

Warner Music Group Corp.  
Form 10-Q  
May 07, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2018

OR

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

Commission File Number 001-32502

Warner Music Group Corp.

(Exact name of Registrant as specified in its charter)

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

1633 Broadway

New York, NY 10019

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(Address of principal executive offices)

(212) 275-2000

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

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

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

There is no public market for the Registrant's common stock. As of May 7, 2018 the number of shares of the Registrant's common stock, par value \$0.001 per share, outstanding was 1,052. All of the Registrant's common stock is owned by affiliates of Access Industries, Inc. The Registrant has filed all Exchange Act reports for the preceding 12 months.

WARNER MUSIC GROUP CORP.

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## ITEM 1. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Warner Music Group Corp.

Consolidated Balance Sheets (Unaudited)

|   | March<br>31,<br>2018 | September<br>30,<br>2017 |
|---|----------------------|--------------------------|
|   | (in millions)        |                          |
| <b>Assets</b>   |                      |                          |
| <b>Current assets:</b>  |                      |                          |
| Cash and equivalents  | \$612                | \$ 647                   |
| Redemption deposit  | 119                  | —                        |
| Accounts receivable, net of allowances of \$49 million and \$50 million                         | 427                  | 404                      |
| Inventories   | 39                   | 39                       |
| Royalty advances expected to be recouped within one year  | 148                  | 141                      |
| Prepaid and other current assets  | 62                   | 44                       |
| <b>Total current assets</b>   | <b>1,407</b>         | <b>1,275</b>             |
| Royalty advances expected to be recouped after one year   | 181                  | 172                      |
| Property, plant and equipment, net  | 214                  | 213                      |
| Goodwill  | 1,696                | 1,685                    |
| Intangible assets subject to amortization, net  | 2,037                | 2,090                    |
| Intangible assets not subject to amortization   | 118                  | 117                      |
| Deferred tax assets, net  | 52                   | 97                       |
| Other assets  | 77                   | 69                       |
| <b>Total assets</b>   | <b>\$5,782</b>       | <b>\$ 5,718</b>          |
| <b>Liabilities and Equity</b>   |                      |                          |
| <b>Current liabilities:</b>   |                      |                          |
| Accounts payable  | \$203                | \$ 208                   |
| Accrued royalties   | 1,358                | 1,263                    |
| Accrued liabilities   | 340                  | 365                      |
| Accrued interest  | 27                   | 41                       |
| Deferred revenue  | 197                  | 197                      |
| Current portion of long-term debt   | 111                  | —                        |
| Other current liabilities   | 37                   | 26                       |
| <b>Total current liabilities</b>  | <b>2,273</b>         | <b>2,100</b>             |
| Long-term debt  | 2,836                | 2,811                    |
| Deferred tax liabilities, net   | 194                  | 190                      |
| Other noncurrent liabilities  | 274                  | 309                      |
| <b>Total liabilities</b>  | <b>\$5,577</b>       | <b>\$ 5,410</b>          |
| <b>Equity:</b>  |                      |                          |
| Common stock (\$0.001 par value; 10,000 shares authorized; 1,052 shares issued and outstanding) | \$—                  | \$ —                     |
| Additional paid-in capital  | 1,128                | 1,128                    |

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|   |         |          |
|---|---------|----------|
| Accumulated deficit                       | (778 )  | (654 )   |
| Accumulated other comprehensive loss, net | (161 )  | (181 )   |
| Total Warner Music Group Corp. equity     | 189     | 293      |
| Noncontrolling interest                   | 16      | 15       |
| Total equity                              | 205     | 308      |
| Total liabilities and equity              | \$5,782 | \$ 5,718 |

See accompanying notes

Warner Music Group Corp.

## Consolidated Statements of Operations (Unaudited)

|  | Three Months<br>Ended<br>March 31,<br>2018 2017 |         | Six Months<br>Ended<br>March 31,<br>2018 2017 |         |
|--|---|---------|---|---------|
|  | (in millions)                                   |         | (in millions)                                 |         |
| Revenue  | \$963   | \$825   | \$2,008                                       | \$1,742 |
| Costs and expenses:  |   |         |   |         |
| Cost of revenue  | (488)   | (415)   | (1,057)                                       | (911 )  |
| Selling, general and administrative expenses (a)           | (337)   | (282)   | (670 )  | (558 )  |
| Amortization expense                                       | (55 )   | (50 )   | (108 )  | (101 )  |
| Total costs and expenses                                   | (880)   | (747)   | (1,835)                                       | (1,570) |
| Operating income   | 83  | 78      | 173   | 172     |
| Loss on extinguishment of debt                             | (23 )   | —       | (24 )   | (32 )   |
| Interest expense, net                                      | (36 )   | (36 )   | (72 )   | (76 )   |
| Other expense, net   | (6 )  | (19 )   | (2 )  | —       |
| Income before income taxes                                 | 18  | 23      | 75  | 64      |
| Income tax expense   | (19 )   | (3 )    | (71 )   | (20 )   |
| Net income (loss)  | (1 )  | 20      | 4   | 44      |
| Less: Income attributable to noncontrolling interest       | (2 )  | (1 )    | (3 )  | (3 )    |
| Net income (loss) attributable to Warner Music Group Corp. | \$(3 )  | \$19    | \$1   | \$41    |
| (a) Includes depreciation expense of:                      | \$(14 )   | \$(13 ) | \$(26 )                                       | \$(25 ) |

See accompanying notes

Warner Music Group Corp.

## Consolidated Statements of Comprehensive Income (Loss) (Unaudited)

|  | Three<br>Months<br>Ended<br>March 31,<br>2018 2017 |       | Six Months<br>Ended<br>March 31,<br>2018 2017 |       |
|--|--|-------|---|-------|
|  | (in millions)                                      |       | (in millions)                                 |       |
| Net income (loss)  | \$ (1 )  | \$ 20 | \$ 4  | \$ 44 |
| Other comprehensive income (loss), net of tax:                   |  |       |   |       |
| Foreign currency adjustment                                      | 9  | 24    | 18  | (13 ) |
| Deferred gains (losses) on derivative financial instruments      | 1  | 1     | 2   | (1 )  |
| Other comprehensive income (loss), net of tax                    | 10   | 25    | 20  | (14 ) |
| Total comprehensive income                                       | 9  | 45    | 24  | 30    |
| Less: Income attributable to noncontrolling interest             | (2 )   | (1 )  | (3 )  | (3 )  |
| Comprehensive income attributable to Warner Music<br>Group Corp. | \$ 7   | \$ 44 | \$ 21   | \$ 27 |

See accompanying notes

Warner Music Group Corp.

## Consolidated Statements of Cash Flows (Unaudited)

|   | Six Months Ended<br>March 31,<br>2018<br>(in millions) | 2017  |
|---|--|-------|
| Cash flows from operating activities  |  |       |
| Net income  | \$ 4   | \$ 44 |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |       |
| Depreciation and amortization   | 134  | 126   |
| Unrealized losses (gains) and remeasurement of foreign denominated loans          | 11   | (1 )  |
| Deferred income taxes   | 38   | (12 ) |
| Loss on extinguishment of debt  | 24   | 32    |
| Net (gain) loss on divestitures and investments                                   | (7 )   | 6     |
| Non-cash interest expense   | 3  | 5     |
| Equity-based compensation expense   | 27   | 17    |
| Changes in operating assets and liabilities:                                      |  |       |
| Accounts receivable   | (15 )  | (41 ) |
| Inventories   | 1  | 3     |
| Royalty advances  | (12 )  | 1     |
| Accounts payable and accrued liabilities  | (100 )   | (43 ) |
| Royalty payables  | 68   | 75    |
| Accrued interest  | (14 )  | 7     |
| Deferred revenue  | (16 )  | (4 )  |
| Other balance sheet changes   | (10 )  | 11    |
| Net cash provided by operating activities   | 136  | 226   |

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|  |        |        |
|--|--------|--------|
| Cash flows from investing activities   |        |        |
| Acquisition of music publishing rights, net                                  | (5 )   | (6 )   |
| Capital expenditures   | (29 )  | (18 )  |
| Investments and acquisitions of businesses, net                              | (6 )   | (6 )   |
| Proceeds from the sale of investments  | 12     | 18     |
| Net cash used in investing activities  | (28 )  | (12 )  |
| Cash flows from financing activities   |        |        |
| Proceeds from issuance of Acquisition Corp. 4.125% Senior Secured Notes      | —      | 380    |
| Proceeds from issuance of Acquisition Corp. 4.875% Senior Secured Notes      | —      | 250    |
| Proceeds from issuance of Acquisition Corp. 5.50% Senior Notes               | 325    | —      |
| Proceeds from supplement of Acquisition Corp. Senior Term Loan Facility      | 320    | 22     |
| Repayment of Acquisition Corp. 6.00% Senior Secured Notes                    | —      | (450 ) |
| Repayment of Acquisition Corp. 6.25% Senior Secured Notes                    | —      | (173 ) |
| Repayment of Acquisition Corp. 5.625% Senior Secured Notes                   | —      | (28 )  |
| Repayment of and redemption deposit for Acquisition Corp. 6.75% Senior Notes | (635 ) | —      |
| Call premiums paid on and redemption deposit for early redemption of debt    | (23 )  | (27 )  |
|  | (9 )   | (12 )  |

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|   |        |        |
|---|--------|--------|
| Deferred financing costs paid                           |        |        |
| Distribution to noncontrolling interest holder          | (2 )   | (1 )   |
| Dividends paid  | (125 ) | (54 )  |
| Net cash used in financing activities                   | (149 ) | (93 )  |
| Effect of exchange rate changes on cash and equivalents | 6      | (4 )   |
| Net (decrease) increase in cash and equivalents         | (35 )  | 117    |
| Cash and equivalents at beginning of period             | 647    | 359    |
| Cash and equivalents at end of period                   | \$ 612 | \$ 476 |

See accompanying notes

Warner Music Group Corp.

## Consolidated Statements of Equity (Unaudited)

|  | Common<br>Shares                    | Additional<br>Paid-in<br>Value<br>Capital | Accumulated<br>Deficit | Other<br>Comprehensive<br>Loss | Total<br>Warner Music<br>Group<br>Corp.<br>Equity | Noncontrolling<br>Interest | Total<br>Equity |
|--|-------------------------------------|---|------------------------|--------------------------------|---|----------------------------|-----------------|
|  | (in millions, except share amounts) |   |                        |                                |   |                            |                 |
| Balance at September 30,<br>2017           | 1,055                               | \$ — \$ 1,128                             | \$ (654 )              | \$ (181 )                      | \$ 293  | \$ 15                      | \$ 308          |
| Net income                                 | —                                   | —   | 1                      | —                              | 1   | 3                          | 4               |
| Dividends                                  | —                                   | —   | (125 )                 | —                              | (125 )  | —                          | (125 )          |
| Other comprehensive income,<br>net         |                                     |   |                        |                                |   |                            |                 |
| of tax                                     | —                                   | —   | —                      | 20                             | 20  | —                          | 20              |
| Distribution to noncontrolling<br>interest |                                     |   |                        |                                |   |                            |                 |
| holders                                    | —                                   | —   | —                      | —                              | —   | (2 )                       | (2 )            |
| Other                                      | (3 )                                | —   | —                      | —                              | —   | —                          | —               |
| Balance at March 31, 2018                  | 1,052                               | \$ — \$ 1,128                             | \$ (778 )              | \$ (161 )                      | \$ 189  | \$ 16                      | \$ 205          |

See accompanying notes

Warner Music Group Corp.

Notes to Consolidated Interim Financial Statements (Unaudited)

## 1. Description of Business

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

### Acquisition of Warner Music Group by Access Industries

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

### Recorded Music Operations

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

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

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

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

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

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

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

The Company has diversified its revenues beyond its traditional businesses by entering into expanded-rights deals with recording artists in order to partner with artists in other aspects of their careers. Under these agreements, the Company provides services to and participates in artists’ activities outside the traditional recorded music business such as touring, merchandising and sponsorships. The Company has built artist services capabilities and platforms for exploiting this broader set of music-related rights and participating more widely in the monetization of the artist brands it helps create.

