equivalents	138	(173)
Cash and equivalents at beginning of period	411	333
Cash and equivalents at end of period	$ 549	$ 160

See accompanying notes.

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Warner Music Group Corp.

Consolidated Statement of Shareholders Deficit (Unaudited)

	Common Stock									
	Shares	Value		Additional Paid-in Capital		Accumulated Deficit		Accumulated Other Comprehensive Income		Total Shareholders Deficit
	(in millions, except number of common shares)									
Balance at September 30, 2008	154,012,885	$ 0.001	$	590	$	(686)	$	10	$	(86)
Comprehensive income:										
Net income						23				23
Foreign currency translation adjustment								23		23
Minimum pension liability										
Deferred losses on derivative financial instruments								(3)		(3)
Total comprehensive income						23		20		43
Issuance of stock options and restricted shares of common stock	450,000			2						2
Balance at December 31, 2008	154,462,885	$ 0.001	$	592	$	(663)	$	30	$	(41)

See accompanying notes.

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Warner Music Group Corp.

Notes to Consolidated Interim Financial Statements (Unaudited)

1. Description of Business

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

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

Recorded Music Operations

The Company s Recorded Music business primarily consists of the discovery and development of artists and the related marketing, distribution and licensing of recorded music produced by such artists. In addition to the more traditional methods of discovering and developing artists, following the Acquisition the Company established Independent Label Group (ILG) to discover artists earlier in the process and at lower cost by leveraging the Company s independent distribution network.

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

In the U.S., Recorded Music operations are conducted principally through the Company s major record labels Warner Bros. Records and The Atlantic Records Group. The Company s Recorded Music operations also include Rhino Entertainment (Rhino), a division that specializes in marketing the Company s music catalog through compilations and reissuances of previously released music and video titles, as well as in the licensing of recordings to and from third parties for various uses, including film and television soundtracks. Rhino is also transitioning into our primary licensing division focused on acquiring broader licensing rights from certain catalog artists. For example, we have an exclusive license with The Grateful Dead to manage the band s intellectual property and have recently acquired a 50% interest in Frank Sinatra Enterprises, an entity that administers licenses for use of Frank Sinatra s name and likeness and manages all aspects of his music, film and stage content. The Company also conducts its Recorded Music operations through a collection of additional record labels, including, among others, Asylum, Bad Boy, Cordless, East West, Elektra, Nonesuch, Reprise, Roadrunner, Rykodisc, Sire and Word.

Outside the U.S., Recorded Music activities are conducted in more than 50 countries, primarily through Warner Music International (WMI) and its various subsidiaries, affiliates and non-affiliated licensees. WMI engages in the same activities as the Company s U.S. labels: discovering and signing artists and distributing, marketing and selling their recorded music. In most cases, WMI also markets and distributes the records of those artists for whom the Company s domestic record labels have international rights. In certain smaller countries, WMI licenses to unaffiliated third-party record labels the right to distribute its records. Recorded Music activities in Canada and Latin America are conducted through Warner Music s North American operations.

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

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

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

Music Publishing Operations

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

Our Music Publishing operations include Warner/Chappell, our global Music Publishing company headquartered in New York with operations in over 50 countries through various subsidiaries, affiliates and non-affiliated licensees. We own or control rights to more than one million musical compositions, including numerous pop hits, American standards, folk songs and motion picture and theatrical compositions. Assembled over decades, our award-winning catalog includes over 65,000 songwriters and composers and a diverse range of genres including pop, rock, jazz, country, R&B, hip-hop, rap, reggae, Latin, folk, blues, symphonic, soul, Broadway, techno, alternative, gospel and other Christian music. Warner/Chappell also administers the music and soundtracks of several third-party television and film producers and studios, including Lucasfilm, Ltd., Hallmark Entertainment, Disney Music Publishing, Home Box Office (HBO), New Line Cinema and Warner Bros. Studios. In 2007, we entered the production music library business with the acquisition of Non-Stop Music. Production music is a complementary alternative to licensing standards and contemporary hits for television, film and advertising producers.

2. Basis of Presentation

Interim Financial Statements

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month period ended December 31, 2008 are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2009.

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The consolidated balance sheet at September 30, 2008 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2008 (File No. 001-32502).

Basis of Consolidation

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

The Company maintains a 52-53 week fiscal year ending on the Friday nearest to each reporting date. As such, all references to December 31, 2008 and 2007 relate to the three month periods ended December 26, 2008 and December 28, 2007, respectively. For convenience purposes, the Company continues to date its financial statements as of December 31.

New Accounting Pronouncements

In September 2006, the FASB issued FASB Statement No. 157, *Fair Value Measurements* (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value under U.S. GAAP and expands disclosures about fair value measurements. FAS 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company adopted the provisions of FAS 157 as of October 1, 2008. The impact of adopting SFAS No. 157 effective October 1, 2008 was not material to our financial statements. Refer to Note 15.

In February 2007, the FASB issued FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* , (FAS 159) including an Amendment of SFAS 115, which permits but does not require the Company to measure financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company adopted the provisions of FAS 159 as of October 1, 2008. Upon initial adoption, Statement 159 provides entities with a one-time chance to elect the fair value option for existing eligible items. The Company has elected not to apply the fair value option to the eligible items.

In December 2007, the FASB issued SFAS 141R, *Business Combinations* (FAS 141R). FAS 141R changes the accounting for business combinations in several areas including contingent consideration, acquisition-related costs, restructuring costs and deferred income taxes. Acquisition costs will generally be expensed as incurred. Restructuring costs associated with a business combination will generally be expensed subsequent to the acquisition date. Changes in deferred tax asset valuation allowances and uncertain tax positions after the acquisition date will generally impact income tax expense. FAS 141R is effective for fiscal years beginning after December 15, 2008 on a prospective basis. The Company will adopt FAS 141R beginning in the first quarter of fiscal year 2010. This standard will change the Company s accounting treatment for business combinations on a prospective basis.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51* (FAS 160). FAS No. 160 requires the recognition of a noncontrolling (minority) interest as a component of equity in the consolidated financial statements as opposed to as a liability or mezzanine equity. FAS 160 also changes the computation of net income of a consolidated group such that earnings attributed to the noncontrolling interest will no longer be deducted in determining net income. Instead, it must be separately presented on the face of the consolidated income statement. FASB requires that FAS 160 and FAS 141R to be adopted concurrently and thus, FAS 160 is also effective for fiscal years beginning after December 15, 2008 on a prospective basis. The Company will adopt the provisions of this statement beginning the first quarter of fiscal year 2010. This standard will change the Company s accounting treatment and presentation of business combinations with noncontrolling interests on a prospective basis.

3. Net Income (Loss) Per Common Share

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

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

	Three Months Ended December 31, 2008	Three Months Ended December 31, 2007
Numerator:		
Basic and diluted net income (loss) per common share:		
Net income (loss)	$ 23	$ (16)
Denominator:		
Weighted average common shares outstanding for basic calculation (a)	149.2	147.2
Dilutive effect of options and restricted stock	0.7	
Weighted average common outstanding shares for diluted calculation	149.9	147.2
Net income (loss) per common share basic	$ 0.15	$ (0.11)
Net income (loss) per common share diluted	$ 0.15	$ (0.11)

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

The calculation of diluted net loss per common share for the three months ended December 31, 2007 excludes an adjustment to the weighted-average common shares outstanding for the potential dilution that would occur if the Company s stock options were exercised or the Company s restricted stock had vested. As a result of the Company s net loss for the three months ended December 31, 2007, the effect of the assumed exercise of any outstanding stock options and the assumed vesting of shares of restricted shares would have been anti-dilutive and accordingly, the following share amounts were excluded from the calculation of diluted net loss per share (in millions):

	Three Months Ended December 31, 2007
Stock options	1.0
Restricted stock	2.1

During the quarter ended December 31, 2008, 253,925 shares of restricted stock purchased by or awarded to certain employees of the Company vested.

4. Significant Acquisitions and Dispositions

Acquisition of Interest in Frank Sinatra Estate

The Company acquired a 50% interest in Frank Sinatra Enterprises, LLC (FSE) on November 19, 2007 for $50 million. FSE is a limited liability company established to administer licenses for use of Frank Sinatra s name and likeness and manage all aspects of his music, film and stage content. The transaction was accounted for under the purchase method of accounting, based on the provisions of FASB Interpretation No. 46 (R), *Consolidation of Variable Interest Entities* and the results of operations of FSE have been included in the Company s results of operations from the date of the acquisition. The purchase price has been allocated to the underlying net assets acquired in proportion to the estimated fair value, principally recorded music catalog of $66 million, trademarks of $20 million and goodwill of $14 million.

Discontinued Operations

During fiscal 2008, the Company shut down the operations of Bulldog Entertainment (Bulldog), an entertainment services company, which was recorded in our Recorded Music operations. As a result of this triggering event, the Company performed an impairment test and determined that an $18 million impairment charge was necessary to adjust the assets to fair market value, based on the discounted value of future cash flows. The Company shut down this operation in January 2008 and reported Bulldog s results as a discontinued operation in the consolidated statement of operations.

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5. Investments

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

	December 31, 2008 (unaudited)	September 30, 2008 (audited)
Cost-method investments	$ 42	$ 43
Equity-method investments	7	112
	$ 49	$ 155

The Company s significant cost-method investments at December 31, 2008 relate to its investment in lala of $20 million and imeem of $15 million.

On October 22, 2008, the Company entered into an agreement to sell its remaining equity stake in Front Line Management to Ticketmaster for $123 million in cash. The transaction closed on October 29, 2008 and the Company recorded a gain on the sale of its equity investment of $36 million for the three months ended December 31, 2008.

During the quarter ended December 31, 2008, the Company chose not to continue its participation in Equatrax, L.P. (formerly known as Royalty Services, L.P.) and Equatrax, LLC (formerly known as Royalty Services, LLC), which were formed in 2004 to develop an outsourced royalty platform. As a result, the Company wrote-off the remaining $10 million related to its investment in the joint venture.

6. Inventories

Inventories consist of the following (in millions):

	December 31, 2008 (unaudited)	September 30, 2008 (audited)
Compact discs and other music-related products	$ 55	$ 55
Published sheet music and song books	2	2
	$ 57	$ 57

7. Goodwill and Intangible Assets

Goodwill

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

	Recorded Music	Music Publishing	Total
Balance at September 30, 2008 (audited)	**$ 494**	**$ 591**	**$ 1,085**
Acquisitions	2		2
Dispositions			
Other adjustments			

Balance at December 31, 2008 (unaudited)	**$ 496**	**$ 591**	**$ 1,087**

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The acquisition of goodwill primarily relates to purchase accounting adjustments performed during the three months ended December 31, 2008 for a few small acquisitions.

Other Intangible Assets

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

	September 30, 2008 (audited)	Acquisitions	Other (a)	December 31, 2008 (unaudited)
Intangible assets subject to amortization:				
Recorded music catalog	$ 1,384		(13)	$ 1371
Music publishing copyrights	948	1	(25)	924
Artist contracts	76		(2)	74
Trademarks	31			31
Other intangible assets	8			8
	2,447	1	(40)	2,408
Accumulated amortization	(908)			(966)
Total net intangible assets subject to amortization	1,539			1,442
Intangible assets not subject to amortization:				
Trademarks and brands	100			100
Total net other intangible assets	$ 1,639			$ 1,542

(a) Other represents foreign currency translation adjustments.

8. Restructuring Costs

Acquisition-Related Restructuring Costs

In connection with the Acquisition that was effective as of March 1, 2004, the Company reviewed its operations and implemented several plans to restructure its operations. As part of these restructuring plans, the Company recorded a restructuring liability during 2004, which included costs to exit and consolidate certain activities of the Company, costs to exit certain leased facilities and operations such as international distribution operations, costs to terminate employees, and costs to terminate certain artist, songwriter, co-publisher and other contracts. The number of employees identified to be involuntarily terminated approximated 1,600. Such liabilities were recognized as part of the cost of the Acquisition. As of December 31, 2008, the Company had approximately $15 million of liabilities outstanding primarily related to long-term lease obligations for vacated facilities, which are expected to be settled by 2019 and $99 million of liabilities outstanding primarily related to revaluations of artist and other contracts.

9. Debt

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

	December 31, 2008 (unaudited)	September 30, 2008 (audited)
Senior secured credit facility:		
Term loan (a)	$ 1,375	$ 1,379

	1,375	1,379
7.375% U.S. dollar-denominated Senior Subordinated Notes due 2014 Acquisition Corp.	465	465
8.125% Sterling-denominated Senior Subordinated Notes due 2014 Acquisition Corp. (b)	147	184
9.5% Senior Discount Notes due 2014 Holdings (c)	236	231
Total debt	2,223	2,259
Less current portion	(17)	(17)
Total long-term debt	$ 2,206	$ 2,242

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

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(b) Change represents the impact of foreign currency exchange rates on the carrying value of the Sterling-denominated notes.
(c) Change represents the accrual of interest on the discount notes in the form of an increase in the accreted value of the discount notes.