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

#### Music Publishing Operations

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

The Company’s Music Publishing operations are conducted principally through Warner/Chappell, its global Music Publishing company, headquartered in Los Angeles with operations in over 50 countries through various subsidiaries, affiliates and non-affiliated licensees. The Company owns or controls rights to more than one million musical compositions, including numerous pop hits, American standards, folk songs and motion picture and theatrical compositions. Assembled over decades, its award-winning catalog includes over 70,000 songwriters and composers and a diverse range of genres including pop, rock, jazz, classical, country, R&B, hip-hop, rap, reggae, Latin, folk, blues, symphonic, soul, Broadway, techno, alternative and gospel. Warner/Chappell also administers the music and soundtracks of several third-party television and film producers and studios. The Company has an extensive production music library collectively branded as Warner/Chappell Production Music.

## 2. Summary of Significant Accounting Policies

### Interim Financial Statements

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six month period ended March 31, 2018 are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2018.

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

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

#### Basis of Consolidation

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

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

The Company maintains a 52-53 week fiscal year ending on the last Friday in each reporting period. As such, all references to March 31, 2018 and March 31, 2017 relate to the periods ended March 30, 2018 and March 31, 2017, respectively. For convenience purposes, the Company continues to date its financial statements as of March 31. The fiscal year ended September 30, 2017 ended on September 29, 2017.

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

#### Income Taxes

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

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the “Tax Act”). In accordance with ASC Topic 740, Income Taxes (“ASC 740”) the Company recorded the impacts in the period of enactment.

#### New Accounting Pronouncements

In October 2017, the Company adopted ASU 2016-09, Compensation - Stock Compensation (“ASU 2016-09”). This ASU provides amended guidance which simplifies the accounting for share-based payment transactions involving multiple aspects of the accounting for share-based transactions, including income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The adoption of ASU 2016-09 did not have any effect on the Company’s consolidated financial statements and footnote disclosures as of March 31, 2018.

In May 2014, the FASB issued guidance codified in ASC 606, Revenue from Contracts with Customers (“ASC 606”), which replaces the guidance in former ASC 605, Revenue Recognition and ASC 928-605, Entertainment – Music. The amendment was the result of a joint effort by the FASB and the International Accounting Standards Board to improve financial reporting by creating common revenue recognition guidance for U.S. GAAP and international financial reporting standards (“IFRS”). The joint project clarifies the principles for recognizing revenue and develops a common revenue standard for U.S. GAAP and IFRS. ASC 606 is effective for annual periods beginning after December 15, 2017, and interim periods within those years. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The update may be applied using one of two methods: retrospective application to each prior reporting period presented, or retrospective application with the cumulative effect of initially applying the update recognized at the date of initial application. The Company currently plans to adopt this ASU under the modified retrospective method. While the Company is currently evaluating the impact of adoption of this new standard on the consolidated financial statements,

the Company believes the most significant impact will be a change in the timing of revenue recognition in our Music Publishing segment. The Company generally records revenue from the licensing of publishing rights when cash is received. Under the new revenue recognition rules, revenues will be recorded based on best estimates available in the period of sales or usage.

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

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

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

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

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

In February 2018, FASB issued ASU 2018-02, Income Statement – Reporting Comprehensive Income (“ASU 2018-02”). This ASU allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Act. ASU 2018-02 is effective for all entities for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted, including adoption in any interim period. The Company is evaluating the impact of the adoption of this standard on its financial statements and disclosures.

In March 2018, the FASB issued ASU 2018-5, Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118 (“ASU 2018-05”). This ASU allows companies, for one year following the enactment date, to consider the impact of the Tax Act as “provisional” when a company can make a reasonable estimate but does not have the necessary information available, prepared or analyzed in reasonable detail to finalize its accounting for the impact of the Tax Act. A company may need to reflect adjustments to its provisional amounts upon obtaining, preparing or analyzing additional information about facts and circumstances that existed at the period of enactment. The Company has adopted this standard on its financial statements and disclosures. Provisional amounts are identified in Note 7 of our Consolidated Financial Statements.



## 3. Comprehensive Income (Loss)

Comprehensive income (loss), which is reported in the accompanying consolidated statements of equity, consists of net income (loss) and other gains and losses affecting equity that, under U.S. GAAP, are excluded from net income (loss). For the Company, the components of other comprehensive income (loss) primarily consist of foreign currency translation gains and losses and minimum pension liabilities. The following summary sets forth the changes in the components of accumulated other comprehensive loss, net of related taxes of less than \$1 million:

|   | Foreign<br>Currency<br>Translation<br>(Loss)<br>Gain (a)<br>(in millions) | Minimum<br>Pension<br>Liability<br>Adjustment | Deferred Income<br>On Derivative<br>Financial<br>Instruments | Accumulated<br>Other<br>Comprehensive<br>Loss, net |
|---|---|---|--|--|
| Balance at September 30, 2017                                       | \$(171)   | \$ (10 )                                      | \$ —   | \$ (181 )  |
| Other comprehensive income  | 18  | —   | 2  | 20   |
| Amounts reclassified from accumulated other<br>comprehensive income | —   | —   | —  | —  |
| Balance at March 31, 2018   | \$(153)   | \$ (10 )                                      | \$ 2   | \$ (161 )  |

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

## 4. Goodwill and Intangible Assets

## Goodwill

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

|                               | Recorded<br>Music<br>(in millions) | Music<br>Publishing | Total   |
|-------------------------------|------------------------------------|---------------------|---------|
| Balance at September 30, 2017 | \$1,221                            | \$ 464              | \$1,685 |
| Acquisitions                  | —                                  | —                   | —       |
| Divestitures                  | —                                  | —                   | —       |
| Other adjustments (a)         | 11                                 | —                   | 11      |
| Balance at March 31, 2018     | \$1,232                            | \$ 464              | \$1,696 |

(a) Other adjustments during the six months ended March 31, 2018 represent foreign currency movements. The Company performs its annual goodwill impairment test in accordance with ASC 350, Intangibles—Goodwill and other (“ASC 350”) during the fourth quarter of each fiscal year as of July 1. The Company may conduct an earlier review if events or circumstances occur that would suggest the carrying value of the Company’s goodwill may not be recoverable. No indicators of impairment were identified during the current period that required the Company to perform an interim assessment or recoverability test.

At March 31, 2018 and September 30, 2017, the goodwill and intangible balances presented include the preliminary purchase accounting allocation resulting from the acquisition of Spinnin’ Records on September 7, 2017. The acquisition of Spinnin’ Records was accounted for as a business combination under ASC 805, which requires the acquisition method of accounting. At September 30, 2017, the Company performed a preliminary purchase allocation under the acquisition method of accounting, which is subject to revision based on final determinations of fair value and allocations of purchase price to the identifiable assets and liabilities acquired. At March 31, 2018, the Company has not made any significant adjustments to the preliminary allocation recorded at September 30, 2017.

Intangible Assets

Intangible assets consist of the following:

|   | Weighted<br>Average<br>Useful Life | March<br>31,<br>2018 | September<br>30,<br>2017 |
|---|------------------------------------|----------------------|--------------------------|
| (in millions)   |                                    |                      |                          |
| <b>Intangible assets subject to amortization:</b>           |                                    |                      |                          |
| Recorded music catalog                                      | 10 years                           | \$920                | \$ 898                   |
| Music publishing copyrights                                 | 27 years                           | 1,564                | 1,534                    |
| Artist and songwriter contracts                             | 13 years                           | 924                  | 904                      |
| Trademarks  | 6 years                            | 14                   | 14                       |
| Other intangible assets                                     | 7 years                            | 17                   | 10                       |
| <b>Total gross intangible asset subject to amortization</b> |                                    | <b>3,439</b>         | <b>3,360</b>             |
| Accumulated amortization                                    |                                    | (1,402)              | (1,270 )                 |
| <b>Total net intangible assets subject to amortization</b>  |                                    | <b>2,037</b>         | <b>2,090</b>             |
| <b>Intangible assets not subject to amortization:</b>       |                                    |                      |                          |
| Trademarks and tradenames                                   | Indefinite                         | 118                  | 117                      |
| <b>Total net intangible assets</b>                          |                                    | <b>\$2,155</b>       | <b>\$ 2,207</b>          |

5. Debt

Debt Capitalization

Long-term debt consists of the following:

|   | March<br>31,<br>2018 | September<br>30,<br>2017 |
|---|----------------------|--------------------------|
| (in millions)   |                      |                          |
| Revolving Credit Facility—Acquisition Corp. (a)             | \$—                  | \$ —                     |
| Senior Term Loan Facility due 2023—Acquisition Corp. (b)    | 1,307                | 990                      |
| 5.625% Senior Secured Notes due 2022—Acquisition Corp. (c)  | 246                  | 246                      |
| 5.00% Senior Secured Notes due 2023—Acquisition Corp. (d)   | 297                  | 297                      |
| 4.125% Senior Secured Notes due 2024— Acquisition Corp. (e) | 419                  | 402                      |
| 4.875% Senior Secured Notes due 2024— Acquisition Corp. (f) | 247                  | 246                      |
| 6.75% Senior Notes due 2022—Acquisition Corp. (g)           | 111                  | 630                      |
| 5.50% Senior Notes due 2026—Acquisition Corp. (h)           | 320                  | —                        |
| <b>Total debt (i)</b>                                       | <b>2,947</b>         | <b>2,811</b>             |
| Less: current portion                                       | 111                  | —                        |

|                      |         |          |
|----------------------|---------|----------|
| Total long-term debt | \$2,836 | \$ 2,811 |
|----------------------|---------|----------|

- (a) Reflects \$180 million and \$150 million of commitments under the Revolving Credit Facility at March 31, 2018 and September 30, 2017, respectively, less letters of credit outstanding of approximately \$12 million at both March 31, 2018 and September 30, 2017. There were no loans outstanding under the Revolving Credit Facility at March 31, 2018 or September 30, 2017.
- (b) Principal amount of \$1.326 billion and \$1.006 billion less unamortized discount of \$5 million and \$6 million and unamortized deferred financing costs of \$14 million and \$10 million at March 31, 2018 and September 30, 2017, respectively.
- (c) Principal amount of \$248 million less unamortized deferred financing costs of \$2 million at both March 31, 2018 and September 30, 2017.
- (d) Principal amount of \$300 million less unamortized deferred financing costs of \$3 million at both March 31, 2018 and September 30, 2017.
- (e) Face amount of €345 million. Above amounts represent the dollar equivalent of such notes at March 31, 2018 and September 30, 2017. Principal amount of \$424 million and \$407 million at March 31, 2018 and September 30, 2017, respectively, less unamortized deferred financing costs of \$5 million at both March 31, 2018 and September 30, 2017.
- (f) Principal amount of \$250 million at both March 31, 2018 and September 30, 2017 less unamortized deferred financing costs of \$3 million and \$4 million at March 31, 2018 and September 30, 2017, respectively.

- (g) Principal amount of \$112 million and \$635 million less unamortized deferred financing costs of \$1 million and \$5 million at March 31, 2018 and September 30, 2017, respectively. Reflects amount not redeemed as of March 31, 2018 as described below under “Tender Offer and Notes Redemption.” The remaining 6.75% Senior Notes were redeemed on April 15, 2018.
- (h) Principal amount of \$325 million less unamortized deferred financing costs of \$5 million at March 31, 2018.
- (i) Principal amount of debt of \$2.985 billion and \$2.846 billion less unamortized discount of \$5 million and \$6 million and unamortized deferred financing costs of \$33 million and \$29 million at March 31, 2018 and September 30, 2017, respectively.

#### December 2017 Senior Term Loan Credit Agreement Amendment

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

#### New Revolving Credit Agreement

On January 31, 2018, the Company entered into a new revolving credit agreement (the “Revolving Credit Agreement”) for its Revolving Credit Facility, and terminated its existing revolving credit agreement (the “Old Revolving Credit Agreement”). The Revolving Credit Agreement differs from the Old Revolving Credit Agreement in that it, among other things, reduces the interest rate margin applicable to the loans, extends the maturity date thereunder, provides for the option to increase the commitments under the Company’s then existing revolving credit agreement, provides for greater flexibility to amend and extend the Company’s then existing revolving credit agreement and create additional tranches thereunder, provides for greater flexibility over future amendments, increases the springing financial maintenance covenant to 4.75:1.00 and provides that the covenant shall not be tested unless at the end of a fiscal quarter the outstanding amount of loans and drawings under letters of credit which have not been reimbursed exceeds \$54 million and aligns the other negative covenants with those of the Senior Term Loan Credit Agreement. References to “Revolving Credit Facility” below in this Note 5 are to our new revolving credit facility

#### March 2018 Senior Term Loan Credit Agreement Amendment

On March 14, 2018, Acquisition Corp. incurred \$320 million of supplemental term loans (the “Supplemental Term Loans”) pursuant to an increase supplement (the “March 2018 Senior Term Loan Credit Agreement Supplement”) to the Senior Term Loan Credit Agreement, dated November 1, 2012, among Acquisition Corp., the guarantors party thereto, the lenders party thereto and Credit Suisse AG, as administrative agent, governing Acquisition Corp.’s senior secured term loan facility with Credit Suisse AG, as administrative agent, and the other financial institutions and lenders from time to time party thereto (as amended, the “Senior Term Loan Credit Agreement”). The principal amount outstanding under the Senior Term Loan Credit Agreement including the Supplemental Term Loans is \$1.326 billion.

#### Notes Offering

On March 14, 2018, Acquisition Corp. issued \$325 million in aggregate principal amount of its 5.50% Senior Notes due 2026. Acquisition Corp. used the net proceeds to pay the consideration in the tender offer for its 6.75% Senior Notes due 2022 (the “6.75% Senior Notes”) and to redeem the remaining 6.75% Senior Notes as described below.



## Tender Offer and Notes Redemption

On March 14, 2018, Acquisition Corp. accepted for purchase in connection with the tender offer for the 6.75% Senior Notes that had been validly tendered and not validly withdrawn at or prior to 5:00 p.m., New York City time on March 13, 2018 (the “Expiration Time”) thereby reducing the aggregate principal amount of the 6.75% Senior Notes by \$523 million. Acquisition Corp. then issued a notice of redemption on March 14, 2018 with respect to the remaining \$112 million of 6.75% Senior Notes outstanding that were not accepted for payment pursuant to the tender offer. Following payment of the 6.75% Senior Notes tendered at or prior to the Expiration Time, Acquisition Corp. deposited with the Trustee funds of \$119 million to satisfy all obligations under the applicable indenture governing the 6.75% Senior Notes, including call premiums and interest through the date of redemption on April 15, 2018, for the remaining 6.75% Senior Notes not accepted for purchase in the tender offer, which is reflected as a current asset on the Company’s balance sheet at March 31, 2018. On April 15, 2018, Acquisition Corp. redeemed the remaining outstanding 6.75% Senior Notes. The Company recorded a loss on extinguishment of debt in connection with the tender offer of approximately \$23 million as a result of the partial debt redemption, which represents the premium paid on early redemption and unamortized deferred financing costs. The Company expects to incur an additional loss on extinguishment of approximately \$5 million in April 2018 related to the redemption on the remaining 6.75% Senior Notes, which represents the premium paid on early redemption and unamortized deferred financing costs.

## Interest Rates

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

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

The Company has entered into, and in the future may enter into, interest rate swaps to manage interest rate risk.

## Maturity of Senior Term Loan Facility

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

Maturity of Revolving Credit Facility

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

Maturities of Senior Notes and Senior Secured Notes

As of March 31, 2018, there are no scheduled maturities of notes until 2022, when \$360 million is scheduled to mature. Of this amount, \$112 million representing the remaining principal amount of the 6.75% Senior Notes were redeemed on April 15, 2018 as described above under “Tender Offer and Notes Redemption.” Thereafter, \$1.299 billion is scheduled to mature.

## Interest Expense, net

Total interest expense, net, was \$36 million for both the three months ended March 31, 2018 and March 31, 2017. Total interest expense, net, was \$72 million and \$76 million for the six months ended March 31, 2018 and March 31, 2017, respectively. The weighted-average interest rate of the Company's total debt was 4.7% at March 31, 2018 (decreasing to 4.6% after the redemption of the remaining 6.75% Senior Notes on April 15, 2018) and 4.9% at September 30, 2017 and March 31, 2017.

## 6. Commitments and Contingencies

### Pricing of Digital Music Downloads

On December 20, 2005 and February 3, 2006, the Attorney General of the State of New York served the Company with requests for information in connection with an industry-wide investigation as to the pricing of digital music downloads. On February 28, 2006, the Antitrust Division of the U.S. Department of Justice served us with a Civil Investigative Demand, also seeking information relating to the pricing of digitally downloaded music. Both investigations were ultimately closed, but subsequent to the announcements of the investigations, more than thirty putative class action lawsuits were filed concerning the pricing of digital music downloads. The lawsuits were consolidated in the Southern District of New York. The consolidated amended complaint, filed on April 13, 2007, alleges conspiracy among record companies to delay the release of their content for digital distribution, inflate their pricing of CDs and fix prices for digital downloads. The complaint seeks unspecified compensatory, statutory and treble damages. On October 9, 2008, the District Court issued an order dismissing the case as to all defendants, including us. However, on January 13, 2010, the Second Circuit vacated the judgment of the District Court and remanded the case for further proceedings and on January 10, 2011, the U.S. Supreme Court denied the defendants' petition for Certiorari.

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

### Sirius XM

On September 11, 2013, the Company joined with Capitol Records, LLC, Sony Music Entertainment, UMG Recordings, Inc. and ABKCO Music & Records, Inc. in a lawsuit brought in California Superior Court against Sirius

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

As part of the settlement, plaintiffs agreed to negotiate in good faith to grant Sirius XM a license to publicly perform the plaintiffs' pre-1972 sound recordings for the five-year period running from January 1, 2018 to December 31, 2022. Pursuant to the settlement, if the parties are unable to reach an agreement on license terms, the royalty rate for each license will be determined by binding arbitration on a willing buyer/willing seller standard. On December 21, 2017, Sirius XM commenced a single arbitration against all of the plaintiffs in California through JAMS to determine the rate for the five-year period. On May 1, 2018, the Company filed a lawsuit against Sirius XM in New York state court to stay the California arbitration and to compel a separate arbitration in New York solely between Sirius XM and the Company.

## Other Matters

In addition to the matters discussed above, the Company is involved in various litigation and regulatory proceedings arising in the normal course of business. Where it is determined, in consultation with counsel based on litigation and settlement risks, that a loss is probable and estimable in a given matter, the Company establishes an accrual. In the currently pending proceedings, the amount of accrual is not material. An estimate of the reasonably possible loss or range of loss in excess of the amounts already accrued cannot be made at this time due to various factors typical in contested proceedings, including (1) the results of ongoing discovery; (2) uncertain damage theories and demands; (3) a less than complete factual record; (4) uncertainty concerning legal theories and their resolution by courts or regulators; and (5) the unpredictable nature of the opposing party and its demands. However, the Company cannot predict with certainty the outcome of any litigation or the potential for future litigation. As such, the Company continuously monitors these proceedings as they develop and adjusts any accrual or disclosure as needed. Regardless of the outcome, litigation could have an adverse impact on the Company, including the Company's brand value, because of defense costs, diversion of management resources and other factors and it could have a material effect on the Company's results of operations for a given reporting period.

## 7. Income Taxes

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

The reduction in U.S. corporate statutory tax rate from 35% to 21% is effective January 1, 2018. The Tax Act requires companies with a fiscal year that begins before and ends after the effective date of the rate change to calculate a blended tax rate based on the pro rata number of days in the fiscal year before and after the effective date. As a result, for the fiscal year ending September 30, 2018, the Company's statutory income tax rate will be 24.5%. For the fiscal year ending September 30, 2019, the Company will be subject to the U.S. corporate statutory tax rate of 21%.

The reduction in the U.S. corporate statutory rate requires the Company to adjust its U.S. deferred tax assets and liabilities using the newly enacted tax rate of 21%. As a result, the Company recorded a provisional U.S. income tax expense of \$26 million for the reduction of its net U.S. deferred tax assets as a discrete item for the three months ended December 31, 2017. Since the Company has a fiscal year ending September 30, 2018, and has applied an annual effective tax rate in calculating its income tax provision for the three and six months ended March 31, 2018, the impact of the U.S. corporate statutory tax rate change will not be finalized until September 30, 2018. Furthermore, the Company has a provisional deferred tax liability of approximately \$4 million, after the impact of the newly enacted tax rate, associated with unremitted earnings due to the uncertainty of the treatment of future distributions under the Tax Act.

The one-time transition tax on accumulated foreign earnings ("Transition Tax") would be imposed at a rate of 15.5% for cash and equivalents and 8% for illiquid assets. The Company reasonably estimates that there is no income tax impact related to the Transition Tax and recorded no income tax liability for the three and six months ended March 31, 2018 due to an estimated overall deficit in accumulated foreign earnings. This estimate is provisional since the Company

has not obtained and analyzed information necessary to finalize its accounting for the impact of the Transition Tax. The final impacts of the Transition Tax may differ from the estimate due to changes in interpretations of the Tax Act and updates or changes to the information that the Company has used to estimate the transition impact, including, but not limited to, the impacts from changes to foreign earnings estimates, foreign exchange rates, and cash positions of foreign subsidiaries.

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

For the three and six months ended March 31, 2018, the Company recorded an income tax expense of \$19 million and \$71 million, respectively. The income tax expense for the three months ended March 31, 2018 is greater than expected at the blended statutory tax rate of 24.5% primarily due to foreign income taxed at rates higher than the U.S. statutory tax rate, income withholding taxes, foreign losses with no tax benefit and an increase in uncertain tax positions. The income tax expense for the six months ended March 31, 2018 is greater than the expected income tax expense at the blended statutory tax rate of 24.5% primarily due to a U.S. income tax expense of \$26 million arising from a reduction in net U.S. deferred tax assets due to the change in the U.S. statutory tax rate, foreign income taxed at rates higher than the U.S. statutory tax rate, income withholding taxes, foreign losses with no tax benefit and an increase in uncertain tax positions.

For the three and six months ended March 31, 2017, the Company recorded income tax expense of \$3 million and \$20 million, respectively. The income tax expense for the three and six months ended March 31, 2017 was lower than the expected income tax expense at the statutory tax rate of 35% primarily due to the U.S. tax benefit of a realized foreign currency loss on an intra-entity loan reduced by a related valuation allowance and further offset by income withholding taxes and foreign losses with no tax benefit.

The Company has determined that it is reasonably possible that the gross unrecognized tax benefits as of March 31, 2018 could decrease by up to approximately \$3 million related to various ongoing audits and settlement discussions in various foreign jurisdictions during the next twelve months.

## 8. Derivative Financial Instruments

The Company uses derivative financial instruments, primarily foreign currency forward exchange contracts and interest rate swaps, for the purposes of managing foreign currency exchange rate risk and interest rate risk on expected future cash flows. However, the Company may choose not to hedge certain exposures for a variety of reasons including, but not limited to, accounting considerations and the prohibitive economic cost of hedging particular exposures. There can be no assurance the hedges will offset more than a portion of the financial impact resulting from movements in foreign currency exchange or interest rates.

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

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

The Company has entered into, and in the future may enter into, interest rate swaps to manage interest rate risk. These instruments may offset a portion of changes in income or expense, or changes in fair value of the Company's term debt. The interest rate swap instruments are designated and qualify as cash flow hedges under the criteria prescribed in ASC 815, Derivatives and Hedging. The Company records these contracts at fair value on its balance sheet and gains

or losses on these contracts are deferred in equity (as a component of comprehensive loss).

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

The Company's hedged interest rate transactions as of March 31, 2018 are expected to be recognized within 5 years. The fair value of interest rate swaps is based on dealer quotes of market rates (i.e., Level 2 inputs) which is discussed further in Note 11. Interest income or expense related to interest rate swaps is recognized in interest income, net in the same period as the related expense is recognized. The ineffective portions of interest rate swaps is recognized in other income/(expense), net in the period measured.

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

As of March 31, 2018, the Company had outstanding hedge contracts for the sale of \$197 million and the purchase of \$114 million of foreign currencies at fixed rates that will be settled by September 2018. As of March 31, 2018, the Company had \$2 million of unrealized deferred income in comprehensive income related to foreign exchange hedging. As of September 30, 2017, the Company had no outstanding hedge contracts and no deferred gains or losses in comprehensive loss related to foreign exchange hedging.

As of March 31, 2018, the Company had outstanding \$320 million in pay-fixed receive-variable interest rate swaps with \$1 million of unrealized deferred losses in comprehensive income related to the interest rate swap. As of September 30, 2017, the Company had no outstanding interest rate swaps and no deferred gains or losses in comprehensive income or losses related to interest rate swaps.

The pre-tax gains and losses of the Company's derivative interest rate swaps designated as cash flow hedges recorded in OCI and the Consolidated Statement of Comprehensive Income at March 31, 2018 and September 30, 2017 were \$1 million and nil, respectively.