Restricted Net Assets

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

10. Stock-based Compensation

The following table represents the expense recorded by the Company with respect to its stock-based awards for the three months ended December 31, 2008 and 2007 (in millions):

	Three Months Ended December 31, 2008	Three Months Ended December 31, 2007
Recorded Music	$ 1	$ 2
Music Publishing		
Corporate	1	1
Total	$ 2	$ 3

During the three months ended December 31, 2008, the Company awarded 450,000 shares of restricted stock and 585,000 stock options to its employees.

11. Commitments and Contingencies

Pricing of Digital Music Downloads

On December 20, 2005 and February 3, 2006, the Attorney General of the State of New York served the Company with requests for information in connection with an industry-wide investigation as to whether the practices of industry participants concerning the pricing of digital music downloads violate Section 1 of the Sherman Act, New York State General Business Law §§ 340 et seq., New York Executive Law §63(12), and related statutes. On February 28, 2006, the Antitrust Division of the U.S. Department of Justice served the Company with a request for information in the form of a Civil Investigative Demand as to whether its activities relating to the pricing of digitally downloaded music violate Section 1 of the Sherman Act. Both investigations have now been closed. Subsequent to the announcements of the above governmental investigations, more than thirty putative class action lawsuits concerning the pricing of digital music downloads were filed and were later consolidated for pre-trial proceedings in the Southern District of New York. The consolidated amended complaint, filed on April 13, 2007, alleges conspiracy among record companies to delay the release of their content for digital distribution, inflate their pricing of CDs and fix prices for digital downloads. The complaint seeks unspecified compensatory, statutory and treble damages. All defendants, including the Company, filed a motion to dismiss the consolidated amended complaint on July 30, 2007. This motion was granted on October 9, 2008. Plaintiffs appealed the decision. The Company intends to defend against these lawsuits vigorously, but is unable to predict the outcome of these suits. Any litigation the Company may become involved in as a result of the inquiries of the Attorney General and Department of Justice, regardless of the merits of the claim, could be costly and divert the time and resources of management.

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

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12. Derivative Financial Instruments

During the three months ended December 31, 2008, the Company did not enter into additional interest rate swap agreements to hedge the variability of its expected future cash interest payments. However, the Company entered into additional foreign exchange contracts to hedge its foreign currency royalty payments for the fiscal year 2009. As of December 31, 2008, the Company had interest rate swap agreements to hedge a total notional debt amount of $897 million and recorded $3 million of deferred net losses in comprehensive income related to hedging on its interest rate swaps and foreign currency forward exchange contracts.

13. Segment Information

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

The accounting policies of the Company s business segments are the same as those described in the summary of significant accounting policies included in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2008. The Company accounts for intersegment sales at fair value as if the sales were to third parties. While intercompany transactions are treated like third-party transactions to determine segment performance, the revenues (and corresponding expenses recognized by the segment that is counterparty to the transaction) are eliminated in consolidation, therefore, do not themselves impact the consolidated results. Segment information consists of the following (in millions):

Three Months Ended	Recorded music	Music publishing	Corporate expenses and eliminations	Total
December 31, 2008				
Revenues	$ 749	$ 134	$ (5)	$ 878
OIBDA	108	21	(22)	107
Depreciation of property, plant and equipment	(5)	(1)	(2)	(8)
Amortization of intangible assets	(43)	(15)		(58)
Operating income (loss)	$ 60	$ 5	$ (24)	$ 41
December 31, 2007				
Revenues	$ 850	$ 144	$ (5)	$ 989
OIBDA	136	21	(28)	129
Depreciation of property, plant and equipment	(9)	(1)	(3)	(13)
Amortization of intangible assets	(38)	(16)		(54)
Operating income (loss)	$ 89	$ 4	$ (31)	$ 62

14. Additional Financial Information

Cash Interest and Taxes

The Company made interest payments of approximately $35 million and $51 million during the three months ended December 31, 2008 and 2007, respectively. The Company paid approximately $12 million and $26 million of income and withholding taxes in the three months ended December 31, 2008 and 2007, respectively. The Company received $9 million and $2 million of income tax refunds in the three months ended December 31, 2008 and 2007, respectively.

15. Fair Value Measurements

FAS 157 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.

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In addition to defining fair value, FAS 157 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.

The Company does not have any significant assets or liabilities measured at fair value using Level 1 or Level 3 inputs as of December 31, 2008. In accordance with the fair value hierarchy, described above, the following table shows the fair value of the Company s financial liabilities that are required to be measured at fair value as of December 31, 2008, which are classified as other current liabilities ($18 million), and other long-term liabilities ($14 million):

	Fair Value Measurements as of December 31, 2008			
	(Level 1)	**(Level 2)**	**(Level 3)**	**Total**
Liabilities:				
Interest Rate Swaps (a)		$ 16		$ 16
Foreign Currency Forward Exchange Contracts (b)		16		16
Total		**$ 32**		**$ 32**

(a) The fair value of the interest rate swaps is based on dealer quotes using relevant market interest rates.

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

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WARNER MUSIC GROUP CORP.

Supplementary Information

Consolidating Financial Statements

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

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

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

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WARNER MUSIC GROUP CORP.

Supplementary Information

Consolidating Balance Sheet (unaudited)

December 31, 2008

	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	Warner Music Group Corp. Consolidated
Assets:					
Current assets:					
Cash and equivalents	$ 98	$	$ 451	$	$ 549
Accounts receivable, net			543		543
Inventories			57		57
Royalty advances expected to be recouped within one year			176		176
Deferred tax assets			32		32
Other current assets			38		38
Total current assets	98		1,297		1,395
Royalty advances expected to be recouped after one year			215		215
Investments in and advances (from) to consolidated subsidiaries	(140)	93		47	
Investments			49		49
Property, plant and equipment, net			108		108
Goodwill			1,087		1,087
Intangible assets subject to amortization, net			1,442		1,442
Intangible assets not subject to amortization			100		100
Other assets		3	66		69
Total assets	$ (42)	$ 96	$ 4,364	$ 47	$ 4,465
Liabilities and Shareholders (Deficit) Equity:					
Current liabilities:					
Accounts payable	$	$	$ 191	$	$ 191
Accrued royalties			1,198		1,198
Taxes and other withholdings	2		22		24
Current portion of long-term debt			17		17
Deferred income			135		135
Other current liabilities			242		242
Total current liabilities	2		1,805		1,807
Long-term debt		236	1,970		2,206
Deferred tax liabilities, net			235		235
Other noncurrent liabilities	(3)		261		258
Total liabilities	(1)	236	4,271		4,506
Shareholders (deficit) equity	(41)	(140)	93	47	(41)

Total liabilities and shareholders (deficit) equity	$	(42)	$	96	$	4,364	$	47	$	4,465

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WARNER MUSIC GROUP CORP.

Supplementary Information

Consolidating Balance Sheet (audited)

September 30, 2008

	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	Warner Music Group Corp. Consolidated
Assets:					
Current assets:					
Cash and equivalents	$ 98	$	$ 313	$	$ 411
Accounts receivable, net			538		538
Inventories			57		57
Royalty advances expected to be recouped within one year			174		174
Deferred tax assets			30		30
Other current assets			38		38
Total current assets	98		1,150		1,248
Royalty advances expected to be recouped after one year			212		212
Investments in and advances to (from) consolidated subsidiaries	(185)	43		142	
Investments			155		155
Property, plant and equipment, net			117		117
Goodwill			1,085		1,085
Intangible assets subject to amortization, net			1,539		1,539
Intangible assets not subject to amortization			100		100
Other assets		3	67		70
Total assets	$ (87)	$ 46	$ 4,425	$ 142	$ 4,526
Liabilities and Shareholders (Deficit) Equity:					
Current liabilities:					
Accounts payable	$	$	$ 219	$	$ 219
Accrued royalties			1,189		1,189
Taxes and other withholdings	2		14		16
Current portion of long-term debt			17		17
Deferred income			117		117
Other current liabilities	1		312		313
Total current liabilities	3		1,868		1,871
Long-term debt		231	2,011		2,242
Deferred tax liabilities, net			237		237
Other noncurrent liabilities	(4)		266		262
Total liabilities	(1)	231	4,382		4,612
Shareholders (deficit) equity	(86)	(185)	43	142	(86)

Total liabilities and shareholders (deficit) equity	$ (87)	$ 46	$ 4,425	$ 142	$ 4,526

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WARNER MUSIC GROUP CORP.

Supplementary Information

Consolidating Statements of Operations (unaudited)

For The Three Months Ended December 31, 2008 and 2007

	Three months ended December 31, 2008				
	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	Warner Music Group Corp. Consolidated
Revenues	$	$	$ 878	$	$ 878
Costs and expenses:					
Cost of revenues			(484)		(484)
Selling, general and administrative expenses			(295)		(295)
Other income					
Amortization of intangible assets			(58)		(58)
Total costs and expenses			(837)		(837)
Operating income			41		41
Interest expense, net		(5)	(39)		(44)
Minority interest income			7		7
Gain on sale of equity investment			36		36
Gain on foreign exchange transaction			9		9
Impairment of equity investment			(10)		(10)
Other (income) expense, net	23	28		(51)	
Income (loss) from continuing operations before income taxes	23	23	44	(51)	39
Income tax expense			(16)		(16)
Net income (loss) from continuing operations	23	23	28	(51)	23
Loss from discontinuing operations					
Net income (loss)	$ 23	$ 23	$ 28	$ (51)	$ 23

	Three months ended December 31, 2007				
	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	Warner Music Group Corp. Consolidated
Revenues	$	$	$ 989	$	$ 989
Costs and expenses:					
Cost of revenues			(545)		(545)
Selling, general and administrative expenses			(331)		(331)
Other income			3		3
Amortization of intangible assets			(54)		(54)
Total costs and expenses			(927)		(927)

Operating income			62		62
Interest expense, net		(5)	(43)		(48)
Minority interest expense			(2)		(2)
Gain on sale of equity investment					
Gain on foreign exchange transaction					
Impairment of equity investment					
Other (income) expense, net	(16)	(11)		27	
(Loss) income from continuing operations before income taxes	(16)	(16)	17	27	12
Income tax expense			(10)		(10)
Net (loss) income from continuing operations	(16)	(16)	7	27	2
Loss from discontinuing operations			(18)		(18)
Net (loss) income	$ (16)	$ (16)	$ (11)	$ 27	$ (16)

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WARNER MUSIC GROUP CORP.

Supplementary Information

Consolidating Statement of Cash Flows (unaudited)

For The Three Months Ended December 31, 2008

	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	Consolidated
Cash flows from operating activities:					
Net income (loss)	$ 23	$ 23	$ 28	$ (51)	$ 23
Loss from discontinued operations					
Income (loss) from continued operations	23	23	28	(51)	23
Adjustments to reconcile net income to net cash used in operating activities:					
Depreciation and amortization			66		66
Deferred taxes					
Gain on sale of equity investment			(36)		(36)
Gain on foreign exchange transaction			(9)		(9)
Impairment of equity investment			10		10
Non-cash interest expense		5	6		11
Non-cash, stock-based compensation expense			2		2
Minority interest (income) expense			(7)		(7)
Other non-cash items	(23)	(28)	(1)	51	(1)
Changes in operating assets and liabilities:					
Accounts receivable			(22)		(22)
Inventories			(3)		(3)
Royalty advances			(26)		(26)
Accounts payable and accrued liabilities			40		40
Other balance sheet changes			(5)		(5)
Net cash provided by operating activities			43		43
Cash flows from investing activities:					
Repayment of loans to third parties			3		3
Investments and acquisitions of businesses			(5)		(5)
Acquisition of publishing rights			(2)		(2)
Proceeds from the sale of investments			124		124
Capital expenditures			(3)		(3)
Net cash provided by investing activities			117		117
Cash flows from financing activities:					
Debt repayments			(4)		(4)
(Decrease) increase in intercompany					
Dividends paid					
Net cash (used in) provided by financing activities			(4)		(4)

Effect of foreign currency exchange rate changes on cash			(18)		(18)
Net increase in cash and equivalents			138		138
Cash and equivalents at beginning of period	98		313		411
Cash and equivalents at end of period	$ 98	$	$ 451	$	$ 549

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WARNER MUSIC GROUP CORP.