The following is a summary of amounts recorded in the Consolidated Balance Sheet pertaining to the Company's designated cash flows hedges at March 31, 2018 and September 30, 2017:

|                              | March<br>31,<br>2018<br>(a) | September<br>30,<br>2017 |
|------------------------------|-----------------------------|--------------------------|
|                              | (in millions)               |                          |
| Other current assets         | \$ 2                        | \$ —                     |
| Other current liabilities    | 3                           | —                        |
| Other noncurrent assets      | —                           | —                        |
| Other noncurrent liabilities | 1                           | —                        |

(a) \$5 million and \$6 million of foreign exchange derivative contracts in asset and liability positions, respectively, and \$1 million of interest rate swap in a liability position including non-designated cash flow hedges.

## 9. Segment Information

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



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

|   | Recorded Music |            | Corporate    | Total   |
|---|----------------|------------|--------------|---------|
|   | Music          | Publishing | expenses and |         |
|   | (in millions)  |            | eliminations |         |
| Three Months Ended                            |                |            |              |         |
| March 31, 2018                                |                |            |              |         |
| Revenues                                      | \$791          | \$ 174     | \$ (2 )      | \$963   |
| Operating income (loss)                       | 80             | 41         | (38 )        | 83      |
| Amortization of intangible assets             | 38             | 17         | —            | 55      |
| Depreciation of property, plant and equipment | 9              | 2          | 3            | 14      |
| OIBDA   | 127            | 60         | (35 )        | 152     |
| March 31, 2017                                |                |            |              |         |
| Revenues                                      | \$686          | \$ 145     | \$ (6 )      | \$825   |
| Operating income (loss)                       | 69             | 41         | (32 )        | 78      |
| Amortization of intangible assets             | 34             | 16         | —            | 50      |
| Depreciation of property, plant and equipment | 9              | 1          | 3            | 13      |
| OIBDA   | 112            | 58         | (29 )        | 141     |
| Six Months Ended                              |                |            |              |         |
| March 31, 2018                                |                |            |              |         |
| Revenues                                      | \$1,695        | \$ 317     | \$ (4 )      | \$2,008 |
| Operating income (loss)                       | 209            | 40         | (76 )        | 173     |
| Amortization of intangible assets             | 74             | 34         | —            | 108     |
| Depreciation of property, plant and equipment | 17             | 3          | 6            | 26      |
| OIBDA   | 300            | 77         | (70 )        | 307     |
| March 31, 2017                                |                |            |              |         |
| Revenues                                      | \$1,483        | \$ 269     | \$ (10 )     | \$1,742 |
| Operating income (loss)                       | 192            | 39         | (59 )        | 172     |
| Amortization of intangible assets             | 69             | 32         | —            | 101     |
| Depreciation of property, plant and equipment | 16             | 3          | 6            | 25      |
| OIBDA   | 277            | 74         | (53 )        | 298     |

## 10. Additional Financial Information

Cash Interest and Taxes

The Company made interest payments of approximately \$34 million and \$17 million during the three months ended March 31, 2018 and March 31, 2017, respectively. The Company made interest payments of approximately \$86 million and \$64 million during the six months ended March 31, 2018 and March 31, 2017, respectively. The Company paid approximately \$10 million of income and withholding taxes, partially offset by \$1 million of refunds, during the three months ended March 31, 2018 and paid approximately \$13 million of income and withholding taxes, partially offset by \$3 million of refunds during the three months ended March 31, 2017. The Company paid approximately \$18 million of income and withholding taxes, partially offset by \$1 million of refunds, during the six months ended March 31, 2018 and paid approximately \$22 million of income and withholding taxes, partially offset by \$3 million of refunds during the six months ended March 31, 2017.

## 11. Fair Value Measurements

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

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

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

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

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

In accordance with the fair value hierarchy, described above, the following table shows the fair value of the Company's financial instruments that are required to be measured at fair value as of March 31, 2018 and September 30, 2017.

|   | Fair Value Measurements as of<br>March 31, 2018 |           |           |         |
|---|---|-----------|-----------|---------|
|   | (Level 1)                                       | (Level 2) | (Level 3) | Total   |
|   | (in millions)                                   |           |           |         |
| <b>Other Current Assets:</b>                    |   |           |           |         |
| Foreign Currency Forward Exchange Contracts (a) | \$ —  | \$ 2      | \$ —      | \$ 2    |
| <b>Other Current Liabilities:</b>               |   |           |           |         |
| Foreign Currency Forward Exchange Contracts (a) | —   | (3 )      | —         | (3 )    |
| <b>Other Current Liabilities:</b>               |   |           |           |         |
| Contractual Obligations (b)                     | —   | —         | —         | —       |
| <b>Other Non-Current Liabilities:</b>           |   |           |           |         |
| Contractual Obligations (b)                     | —   | —         | (6 )      | (6 )    |
| Interest Rate Swap (c)                          | —   | (1 )      | —         | (1 )    |
| Total   | \$ —  | \$ (2 )   | \$ (6 )   | \$ (8 ) |

|                                   | Fair Value Measurements as of<br>September 30, 2017 |           |           |       |
|-----------------------------------|---|-----------|-----------|-------|
|                                   | (Level 1)   | (Level 2) | (Level 3) | Total |
|                                   | (in millions)                                       |           |           |       |
| <b>Other Current Liabilities:</b> |   |           |           |       |
| Contractual Obligations (b)       | —   | —         | —         | —     |

|                                |      |      |         |         |
|--------------------------------|------|------|---------|---------|
| Other Non-Current Liabilities: |      |      |         |         |
| Contractual Obligations (b)    | —    | —    | (5 )    | (5 )    |
| Total                          | \$ — | \$ — | \$ (5 ) | \$ (5 ) |

- (a) The fair value of foreign currency forward exchange contracts is based on dealer quotes of market forward rates and reflects the amount that the Company would receive or pay at their maturity dates for contracts involving the same currencies and maturity dates.
- (b) This represents purchase obligations and contingent consideration related to the Company's various acquisitions. This is based on a discounted cash flow approach and it is adjusted to fair value on a recurring basis and any adjustments are included as a component of operating income in the statement of operations. These amounts were mainly calculated using unobservable inputs such as future earnings performance of the Company's various acquisitions and the expected timing of the payment.
- (c) The fair value of the interest rate swap is based on dealer quotes of market forward rates and reflects the amount that the Company would receive or pay as of March 31, 2018 for contracts involving the same attributes and maturity dates.

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

|                               | Total<br>(in millions) |
|-------------------------------|------------------------|
| Balance at September 30, 2017 | (5 )                   |
| Additions                     | (1 )                   |
| Reductions                    | —                      |
| Payments                      | —                      |
| Balance at March 31, 2018     | \$ (6 )                |

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

#### Fair Value of Debt

Based on the level of interest rates prevailing at March 31, 2018, the fair value of the Company's debt was \$3.027 billion. Based on the level of interest rates prevailing at September 30, 2017, the fair value of the Company's debt was \$2.936 billion. The fair value of the Company's debt instruments are determined using quoted market prices from less active markets or by using quoted market prices for instruments with identical terms and maturities; both approaches are considered a Level 2 measurement.

## 12. Subsequent Events

### Spotify Share Sale

Subsequent to March 31, 2018, the Company sold shares of common stock received as consideration under contracts entered into in the ordinary course of business with Spotify Technology S.A. for aggregate consideration of approximately \$400 million in cash proceeds, a portion of such proceeds which the Company expects to share with artists. The sale of shares will result in a pre-tax gain, net, of approximately \$300 million. Any unrealized gains or losses on the remaining shares held by the Company will be recorded to other income (expense).

### Special Cash Dividend

On May 7, 2018, our Board of Directors declared a special cash dividend of \$300 million to be paid on May 11, 2018 to stockholders of record as of May 7, 2018.

WARNER MUSIC GROUP CORP.

Supplementary Information

Consolidating Financial Statements

The Company is the direct parent of Holdings, which is the direct parent of Acquisition Corp. Acquisition Corp. has issued and outstanding the 5.625% Senior Secured Notes due 2022, the 5.00% Senior Secured Notes due 2023, the 4.125% Senior Secured Notes due 2024, the 4.875% Senior Secured Notes due 2024, the 6.75% Senior Notes due 2022 and the 5.50% Senior Notes due 2026 (together, the “Acquisition Corp. Notes”).

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

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

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Consolidating Balance Sheet (Unaudited)

March 31, 2018

|  | WMG<br>Acquisition<br>Corp.<br>(issuer)<br>(in millions) | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Elimination        | WMG<br>Acquisition<br>Corp.<br>Consolidated | Warner<br>Music<br>Group<br>Holdings<br>Corp. | Warner<br>Music<br>Group<br>Corp.<br>Elimination | Warner<br>Music<br>Group<br>Corp.<br>Consolidated |
|--|--|---------------------------|-----------------------------------|--------------------|---|---|--|---|
| <b>Assets:</b>   |  |                           |                                   |                    |   |   |  |   |
| <b>Current assets:</b>   |  |                           |                                   |                    |   |   |  |   |
| Cash and equivalents   | \$—  | \$ 329                    | \$ 283                            | \$ —               | \$ 612                                      | \$ —  | \$ —   | \$ 612  |
| Redemption deposit   | 119  | —                         | —                                 | —                  | 119   | —   | —  | 119   |
| Accounts receivable, net                                       | —  | 230                       | 197                               | —                  | 427   | —   | —  | 427   |
| Inventories  | —  | 14                        | 25                                | —                  | 39  | —   | —  | 39  |
| Royalty advances<br>expected to be recouped<br>within one year | —  | 98                        | 50                                | —                  | 148   | —   | —  | 148   |
| Prepaid and other<br>current assets                            | —  | 12                        | 50                                | —                  | 62  | —   | —  | 62  |
| <b>Total current assets</b>                                    | <b>119</b>   | <b>683</b>                | <b>605</b>                        | <b>—</b>           | <b>1,407</b>                                | <b>—</b>                                      | <b>—</b>   | <b>1,407</b>                                      |
| Due (to) from parent<br>companies                              | 518  | (49 )                     | (469 )                            | —                  | —   | —   | —  | —   |
| Investments in and<br>advances to consolidated<br>subsidiaries | 2,520  | 1,630                     | —                                 | (4,150 )           | —   | 398   | 398  | (796 )  |
| Royalty advances<br>expected to be recouped<br>after one year  | —  | 120                       | 61                                | —                  | 181   | —   | —  | 181   |
| Property, plant and<br>equipment, net                          | —  | 138                       | 76                                | —                  | 214   | —   | —  | 214   |
| Goodwill   | —  | 1,368                     | 328                               | —                  | 1,696                                       | —   | —  | 1,696   |
| Intangible assets subject<br>to amortization, net              | —  | 992                       | 1,045                             | —                  | 2,037                                       | —   | —  | 2,037   |
| Intangible assets not<br>subject to amortization               | —  | 71                        | 47                                | —                  | 118   | —   | —  | 118   |
| Deferred tax assets, net                                       | —  | 44                        | 8                                 | —                  | 52  | —   | —  | 52  |
| Other assets   | 8  | 50                        | 19                                | —                  | 77  | —   | —  | 77  |
| <b>Total assets</b>  | <b>\$3,165</b>   | <b>\$ 5,047</b>           | <b>\$ 1,720</b>                   | <b>\$ (4,150 )</b> | <b>\$ 5,782</b>                             | <b>\$ 398</b>                                 | <b>\$ 398</b>                                    | <b>\$ (796 ) \$ 5,782</b>                         |
| <b>Liabilities and Deficit:</b>                                |  |                           |                                   |                    |   |   |  |   |
| <b>Current liabilities:</b>                                    |  |                           |                                   |                    |   |   |  |   |
| Accounts payable   | \$1  | \$ 126                    | \$ 76                             | \$ —               | \$ 203                                      | \$ —  | \$ —   | \$ 203  |
| Accrued royalties  | —  | 785                       | 573                               | —                  | 1,358                                       | —   | —  | 1,358   |
| Accrued liabilities  | —  | 155                       | 185                               | —                  | 340   | —   | —  | 340   |
| Accrued interest   | 27   | —                         | —                                 | —                  | 27  | —   | —  | 27  |
| Deferred revenue   | —  | 146                       | 51                                | —                  | 197   | —   | —  | 197   |

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|                                       |         |          |          |             |          |        |        |           |          |
|---------------------------------------|---------|----------|----------|-------------|----------|--------|--------|-----------|----------|
| Current portion of long-term debt     | 111     | —        | —        | —           | 111      | —      | —      | —         | 111      |
| Other current liabilities             | —       | 5        | 32       | —           | 37       | —      | —      | —         | 37       |
| Total current liabilities             | 139     | 1,217    | 917      | —           | 2,273    | —      | —      | —         | 2,273    |
| Long-term debt                        | 2,836   | —        | —        | —           | 2,836    | —      | —      | —         | 2,836    |
| Deferred tax liabilities, net         | —       | —        | 194      | —           | 194      | —      | —      | —         | 194      |
| Other noncurrent liabilities          | 1       | 156      | 117      | —           | 274      | —      | —      | —         | 274      |
| Total liabilities                     | 2,976   | 1,373    | 1,228    | —           | 5,577    | —      | —      | —         | 5,577    |
| Total Warner Music Group Corp. equity | 189     | 3,669    | 481      | (4,150 )    | 189      | 398    | 398    | (796 )    | 189      |
| Noncontrolling interest               | —       | 5        | 11       | —           | 16       | —      | —      | —         | 16       |
| Total equity                          | 189     | 3,674    | 492      | (4,150 )    | 205      | 398    | 398    | (796 )    | 205      |
| Total liabilities and equity          | \$3,165 | \$ 5,047 | \$ 1,720 | \$ (4,150 ) | \$ 5,782 | \$ 398 | \$ 398 | \$ (796 ) | \$ 5,782 |

## Consolidating Balance Sheet

September 30, 2017

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

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

## Consolidating Statement of Operations (Unaudited)

For The Three Months Ended March 31, 2018

|   | WMG<br>Acquisition<br>Corp.<br>(issuer<br>(in millions) | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Elimination | WMG<br>Acquisition<br>Corp.<br>Consolidated | Warner<br>WMG<br>Music<br>Group<br>Corp. | Warner<br>Music<br>Group<br>Corp.<br>Elimination | Warner<br>Music<br>Group<br>Corp.<br>Consolidated |
|---|---|---------------------------|-----------------------------------|-------------|---|--|--|---|
| Revenues  | \$—   | \$ 535                    | \$ 549                            | \$ (121 )   | \$ 963                                      | \$ —                                     | \$ —   | \$ 963  |
| Costs and expenses:   |   |                           |                                   |             |   |  |  |   |
| Cost of revenue   | —   | (242 )                    | (327 )                            | 81          | (488 )                                      | —  | —  | (488 )  |
| Selling, general and<br>administrative expenses               | —   | (244 )                    | (135 )                            | 42          | (337 )                                      | —  | —  | (337 )  |
| Amortization of intangible<br>assets                          | —   | (23 )                     | (32 )                             | —           | (55 )                                       | —  | —  | (55 )   |
| Total costs and expenses                                      | —   | (509 )                    | (494 )                            | 123         | (880 )                                      | —  | —  | (880 )  |
| Operating income  | —   | 26                        | 55                                | 2           | 83  | —  | —  | 83  |
| Loss on extinguishment of debt                                | (23)  | —                         | —                                 | —           | (23 )                                       | —  | —  | (23 )   |
| Interest expense, net   | (31)  | —                         | (5 )                              | —           | (36 )                                       | —  | —  | (36 )   |
| Equity gains (losses) from<br>equity method investments       | 66  | 33                        | —                                 | (99 )       | —   | (3 )                                     | (3 )   | 6   |
| Other expense, net  | 4   | (1 )                      | (9 )                              | —           | (6 )  | —  | —  | (6 )  |
| Income (loss) before income<br>taxes                          | 16  | 58                        | 41                                | (97 )       | 18  | (3 )                                     | (3 )   | 6   |
| Income tax (expense) benefit                                  | (19)  | (18 )                     | (18 )                             | 36          | (19 )                                       | —  | —  | (19 )   |
| Net (loss) income   | (3 )  | 40                        | 23                                | (61 )       | (1 )  | (3 )                                     | (3 )   | 6   |
| Less: income attributable to<br>noncontrolling interest       | —   | (1 )                      | (1 )                              | —           | (2 )  | —  | —  | (2 )  |
| Net (loss) income attributable to<br>Warner Music Group Corp. | \$(3 )  | \$ 39                     | \$ 22                             | \$(61 )     | \$(3 )                                      | \$(3 )                                   | \$(3 )   | \$ 6  |

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Consolidating Statement of Operations (Unaudited)

For The Three Months Ended March 31, 2017

|   | WMG<br>Acquisition<br>Corp.<br>(issuer<br>(in millions) | Non-<br>Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Elimination | WMG<br>Acquisition<br>Corp.<br>Consolidated | Warner<br>WMG<br>Music<br>Group<br>Corp.<br>Elimination | Warner<br>Music<br>Group<br>Corp.<br>Elimination | Warner<br>Music<br>Group<br>Corp.<br>Consolidated |
|---|---|-----------------------------------|-----------------------------------|-------------|---|---|--|---|
| Revenues  | \$—   | \$ 470                            | \$ 439                            | \$ (84 )    | \$ 825                                      | \$ —  | \$ —   | \$ 825  |
| Costs and expenses:                                     |   |                                   |                                   |             |   |   |  |   |
| Cost of revenue   | —   | (204 )                            | (268 )                            | 57          | (415 )                                      | —   | —  | (415 )  |
| Selling, general and<br>administrative expenses         | —   | (199 )                            | (110 )                            | 27          | (282 )                                      | —   | —  | (282 )  |
| Amortization of intangible<br>assets                    | —   | (26 )                             | (24 )                             | —           | (50 )                                       | —   | —  | (50 )   |
| Total costs and expenses                                | —   | (429 )                            | (402 )                            | 84          | (747 )                                      | —   | —  | (747 )  |
| Operating income  | —   | 41                                | 37                                | —           | 78  | —   | —  | 78  |
| Interest (expense) income, net                          | (21)  | 1                                 | (16 )                             | —           | (36 )                                       | —   | —  | (36 )   |
| Equity gains (losses) from<br>equity method investments | 49  | 11                                | —                                 | (60 )       | —   | 19  | 19   | (38 )   |
| Other expense, net                                      | (6 )  | —                                 | (13 )                             | —           | (19 )                                       | —   | —  | (19 )   |
| Income before income taxes                              | 22  | 53                                | 8                                 | (60 )       | 23  | 19  | 19   | (38 )   |
| Income tax (expense) benefit                            | (3 )  | (4 )                              | (7 )                              | 11          | (3 )  | —   | —  | (3 )  |
| Net income  | 19  | 49                                | 1                                 | (49 )       | 20  | 19  | 19   | (38 )   |
| Less: income attributable to<br>noncontrolling interest | —   | —                                 | (1 )                              | —           | (1 )  | —   | —  | (1 )  |
| Net income attributable to<br>Warner Music Group Corp.  | \$19  | \$ 49                             | \$ —                              | \$ (49 )    | \$ 19                                       | \$ 19   | \$ 19  | \$ (38 )  |

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Consolidating Statement of Operations (Unaudited)

For The Six Months Ended March 31, 2018

|   | WMG<br>Acquisition | Non-<br>Guarantor<br>Subsidiaries | Guarantor<br>Subsidiaries | Eliminations | WMG<br>Acquisition<br>Corp.<br>(issuer)<br>(in millions) | Warner<br>Music<br>Group<br>Corp.<br>Eliminations | Warner<br>Music<br>Group<br>Corp.<br>Consolidated | Warner<br>Music<br>Group<br>Corp.<br>Consolidated |
|---|--------------------|-----------------------------------|---------------------------|--------------|--|---|---|---|
| Revenues  | \$—                | \$ 1,082                          | \$ 1,170                  | \$ (244 )    | \$ 2,008   | \$ —  | \$ —  | \$ 2,008  |
| Costs and expenses:                                     |                    |                                   |                           |              |  |   |   |   |
| Cost of revenue   | —                  | (499 )                            | (720 )                    | 162          | (1,057 )   | —   | —   | (1,057 )  |
| Selling, general and<br>administrative expenses         | —                  | (479 )                            | (273 )                    | 82           | (670 )   | —   | —   | (670 )  |
| Amortization of intangible<br>assets                    | —                  | (47 )                             | (61 )                     | —            | (108 )   | —   | —   | (108 )  |
| Total costs and expenses                                | —                  | (1,025 )                          | (1,054 )                  | 244          | (1,835 )   | —   | —   | (1,835 )  |
| Operating income  | —                  | 57                                | 116                       | —            | 173  | —   | —   | 173   |
| Loss on extinguishment of<br>debt                       | (24 )              | —                                 | —                         | —            | (24 )  | —   | —   | (24 )   |
| Interest (expense) income,<br>net                       | (60 )              | 1                                 | (13 )                     | —            | (72 )  | —   | —   | (72 )   |
| Equity gains (losses) from<br>equity method investments | 156                | 76                                | —                         | (232 )       | —  | 1   | 1   | (2 )  |
| Other expense, net                                      | —                  | 9                                 | (11 )                     | —            | (2 )   | —   | —   | (2 )  |
| Income before income taxes                              | 72                 | 143                               | 92                        | (232 )       | 75   | 1   | 1   | (2 )  |
| Income tax (expense) benefit                            | (71 )              | (69 )                             | (28 )                     | 97           | (71 )  | —   | —   | (71 )   |
| Net income (loss)                                       | 1                  | 74                                | 64                        | (135 )       | 4  | 1   | 1   | (2 )  |
| Less: income attributable to<br>noncontrolling interest | —                  | (1 )                              | (2 )                      | —            | (3 )   | —   | —   | (3 )  |
| Net income attributable to<br>Warner Music Group Corp.  | \$1                | \$ 73                             | \$ 62                     | \$ (135 )    | \$ 1   | \$ 1  | \$ 1  | \$ (2 )   |

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Consolidating Statement of Operations (Unaudited)

For The Six Months Ended March 31, 2017

|  | WMG Acquisition Corp. |                        |                            |              | Non-Guarantor Subsidiaries |              | Eliminations |              | Warner Music Group Corp. |              | Warner Music Group Corp. |
|--|-----------------------|------------------------|----------------------------|--------------|----------------------------|--------------|--------------|--------------|--------------------------|--------------|--------------------------|
|  | Acquisition           | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated               | Holder Corp. | Group Corp.  | Eliminations | Consolidated             | Consolidated |                          |
|  | (in millions)         |                        |                            |              |                            |              |              |              |                          |              |                          |
| Revenues   | \$—                   | \$ 960                 | \$ 960                     | \$ (178 )    | \$ 1,742                   | \$ —         | \$ —         | \$ —         | \$ 1,742                 | \$ 1,742     |                          |
| Costs and expenses:                                  |                       |                        |                            |              |                            |              |              |              |                          |              |                          |
| Cost of revenue                                      | —                     | (424 )                 | (609 )                     | 122          | (911 )                     | —            | —            | —            | (911 )                   | (911 )       |                          |
| Selling, general and administrative expenses         | (1 )                  | (375 )                 | (238 )                     | 56           | (558 )                     | —            | —            | —            | (558 )                   | (558 )       |                          |
| Amortization of intangible assets                    | —                     | (51 )                  | (50 )                      | —            | (101 )                     | —            | —            | —            | (101 )                   | (101 )       |                          |
| Total costs and expenses                             | (1 )                  | (850 )                 | (897 )                     | 178          | (1,570 )                   | —            | —            | —            | (1,570 )                 | (1,570 )     |                          |
| Operating (loss) income                              | (1 )                  | 110                    | 63                         | —            | 172                        | —            | —            | —            | 172                      | 172          |                          |
| Loss on extinguishment of debt                       | (32 )                 | —                      | —                          | —            | (32 )                      | —            | —            | —            | (32 )                    | (32 )        |                          |
| Interest (expense) income, net                       | (44 )                 | 2                      | (34 )                      | —            | (76 )                      | —            | —            | —            | (76 )                    | (76 )        |                          |
| Equity gains (losses) from equity method investments | 132                   | 51                     | —                          | (183 )       | —                          | 41           | 41           | (82 )        | —                        | —            |                          |
| Other income (expense), net                          | 6                     | 3                      | (9 )                       | —            | —                          | —            | —            | —            | —                        | —            |                          |
| Income before income taxes                           | 61                    | 166                    | 20                         | (183 )       | 64                         | 41           | 41           | (82 )        | 64                       | 64           |                          |
| Income tax (expense) benefit                         | (20 )                 | (22 )                  | (16 )                      | 38           | (20 )                      | —            | —            | —            | (20 )                    | (20 )        |                          |
| Net income   | 41                    | 144                    | 4                          | (145 )       | 44                         | 41           | 41           | (82 )        | 44                       | 44           |                          |
| Less: income attributable to noncontrolling interest | —                     | —                      | (3 )                       | —            | (3 )                       | —            | —            | —            | (3 )                     | (3 )         |                          |
| Net income attributable to Warner Music Group Corp.  | \$41                  | \$ 144                 | \$ 1                       | \$ (145 )    | \$ 41                      | \$ 41        | \$ 41        | \$ (82 )     | \$ 41                    | \$ 41        |                          |