Supplementary Information

Consolidating Statement of Cash Flows (unaudited)

For The Three Months Ended December 31, 2007

	Warner Music Group Corp.	WMG Holdings Corp. (issuer)	WMG Acquisition Corp. (in millions)	Eliminations	Consolidated
Cash flows from operating activities:					
Net (loss) income	$ (16)	$ (16)	$ (11)	$ 27	$ (16)
Loss from discontinued operations			18		18
(Loss) income from continued operations	(16)	(16)	7	27	2
Adjustments to reconcile net income to net cash used in operating activities:					
Depreciation and amortization			67		67
Deferred taxes			(11)		(11)
Gain on sale of equity investment					
Gain on sale of foreign exchange transaction					
Impairment of equity investment					
Non-cash interest expense		5	7		12
Non-cash stock compensation expense			3		3
Minority interest expense			2		2
Other non-cash items	16	11	(2)	(27)	(2)
Changes in operating assets and liabilities:					
Accounts receivable			(96)		(96)
Inventories			(2)		(2)
Royalty advances			(46)		(46)
Accounts payable and accrued liabilities			28		28
Other balance sheet changes	(3)		10		7
Net cash used in operating activities	(3)		(33)		(36)
Cash flows from investing activities:					
Repayment of loans to third parties					
Investments and acquisitions of businesses			(106)		(106)
Acquisition of publishing rights			(11)		(11)
Proceeds from the sale of investments			5		5
Capital expenditures			(7)		(7)
Net cash used in investing activities			(119)		(119)
Cash flows from financing activities:					
Debt repayments			(4)		(4)
(Decrease) increase in intercompany	(8)		8		
Dividends paid	(20)				(20)
Net cash (used in) provided by financing activities	(28)		4		(24)
			6		6

Effect of foreign currency exchange rate changes on cash					
Net decrease in cash and equivalents	(31)		(142)		(173)
Cash and equivalents at beginning of period	74		259		333
Cash and equivalents at end of period	$ 43	$	$ 117	$	$ 160

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

You should read the following discussion of our results of operations and financial condition with the unaudited interim financial statements included elsewhere in this Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2008 (the Quarterly Report). This discussion contains forward-looking statements and involves numerous risks and uncertainties. Actual results may differ materially from those contained in any forward-looking statements.

We make available on our Internet website free of charge our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K as soon as practicable after we electronically file such reports with the Securities and Exchange Commission (the SEC). Our website address is www.wmg.com. The information contained in our website is not incorporated by reference in this Quarterly Report.

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

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

- the impact of our substantial leverage on our ability to raise additional capital to fund our operations, on our ability to react to changes in the economy or our industry and on our ability to meet our obligations under our indebtedness;

- the continued decline in the global recorded music industry and the rate of overall decline in the recorded music industry;

- current uncertainty in global economic conditions could adversely affect our prospects and our results of operations;

- our ability to continue to identify, sign and retain desirable talent at manageable costs;

- the threat posed to our business by piracy of music by means of home CD-R activity, Internet peer-to-peer file-sharing and sideloading of unauthorized content;

- the significant threat posed to our business and the music industry by organized industrial piracy;

the popular demand for particular recording artists and/or songwriters and albums and the timely completion of albums by major recording artists and/or songwriters;

the diversity and quality of our portfolio of songwriters;

the diversity and quality of our album releases;

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

our involvement in intellectual property litigation;

the possible downward pressure on our pricing and profit margins;

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the seasonal and cyclical nature of recorded music sales;

our ability to continue to enforce our intellectual property rights in digital environments;

the ability to develop a successful business model applicable to a digital environment;

the impact of heightened and intensive competition in the recorded music and music publishing businesses and our inability to execute our business strategy;

risks associated with our non-U.S. operations, including limited legal protections of our intellectual property rights and restrictions on the repatriation of capital;

the impact of legitimate music distribution on the Internet or the introduction of other new music distribution formats;

the reliance on a limited number of online music stores and their ability to significantly influence the pricing structure for online music stores;

the impact of rate regulations on our Recorded Music and Music Publishing businesses;

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

risks associated with the fluctuations in foreign currency exchange rates;

our ability and the ability of our joint venture partners to operate our existing joint ventures satisfactorily;

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

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

changes in law and government regulations;

trends that affect the end uses of our musical compositions (which include uses in broadcast radio and television, film and advertising businesses);

the growth of other products that compete for the disposable income of consumers;

risks inherent in relying on one supplier for manufacturing, packaging and distribution services in North America and Europe;

risks inherent in our acquiring or investing in other businesses including our ability to successfully manage new businesses that we may acquire as we diversify revenue streams within the music industry;

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

the fact that we are outsourcing certain back office functions, such as IT infrastructure and development, which will make us more dependent upon third parties;

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

failure to attract and retain key personnel.

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

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

INTRODUCTION

Warner Music Group Corp. was formed by the Investor Group on November 21, 2003. The Company is the direct parent of Holdings, which is the direct parent of Acquisition Corp. Acquisition Corp is one of the world s major music companies and the successor to substantially all of the interests of the recorded music and music publishing businesses of Time Warner. Effective March 1, 2004, Acquisition Corp acquired such interests from Time Warner for approximately $2.6 billion. The original Investor Group included THL, Bain, Providence and Music Capital. Music Capital s partnership agreement required that the Music Capital partnership dissolve and commence winding up by the second anniversary of the Company s May 2005 initial public offering. As a result, on May 7, 2007, Music Capital made a pro rata distribution of all shares of common stock of the Company held by it to its partners. The shares held by Music Capital had been subject to a stockholders agreement among Music Capital, THL, Bain and

Providence and certain other parties. As a result of the distribution, the shares distributed by Music Capital ceased to be subject to the voting and other provisions of the stockholders agreement and Music Capital was no longer part of the Investor Group subject to the stockholders agreement.

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

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

- *Overview.* This section provides a general description of our business, as well as recent developments that we believe are important in understanding our results of operations and financial condition and in anticipating future trends.

- *Results of operations.* This section provides an analysis of our results of operations for the three months ended December 31, 2008 and 2007. This analysis is presented on both a consolidated and segment basis.

- *Financial condition and liquidity.* This section provides an analysis of our cash flows for the three months ended December 31, 2008 and 2007, as well as a discussion of our financial condition and liquidity as of December 31, 2008. The discussion of our financial condition and liquidity includes (i) our available financial capacity under the revolving credit portion of our senior secured credit facility and (ii) a summary of our key debt compliance measures under our debt agreements.

Use of OIBDA

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

Use of Constant Currency

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

OVERVIEW

We are one of the world s major music 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. In addition to the more traditional methods of discovering and developing artists, following the Acquisition we established ILG to discover artists earlier in the process and at a lower cost by leveraging our independent distribution network.

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

In the U.S., our Recorded Music operations are conducted principally through our major record labels Warner Bros. Records and The Atlantic Records Group. Our Recorded Music operations also include Rhino Entertainment (Rhino), a division that specializes in marketing our music catalog through compilations and reissuances of previously released music and video titles, as well as in the licensing of recordings to and from third parties for various uses, including film and television soundtracks. Rhino is also transitioning into our primary licensing division focused on acquiring broader licensing rights from certain catalog artists. For example, we have an exclusive license with The Grateful Dead to manage the band s intellectual property and have recently acquired a 50% interest in Frank Sinatra Enterprises, an entity that administers licenses for use of Frank Sinatra s name and likeness and manages all aspects of his music, film and stage content. The Company also conducts its Recorded Music operations through a collection of additional record labels, including, among others, Asylum, Bad Boy, Cordless, East West, Elektra, Nonesuch, Reprise, Roadrunner, Rykodisc, Sire and Word.

Outside the U.S., our Recorded Music activities are conducted in more than 50 countries primarily through WMI and its various subsidiaries, affiliates and non-affiliated licensees. WMI engages in the same activities as our U.S. labels: discovering and signing artists and distributing, marketing and selling their recorded music. In most cases, WMI also markets and distributes the records of those artists for whom our domestic record labels have international rights. In certain smaller countries, WMI licenses to unaffiliated third-party record labels the right to distribute its records. Recorded Music activities in Canada and Latin America are conducted though Warner Music s North American operations.

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

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

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

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Our principal Recorded Music revenue sources are sales of CDs and DVDs, online digital downloads, mobile phone downloads and ringtones and other recorded music products and license fees received for the ancillary uses of our Recorded Music catalog. Increasingly, we are also diversifying our revenues beyond those revenue sources to include revenues from expanded rights associated with our artists and other artists, including sponsorship, fan club, websites, merchandising, touring, ticketing and artist management. The principal costs associated with our Recorded Music operations are as follows:

- royalty costs and artist and repertoire costs the costs associated with (i) paying royalties to artists, producers, songwriters, other copyright holders and trade unions, (ii) signing and developing artists, (iii) creating master recordings in the studio and (iv) creating artwork for album covers and liner notes;

- product costs the costs to manufacture, package and distribute product to wholesale and retail distribution outlets as well as those principal costs related to expanded rights.

- selling and marketing costs the costs associated with the promotion and marketing of artists and recorded music products, including costs to produce music videos for promotional purposes and artist tour support; and

- general and administrative costs the costs associated with general overhead and other administrative costs.

Music Publishing Operations

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

Our Music Publishing operations include Warner/Chappell, our global Music Publishing company headquartered in New York with operations in over 50 countries through various subsidiaries, affiliates and non-affiliated licensees. We own or control rights to more than one million musical compositions, including numerous pop hits, American standards, folk songs and motion picture and theatrical compositions. Assembled over decades, our award-winning catalog includes over 65,000 songwriters and composers and a diverse range of genres including pop, rock, jazz, country, R&B, hip-hop, rap, reggae, Latin, folk, blues, symphonic, soul, Broadway, techno, alternative, gospel and other Christian music. Warner/Chappell also administers the music and soundtracks of several third-party television and film producers and studios, including Lucasfilm, Ltd., Hallmark Entertainment, Disney Music Publishing, Home Box Office (HBO), New Line Cinema and Warner Bros. Studios. In 2007, we entered the production music library business with the acquisition of Non-Stop Music. Production music is a complementary alternative to licensing standards and contemporary hits for television, film and advertising producers.

Publishing revenues are derived from five main sources:

- *Mechanical:* the licensor receives royalties with respect to compositions embodied in recordings sold in any format or configuration, including physical recordings (*e.g.*, CDs and DVDs).

- *Performance:* the licensor receives royalties if the composition is performed publicly through broadcast of music on television, radio, cable and satellite, live performance at a concert or other venue (*e.g.*, arena concerts, nightclubs), online and wireless streaming and performance of music in staged theatrical productions.

- *Synchronization:* the licensor receives royalties or fees for the right to use the composition in combination with visual images such as in films or television programs, television commercials and videogames as well as from other uses such as in toys or novelty items and merchandise.

Digital: the licensor receives royalties or fees with respect to Internet and mobile downloads, mobile ringtones and online and mobile streaming.

Other: the licensor receives royalties for other uses such as in sheet music.

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

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

- administration costs the costs associated with general overhead and other administrative costs.

Factors Affecting Results of Operations and Financial Condition

Market Factors

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

Current uncertainty in global economic conditions poses a risk to the overall economy, which has already begun to negatively affect demand for our products and other related matters. The current uncertainty in global economic conditions makes it particularly difficult to predict future product demand and other related matters and makes it more likely that our actual results could differ materially from our expectations. Even in the midst of the global economic slowdown, we remain committed to executing on our strategic initiatives and plan to continue our transformation to adapt to the changing music industry in order to maximize cash flow and profitability. We are adapting to the impact of the economic slowdown by continuing our focus on cash and liquidity. We will monitor current events closely and take advantage of our flexible cost structure to minimize any impact.

Settlements

In September 2006, the major record companies reached a global out-of-court settlement of copyright litigation against the operators of the KaZaA peer-to-peer network. Under the terms of the settlement, the KaZaA defendants agreed to pay compensation to the record companies that brought the action, including us. We recorded approximately $13 million of other income related to this settlement in the fiscal year ended September 30, 2006. These amounts were recorded net of the estimated amounts payable to our artists in respect of royalties. The cash related to this settlement was received in the first quarter of fiscal 2008. We recorded approximately $3 million of other income in conjunction with a contingent payment related to this settlement in fiscal year 2008.