Consolidating Statement of Comprehensive Income (Unaudited)

For The Three Months Ended March 31, 2018

|   | WMG<br>Acquisition | Non-<br>Guarantor<br>Subsidiaries | Guarantor<br>Subsidiaries | Elimination | WMG<br>Acquisition<br>Corp.<br>Consolidated | Warner<br>Music<br>Group<br>Corp.<br>Elimination | Warner<br>Music<br>Group<br>Corp.<br>Consolidated |          |         |
|---|--------------------|-----------------------------------|---------------------------|-------------|---|--|---|----------|---------|
|   | (issue)            |                                   |                           |             |   |  |   |          |         |
|   | (in millions)      |                                   |                           |             |   |  |   |          |         |
| Net (loss) income   | \$ (3 )            | \$ 40                             | \$ 23                     | \$ (61 )    | \$ (1 )                                     | \$ (3 )  | \$ (3 )   | \$ 6     | \$ (1 ) |
| Other comprehensive income (loss), net of tax:                |                    |                                   |                           |             |   |  |   |          |         |
| Foreign currency adjustment                                   | 9                  | —                                 | (9 )                      | 9           | 9   | 9  | 9   | (18 )    | 9       |
| Deferred gains on derivative financial instruments            | 1                  | —                                 | 1                         | (1 )        | 1   | 1  | 1   | (2 )     | 1       |
| Other comprehensive income (loss), net of tax:                | 10                 | —                                 | (8 )                      | 8           | 10  | 10   | 10  | (20 )    | 10      |
| Total comprehensive income                                    | 7                  | 40                                | 15                        | (53 )       | 9   | 7  | 7   | (14 )    | 9       |
| Less: income attributable to noncontrolling interest          | —                  | (1 )                              | (1 )                      | —           | (2 )  | —  | —   | —        | (2 )    |
| Comprehensive income attributable to Warner Music Group Corp. | \$ 7               | \$ 39                             | \$ 14                     | \$ (53 )    | \$ 7  | \$ 7   | \$ 7  | \$ (14 ) | \$ 7    |

Consolidating Statement of Comprehensive Income (Unaudited)

For The Three Months Ended March 31, 2017

|  | WMG Acquisition             |                        | Non-Guarantor Subsidiaries |              | Eliminations       |                    | WMG Acquisition |             | Warner Music Group Corp. |             | Warner Music Group Corp. |              |
|--|-----------------------------|------------------------|----------------------------|--------------|--------------------|--------------------|-----------------|-------------|--------------------------|-------------|--------------------------|--------------|
|  | Corp. (issued Subsidiaries) | Guarantor Subsidiaries | Guarantor Subsidiaries     | Eliminations | Corp. Consolidated | Corp. Consolidated | Group Corp.     | Group Corp. | Eliminations             | Group Corp. | Group Corp.              | Consolidated |
|  | (in millions)               |                        |                            |              |                    |                    |                 |             |                          |             |                          |              |
| Net income   | \$ 19                       | \$ 49                  | \$ 1                       | \$ (49 )     | \$ 20              | \$ 19              | \$ 19           | \$ (38 )    | \$ 20                    |             |                          |              |
| Other comprehensive income, net of tax:                              |                             |                        |                            |              |                    |                    |                 |             |                          |             |                          |              |
| Foreign currency adjustment  | 24                          | —                      | (50 )                      | 50           | 24                 | 24                 | 24              | (48 )       | 24                       |             |                          |              |
| Deferred gains on derivative financial instruments                   | 1                           | 1                      | —                          | (1 )         | 1                  | 1                  | 1               | (2 )        | 1                        |             |                          |              |
| Other comprehensive income, net of tax:                              | 25                          | 1                      | (50 )                      | 49           | 25                 | 25                 | 25              | (50 )       | 25                       |             |                          |              |
| Total comprehensive income   | 44                          | 50                     | (49 )                      | —            | 45                 | 44                 | 44              | (88 )       | 45                       |             |                          |              |
| Less: income attributable to noncontrolling interest                 | —                           | —                      | (1 )                       | —            | (1 )               | —                  | —               | —           | (1 )                     |             |                          |              |
| Comprehensive income (loss) attributable to Warner Music Group Corp. | \$ 44                       | \$ 50                  | \$ (50 )                   | \$ —         | \$ 44              | \$ 44              | \$ 44           | \$ (88 )    | \$ 44                    |             |                          |              |

Consolidating Statement of Comprehensive Income (Unaudited)

For The Six Months Ended March 31, 2018

|   | WMG Acquisition Corp. Guarantor (issued Subsidiaries (in millions)) |       |       |           | Non-Guarantor Subsidiaries Elimination |       |       |          | WMG Acquisition Corp. Holding Corp. Consolidated |  |  | Warner Music Group Corp. Elimination |  | Warner Music Group Corp. Consolidated |  |
|---|---|-------|-------|-----------|--|-------|-------|----------|--|--|--|--------------------------------------|--|---------------------------------------|--|
| Net income (loss)   | \$1   | \$ 74 | \$ 64 | \$ (135 ) | \$ 4                                   | \$ 1  | \$ 1  | \$ (2 )  | \$ 4   |  |  |                                      |  |                                       |  |
| Other comprehensive income (loss), net of tax:                |   |       |       |           |  |       |       |          |  |  |  |                                      |  |                                       |  |
| Foreign currency adjustment                                   | 18  | —     | (18 ) | 18        | 18                                     | 18    | 18    | (36 )    | 18   |  |  |                                      |  |                                       |  |
| Deferred losses on derivative financial instruments           | 2   | —     | —     | —         | 2                                      | 2     | 2     | (4 )     | 2  |  |  |                                      |  |                                       |  |
| Other comprehensive income (loss), net of tax:                | 20  | —     | (18 ) | 18        | 20                                     | 20    | 20    | (40 )    | 20   |  |  |                                      |  |                                       |  |
| Total comprehensive income (loss)                             | 21  | 74    | 46    | (117 )    | 24                                     | 21    | 21    | (42 )    | 24   |  |  |                                      |  |                                       |  |
| Less: income attributable to noncontrolling interest          | —   | (1 )  | (2 )  | —         | (3 )                                   | —     | —     | —        | (3 )   |  |  |                                      |  |                                       |  |
| Comprehensive income attributable to Warner Music Group Corp. | \$21  | \$ 73 | \$ 44 | \$ (117 ) | \$ 21                                  | \$ 21 | \$ 21 | \$ (42 ) | \$ 21  |  |  |                                      |  |                                       |  |

Consolidating Statement of Comprehensive Income (Unaudited)

For The Six Months Ended March 31, 2017

|  | WMG<br>Acquisition<br>Corp.<br>(issuer<br>(in millions) | Non-<br>Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Elimination | WMG<br>Acquisition<br>Corp.<br>Consolidated | Warner<br>Music<br>Group<br>Corp.<br>Holdings<br>Corp. | Warner<br>Music<br>Group<br>Corp.<br>Elimination | Warner<br>Music<br>Group<br>Corp.<br>Consolidated |       |
|--|---|-----------------------------------|-----------------------------------|-------------|---|--|--|---|-------|
| Net income   | \$41  | \$ 144                            | \$ 4                              | \$ (145 )   | \$ 44                                       | \$ 41  | \$ 41  | \$ (82 )  | \$ 44 |
| Other comprehensive (loss)<br>income, net of tax:                          |   |                                   |                                   |             |   |  |  |   |       |
| Foreign currency adjustment  | (13)  | —                                 | (13 )                             | 13          | (13 )                                       | (13 )  | (13 )  | 26  | (13 ) |
| Deferred losses on derivative<br>financial instruments                     | (1 )  | (1 )                              | —                                 | 1           | (1 )  | (1 )   | (1 )   | 2   | (1 )  |
| Other comprehensive (loss)<br>income, net of tax:                          | (14)  | (1 )                              | (13 )                             | 14          | (14 )                                       | (14 )  | (14 )  | 28  | (14 ) |
| Total comprehensive income<br>(loss)                                       | 27  | 143                               | (9 )                              | (131 )      | 30  | 27   | 27   | (54 )   | 30    |
| Less: income attributable to<br>noncontrolling interest                    | —   | —                                 | (3 )                              | —           | (3 )  | —  | —  | —   | (3 )  |
| Comprehensive income (loss)<br>attributable to Warner Music<br>Group Corp. | \$27  | \$ 143                            | \$ (12 )                          | \$ (131 )   | \$ 27                                       | \$ 27  | \$ 27  | \$ (54 )  | \$ 27 |

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Consolidating Statement of Cash Flows (Unaudited)

For The Six Months Ended March 31, 2018

|   | WMG<br>Acquisition<br>Corp.<br>(issuer)<br>(in millions) | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Elimination | WMG<br>Acquisition<br>Corp.<br>Consolidated | Warner<br>Music<br>Group<br>Corp.<br>Elimination | Warner<br>Music<br>Group<br>Corp.<br>Consolidated |   |        |
|---|--|---------------------------|-----------------------------------|-------------|---|--|---|---|--------|
| Cash flows from operating activities  |  |                           |                                   |             |   |  |   |   |        |
| Net income (loss)   | \$ 1   | \$ 74                     | \$ 64                             | \$ (135 )   | \$ 4  | \$ 1   | \$ 1 \$ (2 ) \$ 4                                 |   |        |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |                           |                                   |             |   |  |   |   |        |
| Depreciation and amortization   | —  | 67                        | 67                                | —           | 134   | —  | —   | — | 134    |
| Unrealized losses and remeasurement of  |  |                           |                                   |             |   |  |   |   |        |
| foreign denominated loans   | 17   | 3                         | (9 )                              | —           | 11  | —  | —   | — | 11     |
| Deferred income taxes   | —  | —                         | 38                                | —           | 38  | —  | —   | — | 38     |
| Loss on extinguishment of debt  | 24   | —                         | —                                 | —           | 24  | —  | —   | — | 24     |
| Net (gain) loss on divestitures and investments                                   | —  | (7 )                      | —                                 | —           | (7 )  | —  | —   | — | (7 )   |
| Non-cash interest expense   | 3  | —                         | —                                 | —           | 3   | —  | —   | — | 3      |
| Equity-based compensation expense   | —  | 27                        | —                                 | —           | 27  | —  | —   | — | 27     |
| Equity (gains) losses, including distributions                                    | (156)  | (76 )                     | —                                 | 232         | —   | (1 )   | (1 )  | 2 | —      |
| Changes in operating assets and liabilities:                                      |  |                           |                                   |             |   |  |   |   |        |
| Accounts receivable   | —  | (16 )                     | 1                                 | —           | (15 )                                       | —  | —   | — | (15 )  |
| Inventories   | —  | (1 )                      | 2                                 | —           | 1   | —  | —   | — | 1      |
| Royalty advances  | —  | (20 )                     | 8                                 | —           | (12 )                                       | —  | —   | — | (12 )  |
| Accounts payable and accrued liabilities  | —  | 101                       | (104 )                            | (97 )       | (100 )                                      | —  | —   | — | (100 ) |
| Royalty payables  | —  | 48                        | 20                                | —           | 68  | —  | —   | — | 68     |
| Accrued interest  | (14 )  | —                         | —                                 | —           | (14 )                                       | —  | —   | — | (14 )  |
| Deferred revenue  | —  | 9                         | (25 )                             | —           | (16 )                                       | —  | —   | — | (16 )  |
| Other balance sheet changes   | (4 )   | 43                        | (49 )                             | —           | (10 )                                       | —  | —   | — | (10 )  |
| Net cash provided (used in) by operating activities                               | (129)  | 252                       | 13                                | —           | 136   | —  | —   | — | 136    |