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RESULTS OF OPERATIONS

Three Months Ended December 31, 2008 Compared with Three Months Ended December 31, 2007

Consolidated Historical Results

Revenues

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

	For the Three Months Ended December 31,		2008 vs 2007	
	2008	2007	$ Change	% Change
Revenue by Type				
Physical	$ 537	$ 665	$ (128)	-19%
Digital	156	132	24	18%
Licensing	56	53	3	6%
Total Recorded Music	**749**	**850**	**(101)**	**-12%**
Mechanical	46	60	(14)	-23%
Performance	49	50	(1)	-2%
Synchronization	22	20	2	10%
Digital	15	10	5	50%
Other	2	4	(2)	-50%
Total Music Publishing	**134**	**144**	**(10)**	**-7%**
Intersegment elimination	(5)	(5)		
Total Revenue	**$ 878**	**$ 989**	**$ (111)**	**-11%**
Revenue by Geographical Location				
U.S. Recorded Music	$ 315	$ 400	$ (85)	-21%
U.S. Publishing	48	47	1	2%
Total U.S.	**363**	**447**	**(84)**	**-19%**
International Recorded Music	434	450	(16)	-4%
International Publishing	86	97	(11)	-11%
Total International	**520**	**547**	**(27)**	**-5%**
Intersegment eliminations	(5)	(5)		
Total Revenue	**$ 878**	**$ 989**	**$ (111)**	**-11%**

Total Revenue

Total revenues decreased by $111 million, or 11%, to $878 million for the three months ended December 31, 2008 from $989 million for the three months ended December 31, 2007. Recorded Music and Music Publishing revenues represented 85% and 15% of total revenues for the three months ended December 31, 2008, respectively, compared to 86% and 14% for the three months ended December 31, 2007, respectively. U.S. and international revenues represented 41% and 59% of total revenues for the three months ended December 31, 2008, respectively, compared to 45% and 55% for the three months ended December 31, 2007, respectively. Excluding the unfavorable impact of foreign currency exchange rates, total revenues decreased $59 million, or 6%, for the three months ended December 31, 2008.

Total digital revenues increased by $29 million, or 20%, to $171 million for the three months ended December 31, 2008 from $142 million for the three months ended December 31, 2007. Total digital revenues represented 19% and 14% of consolidated revenues for the three months ended December 31, 2008 and 2007, respectively. Total digital revenues for the three months ended December 31, 2008 were comprised of U.S. revenues of $110 million, or 64% of total digital revenues, and international revenues of $61 million, or 36% of total digital revenues. Total digital revenues for the three months ended December 31, 2007 were comprised of U.S. revenues of $96 million, or 68% of total digital revenues, and international revenues of $46 million, or 32% of total digital revenues. Excluding the unfavorable impact of foreign currency exchange rates, total digital sales increased by $33 million, or 24%, for the three months ended December 31, 2008.

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Recorded Music revenues decreased by $101 million, or 12%, to $749 million for the three months ended December 31, 2008 from $850 million for the three months ended December 31, 2007. The net decrease in physical revenues of $128 million was a result of the ongoing transition in the recorded music industry characterized by a shift in consumption patterns from physical CD/DVD sales to new forms of digital music as well as the impact of the recessionary global economy on retailers. In addition, domestic revenues in the prior period included the release of the largest selling album of calendar 2007 in the U.S. according to SoundScan, Noel by Josh Groban, which sold nearly 4 million units. The decrease in physical CD/DVD sales was partially offset by an increase in revenues from expanded rights.

Digital revenues increased $24 million from the prior-year quarter, largely due to the shift in consumption patterns as noted above. Licensing revenues increased $3 million versus the prior-year quarter.

Excluding the unfavorable impact of foreign currency exchange rates, total Recorded Music revenues decreased $60 million, or 7%, for the three months ended December 31, 2008.

Music Publishing revenues decreased by $10 million, or 7%, to $134 million for the three months ended December 31, 2008 from $144 million for the three months ended December 31, 2007. The decrease was due primarily to declines in mechanical and performance revenues as a result of the continued decline in physical sales in the overall recorded music industry, partially offset by the increases in digital and synchronization revenues. Excluding the unfavorable impact of foreign currency exchange rates, total Music Publishing revenues increased $1 million, or 1%, for the three months ended December 31, 2008.

Revenue by Geographical Location

U.S. revenues decreased by $84 million, or 19%, to $363 million for the three months ended December 31, 2008 from $447 million for the three months ended December 31, 2007 primarily due to decreases of $84 million in physical CD/DVD sales and $10 million in licensing revenues. The overall decline in the U.S. Recorded Music business reflects the ongoing transition in the recorded music industry characterized by a shift in consumption patterns from physical CD/DVD sales to new forms of digital music as well as the impact of the turbulent global economy on retailers. In addition, U.S. sales in the prior period included the release of Noel. Licensing revenue decreased $10 million offset by growth in U.S. digital revenues of $14 million, which was driven by growth of both online downloads and mobile.

International revenues decreased by $27 million, or 5%, to $520 million for the three months ended December 31, 2008 from $547 million for the three months ended December 31, 2007 due in part to decreases of $44 million in physical CD/DVD sales and $10 million in mechanical revenues. These decreases were driven by continued contracting demand for physical product by retailers offset by increased expanded rights revenues as we continue to broaden our revenue mix into growing areas of the music business, including sponsorship, fan club, websites, merchandising, touring, ticketing and artist management. In addition, the prior-year quarter reflected significant sales of several successful international releases, primarily in Europe. Offsetting these decreases in physical CD/DVD sales was an increase of $15 million in international digital sales and an increase of $9 million in licensing revenues due primarily to continued focus on expanding our revenues in this area. Excluding the unfavorable impact of foreign currency exchange rates, total international revenues increased $25 million, or 5%, for the three months ended December 31, 2008.

Cost of revenues

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

	For the Three Months Ended December 31,		*2008 vs 2007*	
	2008	**2007**	**$ Change**	**% Change**
Artist and repertoire costs	$ 313	$ 344	$ (31)	-9%
Product costs	155	182	(27)	-15%
Licensing costs	16	19	(3)	-16%
Total cost of revenues	**$ 484**	**$ 545**	**$ (61)**	**-11%**

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Our cost of revenues decreased by $61 million, or 11%, to $484 million for the three months ended December 31, 2008 from $545 million for the three months ended December 31, 2007. Expressed as a percentage of revenues, cost of revenues was 55% for each of the three months ended December 31, 2008 and 2007.

Artist and repertoire costs increased as a percentage of current year revenues from 35% in the prior-year quarter to 36% in the current-year quarter driven primarily by higher royalty rates on products sold in the quarter compared with those in the prior-year quarter, offset in part by a benefit relating to the timing of artist and repertoire spending.

Product costs remained flat at 18% of revenues in the three months ended December 31, 2008 and 2007. The decrease in product costs was due primarily to change in mix from physical to digital offset by increased cost of revenues related to touring and merchandising.

Licensing costs decreased $3 million, or 16%, to $16 million for the three months ended December 31, 2008 from $19 million for the three months ended December 31, 2007, and licensing costs represented 29% and 36% of licensing revenues for the three months ended December 31, 2008 and 2007, respectively. Excluding the unfavorable impact of foreign currency exchange rates, licensing costs remained unchanged compared to the three months ended December 31, 2007.

Selling, general and administrative expenses

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

	For the Three Months Ended December 31,		*2008 vs 2007*	
	2008	**2007**	**$ Change**	**% Change**
General and administrative expense (1)	$ 140	$ 152	$ (12)	-8%
Selling and marketing expense	137	161	(24)	-15%
Distribution expense	18	18		
Total selling, general and administrative expense	**$ 295**	**$ 331**	**$ (36)**	**-11%**

(1) Includes depreciation expense of $8 million and $13 million for the three months ended December 31, 2008, and 2007, respectively.

Total selling, general and administrative expense decreased by $36 million, or 11%, to $295 million for the three months ended December 31, 2008 from $331 million for the three months ended December 31, 2007. Expressed as a percentage of revenues, selling, general and administrative expenses were 34% and 33% for the three months ended December 31, 2008 and 2007, respectively.

General and administrative expenses decreased by $12 million, or 8%, to $140 million for the three months ended December 31, 2008 from $152 million for the three months ended December 31, 2007. The decrease in general and administrative expense is primarily a result of decreased IT consulting and legal costs. Partially offsetting the decrease was a slight increase in bad debt expense.

Selling and marketing expense decreased by $24 million, or 15%, to $137 million for the three months ended December 31, 2008 from $161 million for the three months ended December 31, 2007. This decrease was primarily the result of our efforts to better align spending on selling and marketing expense with revenues earned. Expressed as a percentage of revenues, selling and marketing expense remained flat at 16% for the three months ended December 31, 2008 and 2007, respectively.

Distribution expense remained flat at 2% of revenues and in absolute dollars.

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Other income

Other income of $3 million for the three months ended December 31, 2007 related to a contingent payment related to settlement of copyright litigation against the operators of the KaZaA peer-to-peer network.

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

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

	For the Three Months Ended December 31,		*2008 vs 2007*	
	2008	2007	$ Change	% Change
OIBDA	$ 107	$ 129	$ (22)	-17%
Depreciation expense	(8)	(13)	5	-38%
Amortization expense	(58)	(54)	(4)	7%
Operating income from continuing operations	**41**	**62**	**(21)**	**-34%**
Interest expense, net	(44)	(48)	4	-8%
Minority interest income (expense)	7	(2)	9	-450%
Gain on sale of equity investment	36		36	
Gain on foreign exchange transaction	9		9	
Impairment of equity investment	(10)		(10)	
Other expense, net				
Income from continuing operations before income taxes	**39**	**12**	**27**	**225%**
Income tax expense	(16)	(10)	(6)	60%
Income from continuing operations	**23**	**2**	**21**	**1050%**
Loss from discontinued operations, net of taxes		**(18)**	**18**	**-100%**
Net income (loss)	**$ 23**	**$ (16)**	**$ 39**	**244%**

OIBDA

Our OIBDA decreased by $22 million to $107 million for the three months ended December 31, 2008 as compared to $129 million for the three months ended December 31, 2007. Expressed as a percentage of revenues, total OIBDA margin was 12% for the three months ended December 31, 2008 as compared to 13% for the three months ended December 31, 2007. Our OIBDA decrease was primarily driven by margin benefits in the prior-year quarter related to Noel as well as negative operating leverage from lower sales on a similar fixed cost base.

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

Depreciation expense

Our depreciation expense decreased by $5 million, or 38%, to $8 million for three months ended December 31, 2008. The decrease primarily related the effects of lower capital spending in prior periods as well as lower expenses related to projects that have been fully depreciated. Excluding the unfavorable impact of foreign currency exchange rates, depreciation expense decreased $4 million or 33%, for the three months ended December 31, 2008.

Amortization expense

Amortization expense increased by $4 million, or 7%, to $58 million for the three months ended December 31, 2008. The increase was due primarily to the increased value of intangible assets acquired.

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Operating income from continuing operations

Our operating income decreased $21 million, or 34%, to $41 million for the three months ended December 31, 2008 as compared to $62 million for the prior-year. The decrease in operating income was due to the decline in OIBDA noted above.

Interest expense, net

Our interest expense, net, decreased $4 million, or 8%, to $44 million for the three months ended December 31, 2008 as compared to $48 million for the three months ended December 31, 2007. This was the result of decreases in the interest rates on our floating rate debt obligations.

See Financial Condition and Liquidity for more information.

Minority interest income (expense)

Minority interest increased $9 million for the three months ended December 31, 2008 related to the losses ascribed to minority holders.

Gain on sale of equity investment

During the quarter ended December 31, 2008, we entered into an agreement to sell our remaining equity stake in Front Line Management to Ticketmaster for $123 million in cash. As a result of the transaction, we recorded a gain on sale of equity investment of $36 million for the three months ended December 31, 2008.

Gain on foreign exchange transaction

During the quarter ended December 31, 2008, we recorded a $9 million non-cash gain on a foreign exchange transaction as a result of a settlement of a short-term foreign denominated loan related to the Front Line Management sale.

Impairment of equity investment

During the quarter ended December 31, 2008, we chose not to continue our participation in Equatrax, L.P. (formerly known as Royalty Services, L.P.) and Equatrax, LLC (formerly known as Royalty Services, LLC), which were formed in 2004 to develop an outsourced royalty platform. As a result, the company, wrote-off the remaining $10 million related to its investment in the joint venture.

Other expense, net

Other income (expense), net for the three months ended December 31, 2008 includes net hedging losses on foreign exchange contracts, which represent currency exchange movements associated with inter-company receivables and payables that are short term in nature. These losses were offset by equity in earnings on our share of net income on investments recorded in accordance with the equity method of accounting for an unconsolidated investee.

Income tax expense

We provided income tax expense of $16 million and $10 million for the three months ended December 31, 2008 and 2007, respectively. The prior-year quarter income tax expense included a tax benefit of $6 million related to enacted tax rate changes in various jurisdictions.

We are currently under examination by the Internal Revenue Service for the fiscal years ended September 30, 2004 through September 30, 2006. The examination is anticipated to be completed in the next twelve months. We do not expect the total reserve for uncertain tax positions to change significantly in the next twelve months.

Income from continuing operations

Our income from continuing operations increased by $21 million, to $23 million for the three months ended December 31, 2008 as compared to $2 million for the three months ended December 31, 2007. The increase was primarily the result of our gain on the sale of our remaining stake in Front Line Management, our gain on a foreign exchange transaction, and an increase in minority interest income, partially offset by an increase in income tax expense, the impairment of an equity investment and a decrease in OIBDA as discussed above.

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Loss from discontinued operations, net of taxes

During the quarter ended December 31, 2007, we discontinued our Bulldog operations. In connection with shutting down Bulldog, we incurred a loss of $18 million representing an impairment of goodwill recorded at the time of the decision to shut down its operations.

Business Segment Results

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

	For the Three Months Ended December 31,		*2008 vs 2007*	
	2008	**2007**	**$ Change**	**% Change**
Recorded Music				
Revenue	$ 749	$ 850	$ (101)	-12%
OIBDA	108	136	(28)	-21%
Operating income from continuing operations	$ 60	$ 89	$ (29)	-33%
Music Publishing				
Revenue	$ 134	$ 144	$ (10)	-7%
OIBDA	21	21		0%
Operating income from continuing operations	$ 5	$ 4	$ 1	25%
Corporate expenses and eliminations				
Revenue	$ (5)	$ (5)	$	0%
OIBDA	(22)	(28)	6	-21%
Operating loss from continuing operations	$ (24)	$ (31)	$ 7	-23%
Total				
Revenue	$ 878	$ 989	$ (111)	-11%
OIBDA	107	129	(22)	-17%
Operating income from continuing operations	$ 41	$ 62	$ (21)	-34%

Recorded Music

Revenues

Recorded Music revenues decreased by $101 million, or 12%, to $749 million for the three months ended December 31, 2008 from $850 million for the three months ended December 31, 2007. Recorded Music revenues represented 85% and 86% of consolidated revenues for the three months ended December 31, 2008 and 2007, respectively. International Recorded Music revenues were $434 million and $450 million, or 58% and 53% of consolidated Recorded Music revenues for the three months ended December 31, 2008 and 2007, respectively.

The net decrease in Recorded Music revenues was primarily a result of a decline in physical CD/DVD sales offset in part by increases in digital sales and increased revenues from expanded rights. The decrease in physical CD/DVD sales related to the ongoing transition in the recorded music industry characterized by a shift in consumption patterns from physical CD/DVD sales to new forms of digital music as well as the impact of the recessionary global economy on retailers. In addition, domestic revenues in the prior-year quarter included the release of Noel, which sold nearly 4 million units in the U.S.

This decrease was partially offset by an increase in digital sales of $24 million, resulting from global growth of both online downloads and mobile.

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OIBDA and Operating Income from continuing operations

Recorded Music OIBDA was $108 million for the three months ended December 31, 2008 as compared to $136 million for the three months ended December 31, 2007. Recorded Music operating income included the following (in millions):

	For the Three Months Ended December 31,		*2008 vs 2007*	
	2008	**2007**	**$ Change**	**% Change**
OIBDA	$ 108	$ 136	$ (28)	-21%
Depreciation and amortization	(48)	(47)	(1)	2%
Operating income from continuing operations	**$ 60**	**$ 89**	**$ (29)**	**-33%**

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

	For the Three Months Ended December 31,		*2008 vs 2007*	
	2008	**2007**	**$ Change**	**% Change**
Artist and repertoire costs	$ 222	$ 242	$ (20)	-8%
Product costs	153	182	(29)	-16%
Licensing costs	17	19	(2)	-11%
Total cost of revenues	**$ 392**	**$ 443**	**$ (51)**	**-12%**

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

	For the Three Months Ended December 31,		*2008 vs 2007*	
	2008	**2007**	**$ Change**	**% Change**
General and administrative expense (1)	$ 99	$ 108	$ (9)	-8%
Selling and marketing expense	136	158	(22)	-14%
Distribution expense	19	17	2	12%
Total selling, general and administrative expense	**$ 254**	**$ 283**	**$ (29)**	**-10%**

(1) Includes depreciation expense of $5 million and $9 million for the three months ended December 31, 2008 and 2007, respectively.
Recorded Music operating income from continuing operations decreased by $29 million, or 33% due to the decreases in OIBDA described above.

Recorded Music OIBDA decreased by $28 million, or 21%, to $108 million for the three months ended December 31, 2008 compared to $136 million for the three months ended December 31, 2007. Expressed as a percentage of Recorded Music revenues, Recorded Music OIBDA was 14% and 16% for the three months ended December 31, 2008 and 2007, respectively. Our OIBDA decrease largely reflects margin benefits in the prior-year quarter related to sales from Noel , partially offset by a shift to higher-margin digital products.

Cost of revenues

Recorded Music cost of revenues decreased $51 million, or 12%, for the three months ended December 31, 2008 and remained flat as a percentage of sales compared with the three months ended December 31, 2007. The decrease was comprised of decreases in product costs of $29 million, artist and repertoire costs of $20 million and licensing costs of $2 million. The decrease in product costs was driven by a change in product mix with an increase in the volume of digital sales. Artist and repertoire costs increased as a percentage of revenues from 28% in the prior-year quarter to 30% in the current-year quarter driven primarily by higher royalty rates on products sold in the quarter compared with those in the prior-year quarter, offset in part by a benefit relating to the timing of artist and repertoire spending, which is expensed when paid.

Selling, general and administrative expense

Recorded Music selling, general and administrative expense decreased $29 million, or 10%, for the three months ended December 31, 2008. This decrease was primarily the result of our efforts to better align spending on selling and marketing expense with revenues earned.

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Music Publishing

Revenues

Music Publishing revenues decreased by $10 million, or 7%, to $134 million for the three months ended December 31, 2008 compared to $144 million for the three months ended December 31, 2007. Music Publishing revenues represented 15% and 14% of consolidated revenues, for the three months ended December 31, 2008 and 2007, respectively. International Music Publishing revenues were $86 million and $97 million, or 64% and 67% of consolidated Music Publishing revenues for the three months ended December 31, 2008 and 2007, respectively.

The decrease in Music Publishing revenues was primarily attributable to decreased mechanical revenue as a result of continued industry-wide declines in physical sales as well as decreased performance revenue. These decreases were offset by increased digital sales of $5 million and synchronization revenues of $2 million. Digital sales represented 11% and 7% of Music Publishing revenues for the three months ended December 31, 2008 and 2007, respectively.

OIBDA and Operating Income

Music Publishing operating income increased to $5 million for the three months ended December 31, 2008 as compared to $4 million for the three months ended December 31, 2007. Music Publishing operating income includes the following (in millions):

	For the Three Months Ended December 31,		*2008 vs 2007*	
	2008	**2007**	**$ Change**	**% Change**
OIBDA	$ 21	$ 21	$	
Depreciation and amortization	(16)	(17)	1	-6%
Operating income	**$ 5**	**$ 4**	**$ 1**	**25%**

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

	For the Three Months Ended December 31,		*2008 vs 2007*	
	2008	**2007**	**$ Change**	**% Change**
Artist and repertoire costs	$ 99	$ 108	$ (9)	-8%
Total cost of revenues	**$ 99**	**$ 108**	**$ (9)**	**-8%**

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

	For the Three Months Ended December 31,		*2008 vs 2007*	
	2008	**2007**	**$ Change**	**% Change**
General and administrative expense (1)	$ 15	$ 16	$ (1)	-6%
Total selling, general and administrative expense	**$ 15**	**$ 16**	**$ (1)**	**-6%**

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

Music Publishing operating income increased by $1 million due to the decrease in amortization.

Music Publishing OIBDA remained flat at $21 million for the three months ended December 31, 2008 and 2007, respectively. Expressed as a percentage of Music Publishing revenues, Music Publishing OIBDA was 16% and 15% for the three months ended December 31, 2008 and 2007, respectively.

Cost of revenues

Music Publishing cost of revenues decreased by $9 million for the three months ended December 31, 2008. Expressed as a percentage of Music Publishing revenues, Music Publishing cost of revenues was 74% and 75% for the three months ended December 31, 2008 and 2007, respectively. The decrease was driven by a decrease in artist and repertoire costs relating to the timing of artist and repertoire spending as well as the change in revenue mix as different rates apply to different revenue streams.

Selling, general and administrative expense

Music Publishing selling, general and administrative expense decreased $1 million for the three months ended December 31, 2008. Expressed as a percentage of Music Publishing revenues, Music Publishing selling, general and administrative expense remained flat at 11% for the three months ended December 31, 2008 and 2007, respectively.

Corporate Expenses and Eliminations

Corporate expenses before depreciation and amortization expense decreased by $6 million to $22 million for the three months ended December 31, 2008, compared to $28 million for the three months ended December 31, 2007. The decrease was primarily driven by a decrease in selling, general and administrative expense of $6 million, which is in line with the overall corporate directive to monitor expenses. Corporate overhead is down as a result of lower IT consulting and professional fees partially offset by expenses related to outsourcing projects which started in the current year quarter.

FINANCIAL CONDITION AND LIQUIDITY

Financial Condition

At December 31, 2008, we had $2.223 billion of debt, $549 million of cash and equivalents (net debt of $1.674 billion, defined as total debt less cash and equivalents and short-term investments) and a $41 million shareholders deficit. This compares to $2.259 billion of debt, $411 million of cash and equivalents (net debt of $1.848 billion, defined as total debt less cash and equivalents and short-term investments) and an $86 million shareholders deficit at September 30, 2008. Net debt decreased by $174 million as a result of (i) a $138 million increase in cash and equivalents as more fully described below, (ii) a $37 million impact in foreign exchange rates on our Sterling-denominated Senior Subordinated Notes, (iii) a $4 million quarterly principal repayment of our long-term loans under our senior secured credit facility offset by (iv) a $5 million increase related to the accretion on our Holdings Discount Notes.

The $45 million decrease in shareholders deficit during the three months ended December 31, 2008 consisted of $23 million of net income for the three months ended December 31, 2008, foreign currency exchange movements of $23 million, and $2 million of stock compensation offset by deferred losses on derivative financials instruments of $3 million.

Cash Flows

The following table summarizes our historical cash flows. The financial data for the three months ended December 31, 2008 and 2007 are unaudited and are derived from our interim financial statements included elsewhere herein. The cash flow is comprised of the following in millions:

	Three Months Ended December 31, 2008 (unaudited)	Three Months Ended December 31, 2007 (unaudited)
Cash provided by (used in):		
Operating activities	$ 43	$ (36)
Investing activities	117	(119)
Financing activities	(4)	(24)

Operating Activities

Cash provided by operations was $43 million for the three months ended December 31, 2008 compared to cash used of $36 million for the three months ended December 31, 2007. The $79 million increase in cash provided by operations related primarily to the variable timing of our working capital requirements in association with our business cycle, which included a decrease of use of cash paid for songwriter and artist advance payments, as well as a decrease in cash paid for interest and taxes.

Investing Activities

Cash provided by investing activities was $117 million for the three months ended December 31, 2008 as compared to cash used of $119 million for the three months ended December 31, 2007. The $117 million of cash provided by investing activities in the three months ended December 31, 2008 consisted primarily of proceeds received from the sale of our remaining stake in Front Line Management to Ticketmaster for $123 million, offset by cash used for acquisitions totaling $5 million, net of cash acquired, and $2 million to acquire music publishing rights. The $119 million of cash used in investing activities in the three months ended December 31, 2007 consisted primarily of the investment in FSE for $50 million, additional smaller acquisitions totaling $23 million, net of cash acquired, and $11 million to acquire music publishing rights. In addition, cash used in investing activities reflected $35 million invested in the cost-method investments lala and imeem.

Financing Activities

Cash used in financing activities was $4 million for the three months ended December 31, 2008 compared to $24 million for the three months ended December 31, 2007. The $4 million of cash used in financing activities in the three months ended December 31, 2008 consisted of our quarterly repayments of debt. The $24 million of cash used in financing activities in the three months ended December 31, 2007 consisted of our quarterly repayments of debt and dividend payments.