## Cash flows from investing activities

|  |       |        |        |        |        |      |      |      |        |
|--|-------|--------|--------|--------|--------|------|------|------|--------|
| Acquisition of music publishing rights, net                                  | —     | (4 )   | (1 )   | —      | (5 )   | —    | —    | —    | (5 )   |
| Capital expenditures   | —     | (23 )  | (6 )   | —      | (29 )  | —    | —    | —    | (29 )  |
| Investments and acquisitions of businesses, net                              | —     | (6 )   | —      | —      | (6 )   | —    | —    | —    | (6 )   |
| Proceeds from the sale of investments  | —     | 12     | —      | —      | 12     | —    | —    | —    | 12     |
| Advances from issuer   | 151   | —      | —      | (151 ) | —      | —    | —    | —    | —      |
| Net cash (used in) provided by investing activities                          | 151   | (21 )  | (7 )   | (151 ) | (28 )  | —    | —    | —    | (28 )  |
| Cash flows from financing activities   |       |        |        |        |        |      |      |      |        |
| Proceeds from issuance of Acquisition Corp. 5.50% Senior Notes               | 325   | —      | —      | —      | 325    | —    | —    | —    | 325    |
| Proceeds from supplement of Acquisition Corp. Senior Term Loan Facility      | 320   | —      | —      | —      | 320    | —    | —    | —    | 320    |
| Repayment of and redemption deposit for Acquisition Corp. 6.75% Senior Notes | (635) | —      | —      | —      | (635 ) | —    | —    | —    | (635 ) |
| Call premiums paid on and redemption deposit for early redemption of debt    | (23 ) | —      | —      | —      | (23 )  | —    | —    | —    | (23 )  |
| Deferred financing costs paid  | (9 )  | —      | —      | —      | (9 )   | —    | —    | —    | (9 )   |
| Distribution to noncontrolling interest holder                               | —     | —      | (2 )   | —      | (2 )   | —    | —    | —    | (2 )   |
| Dividends paid   | —     | (98 )  | (27 )  | —      | (125 ) | —    | —    | —    | (125 ) |
| Change in due to (from) issuer   | —     | (151 ) | —      | 151    | —      | —    | —    | —    | —      |
| Net cash (used in) provided by financing activities                          | (22 ) | (249 ) | (29 )  | 151    | (149 ) | —    | —    | —    | (149 ) |
| Effect of exchange rate changes on cash and equivalents                      | —     | —      | 6      | —      | 6      | —    | —    | —    | 6      |
| Net decrease in cash and equivalents   | —     | (18 )  | (17 )  | —      | (35 )  | —    | —    | —    | (35 )  |
| Cash and equivalents at beginning of period                                  | —     | 347    | 300    | —      | 647    | —    | —    | —    | 647    |
| Cash and equivalents at end of period  | \$—   | \$ 329 | \$ 283 | \$ —   | \$ 612 | \$ — | \$ — | \$ — | \$ 612 |

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Consolidating Statement of Cash Flows (Unaudited)

For The Six Months Ended March 31, 2017

|   | WMG<br>Acquisition<br>Corp.<br>(issuer)<br>(in millions) | Non-<br>Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Elimination | WMG<br>Acquisition<br>Corp.<br>Consolidated | Warner<br>Music<br>Group<br>Corp.<br>Holdings<br>Corp. | Warner<br>Music<br>Group<br>Corp.<br>Elimination | Warner<br>Music<br>Group<br>Corp.<br>Consolidated |
|---|--|-----------------------------------|-----------------------------------|-------------|---|--|--|---|
| Cash flows from operating activities  |  |                                   |                                   |             |   |  |  |   |
| Net income  | \$ 41  | \$ 144                            | \$ 4                              | \$ (145 )   | \$ 44                                       | \$ 41  | \$ 41  | \$ (82 ) \$ 44                                    |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |                                   |                                   |             |   |  |  |   |
| Depreciation and amortization   | —  | 70                                | 56                                | —           | 126   | —  | —  | 126   |
| Unrealized (gains)/losses and remeasurement of                                    |  |                                   |                                   |             |   |  |  |   |
| foreign denominated loans   | (11 )  | (3 )                              | 13                                | —           | (1 )  | —  | —  | (1 )  |
| Deferred income taxes   | 2  | 2                                 | (12 )                             | (4 )        | (12 )                                       | —  | —  | (12 )   |
| Loss on extinguishment of debt  | 32   | —                                 | —                                 | —           | 32  | —  | —  | 32  |
| Net loss on divestiture and investments   | —  | 5                                 | 1                                 | —           | 6   | —  | —  | 6   |
| Non-cash interest expense   | 5  | —                                 | —                                 | —           | 5   | —  | —  | 5   |
| Equity-based compensation expense   | —  | 17                                | —                                 | —           | 17  | —  | —  | 17  |
| Equity (gains) losses, including distributions                                    | (132)  | (51 )                             | —                                 | 183         | —   | (41 )  | (41 )  | 82 —  |
| Changes in operating assets and liabilities:                                      |  |                                   |                                   |             |   |  |  |   |
| Accounts receivable   | —  | (2 )                              | (39 )                             | —           | (41 )                                       | —  | —  | (41 )   |
| Inventories   | —  | 2                                 | 1                                 | —           | 3   | —  | —  | 3   |
| Royalty advances  | —  | (4 )                              | 5                                 | —           | 1   | —  | —  | 1   |
| Accounts payable and accrued liabilities  | —  | (5 )                              | (4 )                              | (34 )       | (43 )                                       | —  | —  | (43 )   |
| Royalty payables  | —  | 54                                | 21                                | —           | 75  | —  | —  | 75  |
| Accrued interest  | 7  | —                                 | —                                 | —           | 7   | —  | —  | 7   |
| Deferred revenue  | —  | (34 )                             | 30                                | —           | (4 )  | —  | —  | (4 )  |
| Other balance sheet changes   | 7  | 10                                | (6 )                              | —           | 11  | —  | —  | 11  |
| Net cash (used in) provided by operating activities                               | (49 )  | 205                               | 70                                | —           | 226   | —  | —  | 226   |

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Cash flows from investing activities

|   |    |       |      |       |       |   |   |   |       |
|---|----|-------|------|-------|-------|---|---|---|-------|
| Acquisition of music publishing rights, net         | —  | (3 )  | (3 ) | —     | (6 )  | — | — | — | (6 )  |
| Capital expenditures                                | —  | (13 ) | (5 ) | —     | (18 ) | — | — | — | (18 ) |
| Investments and acquisitions of businesses, net     | —  | (5 )  | (1 ) | —     | (6 )  | — | — | — | (6 )  |
| Divestitures, net                                   | —  | 7     | 11   | —     | 18    | — | — | — | 18    |
| Advances to issuer                                  | 87 | —     | —    | (87 ) | —     | — | — | — | —     |
| Net cash provided (used in) by investing activities | 87 | (14 ) | 2    | (87 ) | (12 ) | — | — | — | (12 ) |

Cash flows from financing activities

|   |       |        |        |      |        |      |      |      |        |
|---|-------|--------|--------|------|--------|------|------|------|--------|
| Proceeds from issuance of Acquisition Corp. 4.125% Senior Secured Notes | 380   | —      | —      | —    | 380    | —    | —    | —    | 380    |
| Proceeds from issuance of Acquisition Corp. 4.875% Senior Secured Notes | 250   | —      | —      | —    | 250    | —    | —    | —    | 250    |
| Proceeds from issuance of Acquisition Corp. Senior Term Loan Facility   | 22    | —      | —      | —    | 22     | —    | —    | —    | 22     |
| Repayment of Acquisition Corp. 6.00% Senior Secured Notes               | (450) | —      | —      | —    | (450 ) | —    | —    | —    | (450 ) |
| Repayment of Acquisition Corp. 6.25% Senior Secured Notes               | (173) | —      | —      | —    | (173 ) | —    | —    | —    | (173 ) |
| Repayment of Acquisition Corp. 5.625% Senior Secured Notes              | (28 ) | —      | —      | —    | (28 )  | —    | —    | —    | (28 )  |
| Call premiums paid on early redemption of debt                          | (27 ) | —      | —      | —    | (27 )  | —    | —    | —    | (27 )  |
| Deferred financing costs paid   | (12 ) | —      | —      | —    | (12 )  | —    | —    | —    | (12 )  |
| Distribution to noncontrolling interest holder                          | —     | —      | (1 )   | —    | (1 )   | —    | —    | —    | (1 )   |
| Dividends paid  | —     | (54 )  | —      | —    | (54 )  | —    | —    | —    | (54 )  |
| Change in due to (from) issuer  | —     | (87 )  | —      | 87   | —      | —    | —    | —    | —      |
| Net cash (used in) provided by financing activities                     | (38 ) | (141 ) | (1 )   | 87   | (93 )  | —    | —    | —    | (93 )  |
| Effect of exchange rate changes on cash and equivalents                 | —     | —      | (4 )   | —    | (4 )   | —    | —    | —    | (4 )   |
| Net increase in cash and equivalents                                    | —     | 50     | 67     | —    | 117    | —    | —    | —    | 117    |
| Cash and equivalents at beginning of period                             | —     | 180    | 179    | —    | 359    | —    | —    | —    | 359    |
| Cash and equivalents at end of period                                   | \$—   | \$ 230 | \$ 246 | \$ — | \$ 476 | \$ — | \$ — | \$ — | \$ 476 |



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

You should read the following discussion of our results of operations and financial condition with the unaudited interim financial statements included elsewhere in this Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2018 (the "Quarterly Report").

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

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

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

- the failure of the digital portion of the global recorded music industry to grow or grow at a significant rate to offset declines in the physical portion of the global recorded music industry;
- downward pressure on our pricing and our profit margins and reductions in shelf space;
- our ability to identify, sign and retain artists and songwriters and the existence or absence of superstar releases;
- threats to our business associated with digital piracy;
- the significant threat posed to our business and the music industry by organized industrial piracy;
- the popular demand for particular recording artists and/or songwriters and albums and the timely completion of albums by major recording artists and/or songwriters;
- the diversity and quality of our portfolio of songwriters;
- the diversity and quality of our album releases;
- the impact of legitimate channels for digital distribution of our creative content;
- our dependence on a limited number of digital music services for the online sale of our music recordings and their ability to significantly influence the pricing structure for online music stores;
- our involvement in intellectual property litigation;

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

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

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

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

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

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

local economic conditions in the countries in which we operate;

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

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

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

unfavorable currency exchange rate fluctuations;

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

## INTRODUCTION

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

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

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

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

**Results of operations.** This section provides an analysis of our results of operations for the three and six months ended March 31, 2018 and March 31, 2017. This analysis is presented on both a consolidated and segment basis.

**Financial condition and liquidity.** This section provides an analysis of our cash flows for the six months ended March 31, 2018 and March 31, 2017 as well as a discussion of our financial condition and liquidity as of March 31, 2018.

The discussion of our financial condition and liquidity includes a summary of the key debt covenant compliance measures under our debt agreements.

### Use of OIBDA

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



## Use of Constant Currency

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

## OVERVIEW

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

### Recorded Music Operations

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

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

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

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

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

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

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

We have diversified our revenues beyond our traditional businesses by entering into expanded-rights deals with recording artists in order to partner with artists in other aspects of their careers. Under these agreements, we provide services to and participate in artists' activities outside the traditional recorded music business such as touring, merchandising and sponsorships. We have built artist services capabilities and platforms for exploiting this broader set of music-related rights and participating more widely in the monetization of the artist brands we help create.

We believe that entering into expanded-rights deals and enhancing our artist services capabilities in areas such as concert promotion and management has permitted us to diversify revenue streams and capitalize on other revenue opportunities. This provides for improved long-term relationships with artists and allows us to more effectively connect artists and fans.

Recorded Music revenues are derived from four main sources:

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

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

- **Artist and repertoire costs**—the costs associated with (i) paying royalties to artists, producers, songwriters, other copyright holders and trade unions; (ii) signing and developing artists; and (iii) creating master recordings in the studio;
- **Product costs**—the costs to manufacture, package and distribute products to wholesale and retail distribution outlets, the royalty costs associated with distributing products of independent labels to wholesale and retail distribution outlets, as well as the costs related to our artist services business;
- **Selling and marketing expenses**—the costs associated with the promotion and marketing of artists and recorded music products, including costs to produce music videos for promotional purposes and artist tour support; and
- **General and administrative expenses**—the costs associated with general overhead and other administrative expenses.

#### Music Publishing Operations

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

Our Music Publishing operations are conducted principally through Warner/Chappell, our global music publishing company headquartered in Los Angeles with operations in over 50 countries through various subsidiaries, affiliates and non-affiliated licensees. We own or control rights to more than one million musical compositions, including numerous pop hits, American standards, folk songs and motion picture and theatrical compositions. Assembled over decades, our award-winning catalog includes over 70,000 songwriters and composers and a diverse range of genres including pop, rock, jazz, classical, country, R&B, hip-hop, rap, reggae, Latin, folk, blues, symphonic, soul, Broadway, techno, alternative and gospel. Warner/Chappell also administers the music and soundtracks of several third-party television and film producers and studios. We have an extensive production music library collectively branded as Warner/Chappell Production Music.