Liquidity

Our primary sources of liquidity are the cash flow generated from our subsidiaries operations, availability under the $250 million (less $4 million of outstanding letters of credit as of December 31, 2008) revolving line of credit of our senior secured credit facility and available cash and equivalents and short-term investments. These sources of liquidity are needed to fund our debt service requirements, working capital requirements, capital expenditure requirements and any regular quarterly dividends we may elect to pay. We believe that our existing sources of cash will be sufficient to support our existing operations over the next twelve months.

As of December 31, 2008, our long-term debt consisted of $1.375 billion of borrowings (including $17 million of debt that is classified as a current obligation) under the term loan portion of our senior secured credit facility, $612 million of Acquisition Corp. Senior Subordinated Notes and $236 million of Holdings Discount Notes. There were no borrowings under the revolving portion of our senior secured credit facility as of December 31, 2008.

Senior Secured Credit Facility

The senior secured credit facility consists of a $1.375 billion outstanding term loan portion and a $250 million revolving credit portion. The term loan portion of the facility matures in February 2011. We are required to prepay outstanding term loans, subject to certain exceptions and conditions, with excess cash flow or in the event of certain asset sales and casualty and condemnation events and incurrence of debt. We are required to make minimum repayments under the term loan portion of our facility in quarterly principal amounts of approximately $4 million through November 2010, with a remaining balloon payment in February 2011. The revolving credit portion of the senior secured credit facility matures in February 2010. There are no mandatory reductions in borrowing availability for the revolving credit portion of the facility through its term.

Borrowings under both the term loan and revolving credit portion of the senior secured credit facility currently bear interest at a rate equal to an applicable margin plus, at our option, either (a) a base rate determined by reference to the higher of (1) the prime rate of Bank of America, N.A. and (2) the federal funds rate plus 0.5% of 1% or (b) a LIBOR rate determined by reference to the costs of funds for deposits in the currency of such borrowing for the interest period relevant to such borrowing adjusted for certain additional costs. As of December 31, 2008, the applicable margins with respect to base rate borrowings and LIBOR borrowings were 1.25% and 2.25%, respectively, for borrowings under the revolving credit facility. The applicable margins are variable subject to changes in certain leverage ratios. For borrowings under the term loan facility, the margins with respect to the base rate borrowings and LIBOR borrowings are 1.00% and 2.00%, respectively, but will be 0.75% and 1.75%, respectively, if the senior secured debt of Acquisition Corp. is rated at least BB by S&P and Ba2 by Moody s. As of February 4, 2009 our term loan facility was rated BB by S&P and Ba3 by Moody s.

In addition to paying interest on outstanding principal under the senior secured credit facility, we are required to pay a commitment fee to the lenders under the revolving credit facility in respect of the unutilized commitments. The initial commitment fee was 0.5%. As of December 31, 2008, the commitment fee rate was 0.375%. The commitment fee rate is variable subject to changes in our leverage ratio. We also are required to pay customary letter of credit fees, as necessary.

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The senior secured credit facility contains a number of covenants that, among other things, restrict, subject to certain exceptions, our ability and the ability of our restricted subsidiaries to sell assets, incur additional indebtedness or issue preferred stock, pay dividends and distributions or repurchase capital stock, create liens on assets, make investments, loans or advances, make certain acquisitions, engage in mergers or consolidations, engage in certain transactions with affiliates, amend certain material agreements, change the business conducted by us and enter into agreements that restrict dividends from subsidiaries. In addition, the senior secured credit facility requires us to maintain the following financial covenants: a maximum total leverage ratio and a minimum interest coverage ratio, which are both tested quarterly for compliance, and a maximum annual capital expenditures covenant. The maximum total leverage ratio, which decreases over time, was 4:00:1 for the quarter ended December 31, 2008 and decreases from 4.0:1 to 3.75:1 for the two quarters ending June 30, 2009 and September 30, 2009. Our minimum interest coverage ratio, which increases over time, was 3.00:1 for the fiscal year ended September 30, 2009 and increases to 3.25:1 for fiscal 2010.

Senior Subordinated Notes of Acquisition Corp.

Acquisition Corp. has outstanding two tranches of senior subordinated notes due 2014: $465 million principal amount of U.S. dollar-denominated notes and £100 million principal amount of Sterling-denominated notes (collectively, the Acquisition Corp. Senior Subordinated Notes). The Acquisition Corp. Senior Subordinated Notes mature on April 15, 2014 and bear interest at a fixed rate of 7.375% per annum on the $465 million dollar notes and 8.125% per annum on the £100 million Sterling-denominated notes. The indenture governing the notes limits our ability and the ability of our restricted subsidiaries to incur additional indebtedness or issue certain preferred shares; to pay dividends on or make other distributions in respect of our capital stock or make other restricted payments; to make certain investments; to sell certain assets; to create liens on certain debt without securing the notes; to consolidate, merge, sell or otherwise dispose of all or substantially all of our assets; to enter into certain transactions with affiliates; and to designate our subsidiaries as unrestricted subsidiaries. Subject to certain exceptions, the indenture governing the notes permits us and our restricted subsidiaries to incur additional indebtedness, including secured indebtedness, and to make certain restricted payments and investments.

Holdings Discount Notes

As of December 31, 2008, Holdings had $236 million of debt on its balance sheet represented by the Holdings Discount Notes, net of issuance discounts. The Holdings Discount Notes were issued at a discount and had an initial accreted value of $630.02 per $1,000 principal amount at maturity. Prior to December 15, 2009, no cash interest payments accrue. However, interest accrues on the Holdings Discount Notes in the form of an increase in the accreted value of such notes such that the accreted value of the Holdings Discount Notes will equal the principal amount at maturity of $257 million on December 15, 2009. Thereafter, cash interest on the Holdings Discount Notes is payable semi-annually at a fixed rate of 9.5% per annum with the initial cash interest payment payable on June 15, 2010. The Holdings Discount Notes mature on December 15, 2014.

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

Dividends

We discontinued our previous policy of paying a regular quarterly dividend during the second quarter of fiscal year 2008. We currently intend to retain future earnings to build cash on the balance sheet and invest in our business, particularly in A&R. Any future determination to pay dividends will be at the discretion of our Board of Directors and will depend on, among other things, our results of operations, cash requirements, financial condition, contractual restrictions and other factors our Board of Directors may deem relevant.

On February 6, 2008, we declared our final quarterly dividend under the now discontinued policy on our outstanding common stock at a rate of $0.13 per share. The final dividend was paid on February 29, 2008. On December 29, 2006, March 8, 2007, June 5, 2007 and September 4, 2007 we declared dividends on our outstanding common stock at a rate of $0.13 per share. The dividends were paid on February 16, 2007, April 27, 2007, July 25, 2007 and October 24, 2007, respectively, except for the portion of the dividends with respect to unvested restricted stock, which will be paid at such time as such shares become vested.

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Covenant Compliance

Our senior secured credit facility requires us to maintain certain covenants including a maximum Leverage Ratio and a minimum Interest Coverage Ratio, as such terms are defined in the credit facility, and also contains a maximum annual capital expenditures limitation. The maximum total leverage ratio, which decreases over time, was 4.00:1 for the quarter ended December 31, 2008 and decreases from 4.00:1 to 3.75:1 for the two quarters ending June 30, 2009 and September 30, 2009. Our minimum interest coverage ratio, which increases over time, is 3.00:1 for the fiscal year ended September 30, 2009 and increases to 3.25:1 for fiscal 2010.

The credit facility also contains covenants that, among other things, restrict our ability to incur additional debt. The occurrence of an event of default under the credit facility could result in all amounts outstanding under the facility to be immediately due and payable, which could have a material adverse impact on our results of operations, financial position and cash flow. To the extent that we ever were to fail a financial covenant test then there is the opportunity to cure such a breach by the injection of further equity which will count towards EBITDA for the purposes of financial covenants. As of December 31, 2008, we were in compliance with all covenants under the credit facility.

Our borrowing arrangements, including the Holdings Discount Notes and the Acquisition Corp. Senior Subordinated Notes contain certain financial covenants, which limit the ability of our restricted subsidiaries as defined in the indentures governing the notes to, among other things, incur additional indebtedness, issue certain preferred shares, pay dividends, make certain investments, sell certain assets, and consolidate, merge, sell or otherwise dispose of all, or some of, our assets. In order for Acquisition Corp. and Holdings Corp. to incur additional debt or make certain restricted payments using certain exceptions provided for in the indentures governing the Acquisition Corp. Senior Subordinated Notes and the Holdings Discount Notes, the Fixed Charge Coverage Ratio, as defined in such indentures, must exceed a 2.0 to 1.0 ratio. Fixed Charges are defined in such indentures as consolidated interest expense excluding certain non-cash interest expense.

The terms of the indentures governing the Acquisition Corp. Senior Subordinated Notes and Holdings Discount Notes significantly restrict Acquisition Corp., Holdings and other subsidiaries from paying dividends and otherwise transferring assets to us. For example, the ability of Acquisition Corp. and Holdings to make such payments is governed by a formula based on 50% of each of their consolidated net income (which, as defined in the indentures governing such notes, excludes goodwill impairment charges and any after-tax extraordinary, unusual or nonrecurring gains and losses) accruing from June 1, 2004 and July 1, 2004, respectively, plus proceeds from equity offerings and capital contributions, among other items. In addition, as a condition to making such payments to us based on such formula, Acquisition Corp. and Holdings must each have an adjusted EBITDA, as defined in the indenture, to interest expense ratio of at least 2.0 to 1 after giving effect to any such payments. Acquisition Corp. may also make a restricted payment prior to April 15, 2009 if, immediately after giving pro forma effect to such restricted payment and certain indebtedness incurred to finance such restricted payment, its net indebtedness to adjusted EBITDA ratio, as defined in the indenture, would not exceed 3.75 to 1 and its net senior indebtedness to adjusted EBITDA ratio, as defined in the indenture, would not exceed 2.50 to 1. In addition, Holdings may make a restricted payment if, immediately after giving pro forma effect to such restricted payment and certain indebtedness incurred to finance such restricted payment, its net indebtedness to adjusted EBITDA ratio would not exceed 4.25 to 1. Notwithstanding such restrictions, the indentures permit an aggregate of $45.0 million and $75.0 million of such payments to be made by Acquisition Corp. and Holdings, respectively, whether or not there is availability under the formula or the conditions to its use are met. Acquisition Corp. s senior secured credit facility permits Acquisition Corp. to make additional restricted payments to Holdings, the proceeds of which may be utilized by Holdings to make additional restricted payments, in an aggregate amount not to exceed $10.0 million (such amount is subject to increase to $35.0 million if the leverage ratio as of the last day of the immediately preceding four fiscal quarters was less than 4.0 to 1 and to $50.0 million if the leverage ratio as of the last day of the immediately preceding four fiscal quarters was less than 3.5 to 1), and subject to further increase in an amount equal to 50% of cumulative excess cash flow that is not otherwise applied pursuant to Acquisition Corp. s senior secured credit facility, and, in addition, permits Acquisition Corp. to make restricted payments to Holdings, the proceeds of which may be utilized by Holdings to make additional restricted payments not to exceed $90 million in any fiscal year, provided that the proceeds of such restricted payments shall be applied solely to pay cash dividends on the Company s common stock, and restricted payments to Holdings to pay cash interest on the Holdings Discount Notes. Furthermore, Holdings subsidiaries will be permitted under the terms of Acquisition Corp. s existing senior secured credit facility, as it may be amended, and under other indebtedness, to incur additional indebtedness that may restrict or prohibit the making of distributions, the payment of dividends or the making of loans by such subsidiaries to Holdings.

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

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Summary

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As discussed in Note 18 to our audited consolidated financial statements for the fiscal year ended September 30, 2008, the Company is exposed to market risk arising from changes in market rates and prices, including movements in foreign currency exchange rates and interest rates. As of December 31, 2008, other than as described below, there have been no material changes to the Company s exposure to market risk since September 30, 2008.

We have transactional exposure to changes in foreign currency exchange rates relative to the U.S. dollar due to the global scope of our operations. We use foreign exchange contracts, primarily to hedge the risk that unremitted or future royalties and license fees owed to our domestic companies for the sale, or anticipated sale, of U.S.-copyrighted products abroad may be adversely affected by changes in foreign currency exchange rates. We focus on managing the level of exposure to the risk of foreign currency exchange rate fluctuations on our major currencies, which include the Euro, British pound sterling, Japanese yen, Canadian dollar, and Australian dollar. During the three months ended December 31, 2008, the Company entered into additional foreign exchange hedge contracts and, as of December 31, 2008, the Company has outstanding hedge contracts for the sale of $477 million and the purchase of $168 million of foreign currencies at fixed rates. During the current-year quarter, certain of our foreign exchange contracts expired and new foreign exchange contracts were renewed with similar features.

The fair value of foreign exchange contracts is subject to changes in foreign currency exchange rates. For the purpose of assessing the specific risks, we use a sensitivity analysis to determine the effects that market risk exposures may have on the fair value of our financial instruments.

We are exposed to foreign currency exchange rate risk with respect to our £100 million principal amount of Sterling-denominated notes that were issued in April 2004. These sterling notes mature on April 15, 2014. As of December 31, 2008, these Sterling-denominated notes had a carrying value of approximately $147 million. However, a weakening or strengthening of the U.S. dollar compared to the British Pound Sterling would not have an impact on the fair value of these Sterling notes, as these notes are completely hedged as of December 31, 2008. We did not enter into any additional hedges related to this debt subsequent to December 31, 2008.

We are exposed to interest rate risk with respect to our floating rate debt. The Company did not enter into additional interest rate swap agreements to hedge the variability of its expected future cash interest payments during the quarter ended December 31, 2008. The total notional amount of debt hedged as of December 31, 2008 was $897 million. We did not enter into any additional interest rate swap agreements subsequent to December 31, 2008.

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

ITEM 4. CONTROLS AND PROCEDURES

Certification

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

Certifications for a more complete understanding of the topics presented.

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Introduction

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

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

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

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

There have been no changes, other than as noted below, in our Internal Controls over financial reporting or other factors during the period ended December 31, 2008 that have materially affected, or are reasonably likely to materially affect, our Internal Controls.

In an effort to make our information technology, or IT, more efficient and increase our IT capabilities and reduce potential disruptions, as well as generate cost savings, we signed a contract during the first quarter of fiscal 2009 with a third-party service provider to outsource a significant portion of our IT functions. We began transitioning work to the service provider in December 2008, and the transition will continue through the following 18 months. The outsourcing arrangements are expected to enhance the cost efficiency of these administrative functions. The outsourcing of these functions will have an immediate effect with regard to the responsibilities for the performance of certain processes and internal controls over financial reporting. We anticipate that internal controls over financial reporting could be further impacted in the future as these outsourced functions benefit from expected innovations and improvements from our service provider.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Pricing of Digital Music Downloads

On December 20, 2005 and February 3, 2006, the Attorney General of the State of New York served the Company with requests for information in connection with an industry-wide investigation as to whether the practices of industry participants concerning the pricing of digital music downloads violate Section 1 of the Sherman Act, New York State General Business Law §§ 340 et seq., New York Executive Law §63(12), and related statutes. On February 28, 2006, the Antitrust Division of the U.S. Department of Justice served the Company with a request for information in the form of a Civil Investigative Demand as to whether its activities relating to the pricing of digitally downloaded music violate Section 1 of the Sherman Act. Both investigations have now been closed. Subsequent to the announcements of the above governmental investigations, more than thirty putative class action lawsuits concerning the pricing of digital music downloads were filed and were later consolidated for pre-trial proceedings in the Southern District of New York. The consolidated amended complaint, filed on April 13, 2007, alleges conspiracy among record companies to delay the release of their content for digital distribution, inflate their pricing of CDs and fix prices for digital downloads. The complaint seeks unspecified compensatory, statutory and treble damages. All defendants, including the Company, filed a motion to dismiss the consolidated amended complaint on July 30, 2007. This motion was granted on October 9, 2008. Plaintiffs appealed the decision. The Company intends to defend against these lawsuits vigorously, but is unable to predict the outcome of these suits. Any litigation the Company may become involved in as a result of the inquiries of the Attorney General and Department of Justice, regardless of the merits of the claim, could be costly and divert the time and resources of management.

Other Matters

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

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ITEM 1A. RISK FACTORS

You should carefully consider the following risks and other information in this report before making an investment decision with respect to shares of our common stock. Any of the following risks could materially and adversely affect our business, financial condition or results of operations.

Risks Related to our Business

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

The industry began experiencing negative growth rates in 1999 on a global basis and the worldwide recorded music market has contracted considerably. Illegal downloading of music from the Internet, CD-R piracy, industrial piracy, economic recession, bankruptcies of record wholesalers and retailers, and growing competition for consumer discretionary spending and retail shelf space may all be contributing to a declining recorded music industry. Additionally, the period of growth in recorded music sales driven by the introduction and penetration of the CD format has ended. While CD sales still generate most of the recorded music revenues, CD sales continue to decline industry-wide and we expect that trend to continue. However, new formats for selling recorded music product have been created, including the legal downloading of digital music using the Internet, the distribution of music on mobile devices and revenue streams from these new channels are beginning to emerge. These new digital revenue streams are important to offset declines in physical sales and represent the fastest growing area of our business. In addition, we are also taking steps to broaden our revenue mix into growing areas of the music business, including sponsorship, fan clubs, websites, merchandising, touring, ticketing and artist management. As our expansion into these new areas is recent, we cannot determine how our expansion into these new areas will impact our business. Despite the increase in digital sales and expanded rights revenues, revenues from these sources have yet to completely offset declining physical sales on a worldwide industry basis and it is too soon to determine the impact that sales of music through new channels might have on the industry or when the decline in physical sales might be offset by the increase in digital sales and other expanded rights revenues. Accordingly, the recorded music industry performance may continue to negatively impact our operating results. While it is believed within the recorded music industry that growth in digital sales will re-establish a growth pattern for recorded music sales, the timing of the recovery cannot be established with accuracy nor can it be determined how these changes will affect individual markets. A declining recorded music industry is likely to lead to reduced levels of revenue and operating income generated by our Recorded Music business. Additionally, a declining recorded music industry is also likely to have a negative impact on our Music Publishing business, which generates a significant portion of its revenues from mechanical royalties, primarily from the sale of music in CD and other recorded music formats.

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

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

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

There are a variety of factors that could cause us to reduce our prices and reduce our profit margins. They are, among others, price competition from the sale of motion pictures in DVD-Video format and videogames, the negotiating leverage of mass merchandisers, big-box retailers and distributors of digital music, the increased costs of doing business with mass merchandisers and big-box retailers as a result of complying with operating procedures that are unique to their needs and any changes in costs associated with new digital formats. In addition, we are currently dependent on a small number of leading online music stores, which allows

them to significantly influence the prices we can charge in connection with the distribution of digital music. Over the course of the last decade, U.S. mass-market and other stores share of U.S physical music sales has continued to grow. While we cannot predict how future competition will impact music retailers, as the music industry continues to transform it is possible that the share of music sales by mass-market retailers such as Wal-Mart and Target and online music stores such as Apple s iTunes will continue to grow as a result of the decline of specialty music retailers, which could further increase their negotiating leverage. Several large specialty music retailers, including Tower Records and Musicland, have filed for bankruptcy protection. The declining number of specialty music retailers may not only put pressure on profit margins, but could also impact catalog sales as mass-market retailers generally sell top chart albums only, with a limited range of back catalog. Recently, global economic conditions have led to a continued challenging retailer landscape which was most pronounced in the U.K., where EUK, Pinnacle and Zavvi have each gone into administration. See Risk Factors We are substantially dependent on a limited number of online music stores, in particular Apple s iTunes Music Store, for the online sale of our music recordings and they are able to significantly influence the pricing structure for online music stores.

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

We are dependent on identifying, signing and retaining artists with long-term potential, whose debut albums are well received on release, whose subsequent albums are anticipated by consumers and whose music will continue to generate sales as part of our catalog for years to come. The competition among record companies for such talent is intense. Competition among record companies to sell records is also intense and the marketing expenditures necessary to compete have increased as well. We are also dependent on signing and retaining songwriters who will write the hit songs of today and the classics of tomorrow. Our competitive position is dependent on our continuing ability to attract and develop talent whose work can achieve a high degree of public acceptance. Our financial results may be adversely affected if we are unable to identify, sign and retain such artists under terms that are economically attractive to us. Our financial results may also be affected by the existence or absence of superstar artist releases during a particular period. Some music industry observers believe that the number of superstar acts with long-term appeal, both in terms of catalog sales and future releases, has declined in recent years. Additionally, our financial results are generally affected by the worldwide economic and retail environment, as well as the appeal of our Recorded Music catalog and our Music Publishing library.

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

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

Organized industrial piracy may lead to decreased sales.

The global organized commercial pirate trade is a significant threat to the music industry. The International Intellectual Property Alliance (IIPA) estimates that trade losses due to physical piracy of records and music in 51 key countries/territories around the world with copyright protection and/or enforcement deficiencies totaled $2.3 billion in 2007. Unauthorized copies and piracy have contributed to the decrease in the volume of legitimate sales and put pressure on the price of legitimate sales. They have had, and may continue to have, an adverse effect on our business.

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

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

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

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

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

Our business has historically been seasonal. For the fiscal year ended September 30, 2008, we derived approximately 82% of our revenues from our Recorded Music business. In the recorded music business, purchases have historically been heavily weighted towards the last three months of the calendar year, which represent our first quarter under our September 30 fiscal year. Historically, we have realized approximately 35% of Recorded Music net sales worldwide during the last three months of the calendar year, making those three months (*i.e.* , our first fiscal quarter) material to our full-year performance. Since the emergence of digital sales, we have noted some shift in this seasonality. We realized 29%, 28% and 32% of Recorded Music calendar year net sales during the last three months of calendar 2007, 2006, and 2005, respectively. This sales seasonality affects our operating cash flow from quarter to quarter. We cannot assure you that our Recorded Music net sales for the last three months of any calendar year will continue to be sufficient to meet our obligations or that they will be higher than such net sales for our other quarters. In the event that we do not derive sufficient Recorded Music net sales in the last three months of any calendar year, we may not be able to meet our debt service requirements, working capital requirements, capital expenditure requirements and other obligations. As digital revenues increase as a percentage of our total revenue, this may continue to affect the overall seasonality of our business. For example, sales of MP3 players or gift cards to purchase digital music sold in the holiday season tend to result in sales of digital music in subsequent periods. However, seasonality with respect to the sale of music in new formats, such as digital, is still developing.

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

The industry in which we operate is highly competitive, is based on consumer preferences and is rapidly changing. Additionally, the music industry requires substantial human and capital resources. We compete with other recorded music companies and music publishers to identify and sign new recording artists and songwriters who subsequently achieve long-term success and to renew agreements with established artists and songwriters. In addition, our competitors may from time to time reduce their prices in an effort to expand market share and introduce new services, or improve the quality of their products or services. We may lose business if we are unable to sign successful artists or songwriters or to match the prices or the quality of products and services, offered by our competitors. Our Recorded Music business competes not only with other recorded music companies, but also with the recorded music efforts of live events companies and artists who may chose to distribute their own works. Our Music Publishing business competes not only with other music publishing companies, but also with songwriters who publish their own works. Our Recorded Music business is to a large extent dependent on technological developments, including access to and selection and viability of new technologies, and is subject to potential pressure from competitors as a result of their technological developments. For example, our Recorded Music business may be adversely affected by technological developments that facilitate the piracy of music, such as Internet peer-to-peer file-sharing and CD-R activity, by an inability to enforce our intellectual property rights in digital environments and by a failure to develop a successful business model applicable to a digital environment. The Recorded Music business also faces competition from other forms of entertainment and leisure activities, such as cable and satellite television, pre-recorded films on videocassettes and DVD, the Internet, computers and videogames.

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

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

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

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

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

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

We intend to increase revenues and cash flow through a business strategy which requires us, among other things, to continue to maximize the value of our music assets, to significantly reduce costs to maximize flexibility and adjust to new realities of the market, to continue to act to contain digital piracy and to diversify our revenue streams and capitalize on digital distribution and emerging technologies.

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

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

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

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

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

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

We derive an increasing portion of our revenues from sales of music through digital distribution channels. We are currently dependent on a small number of leading online music stores that sell consumers digital music. Currently, the largest U.S. online music store, iTunes, charges U.S. consumers $0.99 per single track download. As of April 1, 2009, iTunes will charge its U.S. consumers prices ranging from $0.69 to $0.99 to $1.29 per single track download. We have limited ability to increase our wholesale prices to digital service providers for digital downloads as we believe Apple s iTunes controls more than two-thirds of the legitimate digital music track download business. If iTunes were to adopt a lower pricing model for our music recordings or if there were structural change to other download pricing models, we may receive substantially less per download for our music, which could cause a material reduction in our revenue, unless it is offset by a corresponding increase in the number of downloads. Additionally, Apple s iTunes and other online music stores at present accept and post for sale all the recordings that we and other distributors deliver to them. However, if online stores in the future decide to limit the types or amount of music they will accept from music content owners like us, our revenues could be significantly reduced.

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

Mechanical royalties and performance royalties are the two largest sources of income to our Music Publishing business and mechanical royalties are a significant expense to our Recorded Music business. In the U.S., mechanical rates are set pursuant to an arbitration process under the U.S. Copyright Act unless rates are determined through voluntary industry negotiations and performance rates are set by performing rights societies and subject to challenge by performing rights licensees. Outside the U.S., mechanical and performance rates are typically negotiated on an industry-wide basis. The mechanical and performance rates set pursuant to such processes may adversely affect us by limiting our ability to increase the profitability of our Music Publishing business. If the mechanical rates are set too high it may also adversely affect us by limiting our ability to increase the profitability of our Recorded Music business. In addition, rates our Recorded Music business receives in the U.S. for, among other sources of income and potential income, webcasting and satellite radio are set by an arbitration process under the U.S. Copyright Act unless rates are determined through voluntary industry negotiations. It is important as sales shift from physical to diversified distribution channels that we receive fair value for all of the uses of our intellectual property as our business model now depends upon multiple revenue streams from multiple sources. If the rates for these and those other income sources that are established through legally prescribed rate-setting processes are set too low, it could have a material adverse impact on our Recorded Music business or our business prospects.

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

The reporting currency for our financial statements is the U.S. dollar. We have substantial assets, liabilities, revenues and costs denominated in currencies other than U.S. dollars. To prepare our consolidated financial statements, we must translate those assets, liabilities, revenues and expenses into U.S. dollars at then-applicable exchange rates. Consequently, increases and decreases in the value of the U.S. dollar versus other currencies will affect the amount of these items in our consolidated financial statements, even if their value has not changed in their original currency. These translations could result in significant changes to our results of operations from period to period. For the fiscal year ended September 30, 2008, approximately 54% of our revenues related to operations in foreign territories. For the three months ended December 31, 2008, approximately 59% of our revenues related to foreign territories. From time to time, we enter into foreign exchange contracts to hedge the risk of unfavorable foreign currency exchange rate movements. As of December 31, 2008, we have partially hedged our material foreign currency exposures related to royalty payments remitted between our foreign affiliates and our U.S. affiliates for the next fiscal year.

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

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

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

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

California Labor Code Section 2855 (Section 2855) limits the duration of time any individual can be bound under a contract for personal services to a maximum of seven years. In 1987, Subsection (b) was added, which provides a limited exception to Section 2855 for recording contracts, creating a damages remedy for record companies. Legislation has been introduced in New York in January 2007 to create a statute similar to Section 2855 to limit contracts between artists and record companies to a term of three years, potentially affecting the duration of artist contracts. There is no assurance that California will not introduce legislation in the future seeking to repeal Subsection (b). The repeal of Subsection (b) of Section 2855 and/or the passage of legislation similar to Section 2855 by other states could materially affect our results of operations and financial position.

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

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

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

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

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

The recorded music industry continues to undergo substantial change. These changes continue to have a substantial impact on our business. See The recorded music industry has been declining and may continue to decline, which may adversely affect our prospects and our results of operations. Following the Acquisition, we implemented a broad restructuring plan in order to adapt our cost structure to the changing economics of the music industry. Subsequently, during the second quarter of fiscal 2007, we implemented a realignment plan to more aggressively shift resources from our physical sales channels to efforts focused on digital distribution, emerging technologies and other new revenue streams.

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

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

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

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

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

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

Cinram is currently our exclusive supplier of manufacturing, packaging and physical distribution services in North America and most of Europe. Accordingly, our continued ability to meet our manufacturing, packaging and physical distribution requirements in those territories depends largely on Cinram s continued successful operation in accordance with the service level requirements mandated by us in our service agreements. If, for any reason, Cinram were to fail to meet contractually required service levels, we would have difficulty satisfying our commitments to our wholesale and retail customers, which could have an adverse impact on our revenues. Even though our agreements with Cinram give us a right to terminate based upon failure to meet mandated service levels, and there are several capable substitute suppliers, it might be difficult for us to switch to substitute suppliers for any such services, particularly in the short term, and the delay and transition time associated with finding substitute suppliers could itself have an adverse impact on our revenues.

On March 13, 2007, we entered into amendments to our existing manufacturing, packaging and physical distribution arrangements with Cinram for our physical products in North America and most of Europe. Cinram will remain our exclusive supplier of manufacturing, packaging and physical distribution services in North America and most of Europe. The terms of the Cinram agreements remain substantially the same as the terms of the original agreements. We believe that the terms of these agreements, as amended, continue to reflect market rates. The agreements, as amended, now expire on June 30, 2010.

Risks Related to our Leverage

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

We are highly leveraged. As of December 31, 2008, our total consolidated indebtedness was $2.223 billion. In addition, as of December 31, 2008, we had an additional $250 million available for borrowing under the revolving portion of our senior secured credit facility (less $4 million in letters of credit).

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

- making it more difficult for us and our subsidiaries to make payments on indebtedness;
- increasing our vulnerability to general economic and industry conditions;
- requiring a substantial portion of cash flow from operations to be dedicated to the payment of principal and interest on indebtedness, therefore reducing our ability to use our cash flow to fund our operations, capital expenditures and future business opportunities;
- exposing us to the risk of increased interest rates as certain of the borrowings of our subsidiaries, including borrowings under our senior secured credit facility, will be at variable rates of interest;

- limiting our ability and the ability of our subsidiaries to obtain additional financing for working capital, capital expenditures, product development, debt service requirements, acquisitions and general corporate or other purposes; and

- limiting our ability to adjust to changing market conditions and placing us at a competitive disadvantage compared to our competitors who are less highly leveraged.

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

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

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

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

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

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

Our senior secured credit facility and the indentures governing our outstanding notes contain various covenants that limit our ability to engage in specified types of transactions. These covenants limit the ability of our restricted subsidiaries to, among other things:

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

In addition, under our senior secured credit facility, our subsidiaries are required to satisfy and maintain specified financial ratios and other financial condition tests and also have a maximum annual capital expenditures limitation. Their ability to meet those financial ratios and tests can be affected by events beyond our control, and they may not be able to meet those ratios and tests. The senior secured credit facility ratio test assumes that over time EBITDA increases and/or total debt decreases. For example, the maximum total leverage ratio decreases from 4.00:1 for the two quarters ending December 31, 2008 and March 31, 2009 to 3.75:1 for the two quarters ending June 30, 2009 and September 30, 2009. Our minimum interest coverage ratio also increases from 3.00:1 in fiscal 2009 to 3.25:1 for fiscal 2010. If EBITDA does not increase and/or if net debt does not decrease over time and if we are unable to renegotiate the covenants, we would not comply with these provisions of the senior secured credit facility. A breach of any of these or any other covenants could result in a default under our senior secured credit facility. Upon the occurrence of an event of default under our senior secured credit facility, the lenders could elect to declare all amounts outstanding under our senior secured credit facility to be immediately due and payable and terminate all commitments to extend further credit. If we were unable to repay those amounts, the lenders under our senior secured credit facility could proceed against the collateral granted to them to secure that indebtedness. To the extent that we ever were to fail a financial covenant test then there is the opportunity to cure such a breach by the injection of further equity which will count towards EBITDA for the purposes of financial covenants. We have pledged a significant portion of our assets as collateral under our senior secured credit facility. If the lenders under our senior secured credit facility accelerate the repayment of borrowings, we may not have sufficient assets to repay our senior secured credit facility as well as any unsecured indebtedness. All of these restrictions could affect our ability to operate our business or may limit our ability to take advantage of potential business opportunities as they arise.

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Our credit ratings could impact our cost of capital.

On February 12, 2008, Moody s Investor Services lowered our debt ratings. Although reductions in our debt ratings may not have an immediate impact on the cost of debt or our liquidity, they may impact the cost of debt and liquidity over the medium term and future access at a reasonable rate to the debt markets may be adversely impacted.

Risks Related to our Common Stock

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

The Investor Group controls a majority of our outstanding common stock. As a result, we are a controlled company within the meaning of the NYSE corporate governance standards. Under the NYSE rules, a company of which more than 50% of the voting power is held by an individual, a group, or another company is a controlled company and may elect not to comply with certain NYSE corporate governance requirements, as applicable, including (1) the requirement that a majority of the Board of Directors consist of independent directors, (2) the requirement that we have a nominating/corporate governance committee that is composed entirely of independent directors with a written charter addressing the committee s purpose and responsibilities, (3) the requirement that we have a compensation committee that is composed entirely of independent directors with a written charter addressing the committee s purpose and responsibilities and (4) the requirement that we perform an annual performance evaluation of the nominating/corporate governance committee and compensation committee. We are utilizing and intend to continue to utilize these exemptions while we are a controlled company. As a result, we will not have a majority of independent directors and neither our nominating and corporate governance committee, which also serves as our executive committee, nor our compensation committee will consist entirely of independent directors. While our executive, governance and nominating committee and compensation committee have charters that comply with NYSE requirements, we are not required to maintain those charters. Accordingly, you will not have the same protections afforded to stockholders of companies that are subject to all of the NYSE corporate governance requirements.

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

The market price of our common stock could decline as a result of sales of a large number of shares of common stock in the market or the perception that such sales could occur. These sales, or the possibility that these sales may occur, also might make it more difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate. As of December 31, 2008 we had approximately 154.4 million shares of common stock outstanding. Approximately 93.3 million shares are held by the Investor Group and are eligible for resale from time to time, subject to contractual and Securities Act restrictions. The Investor Group has the ability to cause us to register the resale of their shares and certain other holders of our common stock, including members of our management and certain other parties that have piggyback registration rights, will be able to participate in such registration. In addition, in 2005, we registered approximately 8.3 million shares of restricted common stock and approximately 8.4 million shares underlying options issued and securities that may be issued in the future pursuant to our benefit plans and arrangements on registration statements on Form S-8. Shares registered on these registration statements on Form S-8 may be sold as provided in the respective registration statements on Form S-8. In April 2008, we registered an additional 16.5 million shares underlying options issued, and securities that might be issued in the future pursuant to our benefit plans and arrangements, on an additional Form S-8.

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

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

- actual or anticipated variations in operating results;

- changes in dividend policy or our intentions to deploy our capital, including any decisions to repurchase our debt or common stock;

changes in financial estimates or investment recommendations by research analysts;

actual or anticipated changes in economic, political or market conditions, such as recessions or international currency fluctuations;

actual or anticipated changes in the regulatory environment affecting the music industry;

changes in the retailing environment;

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changes in the market valuations of other content on media companies or diversified media companies that are also engaged in some of the business in which we are engaged that may be deemed our peers; and

announcements by us or our competitors of significant acquisitions, strategic partnerships, divestitures, joint ventures or other strategic initiatives.

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

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

Provisions contained in our Charter and amended and restated bylaws (Bylaws) and Delaware law could make it more difficult for a third party to acquire us, even if doing so might be beneficial to our stockholders. Provisions of our Charter and Bylaws impose various procedural and other requirements, which could make it more difficult for shareholders to effect certain corporate actions. For example, our Charter authorizes our Board of Directors to issue up to 100,000,000 preferred shares and determine the rights including vesting rights, preferences, privileges, qualifications, limitations, and restrictions of unissued series of preferred stock, without any vote or action by our shareholders. Thus, our Board of Directors can authorize and issue shares of preferred stock with voting or conversion rights that could adversely affect the voting or other rights of holders of our common stock. These rights may have the effect of delaying or deterring a change of control of our company. These provisions could limit the price that certain investors might be willing to pay in the future for shares of our common stock.

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

Item 2 is not applicable and has been omitted.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Item 3 is not applicable and has been omitted.

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

Item 4 is not applicable and has been omitted.

ITEM 5. OTHER INFORMATION

Item 5 is not applicable and has been omitted.

ITEM 6. EXHIBITS

3.1	Amended and Restated Certificate of Incorporation of Warner Music Group Corp. (1)
3.2	Amended and Restated Bylaws of Warner Music Group Corp. (2)
10.1	Twelfth Supplemental Indenture, dated as of February 2, 2008, to the Indenture dated April 8, 2004, as amended, among WMG Acquisition Corp., the additional subsidiary guarantors party thereto and Wells Fargo Bank, National Association, as Trustee*
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended*

31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-15(a) of the Securities Exchange Act of 1934, as amended*
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

* Filed herewith.

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

(1) Incorporated by reference to Warner Music Group Corp. s Quarterly Report on Form 10-Q for the period ended March 31, 2005 (File No. 001-32502).

(2) Incorporated by reference to Warner Music Group Corp. s Current Report on Form 8-K filed on December 23, 2008 (File No. 001-32502).

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SIGNATURES

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

February 5, 2009

WARNER MUSIC GROUP CORP.

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