Music Publishing revenues are derived from five main sources:

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

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

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

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

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

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

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

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

## Factors Affecting Results of Operations and Comparability

### Acquisition of Spinnin' Records

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

### Other Business Models to Drive Incremental Revenue

#### Artist Services and Expanded-Rights Deals

As another means to offset declines in physical revenues and download revenues in Recorded Music, for many years we have signed recording artists to expanded-rights deals. Under our expanded-rights deals, we participate in the recording artist's revenue streams, other than from recorded music sales, such as touring, merchandising and sponsorships. Artist services and expanded-rights Recorded Music revenue, which includes revenue from expanded-rights deals as well as revenue from our artist services business, represented approximately 9% of our total revenue during the six months ended March 31, 2018. Artist services and expanded-rights revenue will fluctuate from period to period depending upon touring schedules, among other things. Margins for the various artist services and expanded-rights revenue streams can vary significantly. The overall impact on margins will, therefore, depend on the composition of the various revenue streams in any particular period. For instance, participation in revenue from touring under our expanded-rights deals typically flows straight through to operating income with little associated cost. Revenue from some of our artist services businesses such as our management business and revenue from participation in touring and sponsorships under our expanded-rights deals are all high margin, while merchandising revenue under our expanded-rights deals and revenue from some of our artist services businesses such as our concert promotion businesses tend to be lower margin than our traditional revenue streams in Recorded Music.



## RESULTS OF OPERATIONS

Three Months Ended March 31, 2018 Compared with Three Months Ended March 31, 2017

## Consolidated Results

## Revenues

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

|   | For the Three Months Ended |        | 2018 vs. 2017 |          |   |
|---|----------------------------|--------|---------------|----------|---|
|   | March 31,<br>2018          | 2017   | \$ Change     | % Change |   |
| <b>Revenue by Type</b>                  |                            |        |               |          |   |
| Digital                                 | \$ 491                     | \$ 400 | \$91          | 23       | % |
| Physical                                | 147                        | 142    | 5             | 4        | % |
| Total Digital and Physical              | 638                        | 542    | 96            | 18       | % |
| Artist services and expanded-rights     | 74                         | 81     | (7 )          | -9       | % |
| Licensing                               | 79                         | 63     | 16            | 25       | % |
| Total Recorded Music                    | 791                        | 686    | 105           | 15       | % |
| Performance                             | 59                         | 50     | 9             | 18       | % |
| Digital                                 | 57                         | 43     | 14            | 33       | % |
| Mechanical                              | 20                         | 17     | 3             | 18       | % |
| Synchronization                         | 35                         | 32     | 3             | 9        | % |
| Other                                   | 3                          | 3      | —             | —        | % |
| Total Music Publishing                  | 174                        | 145    | 29            | 20       | % |
| Intersegment eliminations               | (2 )                       | (6 )   | 4             | -67      | % |
| Total Revenue                           | \$ 963                     | \$ 825 | \$138         | 17       | % |
| <b>Revenue by Geographical Location</b> |                            |        |               |          |   |
| U.S. Recorded Music                     | \$ 335                     | \$ 305 | \$30          | 10       | % |
| U.S. Music Publishing                   | 88                         | 76     | 12            | 16       | % |
| Total U.S.                              | 423                        | 381    | 42            | 11       | % |
| International Recorded Music            | 456                        | 381    | 75            | 20       | % |
| International Music Publishing          | 86                         | 69     | 17            | 25       | % |
| Total International                     | 542                        | 450    | 92            | 20       | % |
| Intersegment eliminations               | (2 )                       | (6 )   | 4             | -67      | % |
| Total Revenue                           | \$ 963                     | \$ 825 | \$138         | 17       | % |

## Total Revenue

Total revenue increased by \$138 million, or 17%, to \$963 million for the three months ended March 31, 2018 from \$825 million for the three months ended March 31, 2017. Prior to intersegment eliminations, Recorded Music and Music Publishing revenues represented 82% and 18% of total revenue for the three months ended March 31, 2018, respectively, and 83% and 17% of total revenue for the three months ended March 31, 2017, respectively. Prior to intersegment eliminations, U.S. and international revenues represented 44% and 56% of total revenue for the three

months ended March 31, 2018 and 46% and 54% of total revenue for the three months ended March 31, 2017, respectively.

Total digital revenue after intersegment eliminations increased by \$108 million, or 25%, to \$547 million for the three months ended March 31, 2018 from \$439 million for the three months ended March 31, 2017. Total digital revenue represented 57% and 53% of consolidated revenue for the three months ended March 31, 2018 and March 31, 2017, respectively. Prior to intersegment eliminations, total digital revenue for the three months ended March 31, 2018 was comprised of U.S. revenue of \$278 million and international revenue of \$270 million, or 51% and 49% of total digital revenue, respectively. Prior to intersegment eliminations, total digital revenue for the three months ended March 31, 2017 was comprised of U.S. revenue of \$239 million and international revenue of \$204 million, or 54% and 46% of total digital revenue, respectively.

Recorded Music revenue increased by \$105 million, or 15%, to \$791 million for the three months ended March 31, 2018 from \$686 million for the three months ended March 31, 2017. U.S. Recorded Music revenues were \$335 million and \$305 million, or 42% and 44%, of consolidated Recorded Music revenues for the three months ended March 31, 2018 and March 31, 2017, respectively. International Recorded Music revenues were \$456 million and \$381 million, or 58% and 56%, of consolidated Recorded Music revenues for the three months ended March 31, 2018 and March 31, 2017, respectively.

The overall increase in Recorded Music revenue was driven by increases in digital revenue, licensing revenue, and physical revenue, partially offset by a decrease in artist services and expanded-rights revenue. Digital revenue increased by \$91 million as a result of the continued growth in streaming services. Revenue from streaming services grew by \$115 million to \$415 million for the three months ended March 31, 2018 from \$300 million for the three months ended March 31, 2017 due to continued growth in streaming services and strong release performance, and was partially offset by digital download and other digital declines of \$24 million to \$76 million for the three months ended March 31, 2018 from \$100 million for the three months ended March 31, 2017. Licensing revenue increased by \$16 million primarily due to higher broadcast fee income and increased synchronization activity. Physical revenue increased by \$5 million primarily due to the favorable impact of foreign currency exchange rates of \$12 million, partially offset by the continued shift from physical revenue to digital revenue. Artist services and expanded-rights revenue decreased by \$7 million primarily due to higher merchandise revenue and concert promotion revenue in the prior year, partially offset by the favorable impact of foreign currency exchange rates of \$7 million.

Music Publishing revenues increased by \$29 million, or 20%, to \$174 million for the three months ended March 31, 2018 from \$145 million for the three months ended March 31, 2017. U.S. Music Publishing revenues were \$88 million and \$76 million, or 51% and 52% of Music Publishing revenues for the three months ended March 31, 2018 and March 31, 2017, respectively. International Music Publishing revenues were \$86 million and \$69 million, or 49% and 48%, of Music Publishing revenues for the three months ended March 31, 2018 and March 31, 2017, respectively.

The overall increase in Music Publishing revenue was mainly driven by increases in digital revenue of \$14 million, performance revenue of \$9 million, mechanical revenue of \$3 million, and synchronization revenue of \$3 million. The increase in digital revenue was due to an increase in streaming revenue of \$18 million driven by the continued growth in streaming services, partially offset by a decrease in digital download revenue of \$4 million.

#### Revenue by Geographical Location

U.S. revenue increased by \$42 million, or 11%, to \$423 million for the three months ended March 31, 2018 from \$381 million for the three months ended March 31, 2017. U.S. Recorded Music revenue increased by \$30 million, or 10%. The primary driver was the increase in U.S. Recorded Music digital revenue, which increased by \$33 million driven by the strong new release of *The Greatest Showman: Original Motion Picture Soundtrack*, the continued success of Ed Sheeran, and the continued growth in streaming services. Streaming revenue increased by \$47 million, partially offset by a \$14 million decline in digital download revenue. U.S. Recorded Music licensing revenue increased by \$2 million primarily due to increased synchronization activity. U.S. Recorded Music physical revenue increased by \$2 million primarily due to strong catalog sales. These increases were partially offset by a decline in U.S. artist services and expanded-rights revenue of \$7 million due to higher merchandise revenue in the prior year quarter. U.S. Music Publishing revenue increased by \$12 million, or 16%, to \$88 million for the three months ended March 31, 2018 from \$76 million for the three months ended March 31, 2017. This was primarily driven by the increase in U.S. Music Publishing digital revenue of \$6 million due to increases in streaming revenue of \$11 million due to continued growth in streaming services, partially offset by declines in digital download revenue of \$5 million.

International revenue increased by \$92 million, or 20%, to \$542 million for the three months ended March 31, 2018 from \$450 million for the three months ended March 31, 2017. Excluding the favorable impact of foreign currency

exchange rates, International revenue increased by \$45 million or 9%. International Recorded Music revenue increased \$75 million primarily due to increases in digital revenue of \$58 million, licensing revenue of \$14 million, and physical revenue of \$3 million. International Recorded Music digital revenue increased due to a \$68 million increase in streaming revenue, partially offset by a \$10 million decline in digital download and other digital revenue. The increase in International Recorded Music streaming revenue was due to the continued success of Ed Sheeran, continued growth in streaming services internationally and strong release performance. International Recorded Music licensing revenue increased due to higher broadcast fee income. International Recorded Music physical revenue increased due to the favorable impact of foreign currency exchange rates of \$12 million, partially offset by the continued shift from physical revenue to digital revenue. International Music Publishing revenue increased by \$17 million, or 25%, to \$86 million for the three months ended March 31, 2018 from \$69 million for the three months ended March 31, 2017. This was primarily driven by the increase in International Music Publishing digital revenue of \$8 million due to an increase in streaming revenue of \$7 million.

## Cost of revenues

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

|                             | For the Three Months Ended |        | 2018 vs. 2017 |          |   |
|-----------------------------|----------------------------|--------|---------------|----------|---|
|                             | March 31,<br>2018          | 2017   | \$ Change     | % Change |   |
| Artist and repertoire costs | \$ 335                     | \$ 292 | \$43          | 15       | % |
| Product costs               | 153                        | 123    | 30            | 24       | % |
| Total cost of revenues      | \$ 488                     | \$ 415 | \$73          | 18       | % |

Total cost of revenues increased by \$73 million to \$488 million for the three months ended March 31, 2018 from \$415 million for the three months ended March 31, 2017. Expressed as a percentage of revenues, cost of revenues increased to 51% for the three months ended March 31, 2018 from 50% for the three months ended March 31, 2017.

Artist and repertoire costs increased by \$43 million, to \$335 million for the three months ended March 31, 2018 from \$292 million for the three months ended March 31, 2017. Artist and repertoire costs as a percentage of revenue remained flat at 35% for the three months ended March 31, 2018 and March 31, 2017.

Product costs increased by \$30 million, to \$153 million for the three months ended March 31, 2018 from \$123 million for the three months ended March 31, 2017. Product costs as a percentage of revenue increased to 16% for the three months ended March 31, 2018 from 15% for the three months ended March 31, 2017. The increase was primarily driven by increased sales from lower margin releases.

## Selling, general and administrative expenses

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

|   | For the Three Months Ended |        | 2018 vs. 2017 |          |   |
|---|----------------------------|--------|---------------|----------|---|
|   | March 31,<br>2018          | 2017   | \$ Change     | % Change |   |
| General and administrative expense (1)            | \$ 197                     | \$ 154 | \$43          | 28       | % |
| Selling and marketing expense                     | 124                        | 113    | 11            | 10       | % |
| Distribution expense                              | 16                         | 15     | 1             | 7        | % |
| Total selling, general and administrative expense | \$ 337                     | \$ 282 | \$55          | 20       | % |

(1) Includes depreciation expense of \$14 million and \$13 million for the three months ended March 31, 2018 and March 31, 2017, respectively.

Total selling, general and administrative expense increased by \$55 million, or 20%, to \$337 million for the three months ended March 31, 2018 from \$282 million for the three months ended March 31, 2017. Expressed as a percentage of revenue, selling, general and administrative expense increased to 35% for the three months ended March 31, 2018 from 34% for the three months ended March 31, 2017.

General and administrative expense increased by \$43 million, or 28%, to \$197 million for the three months ended March 31, 2018 from \$154 million for the three months ended March 31, 2017. The increase in general and administrative expense was primarily due to increases in other employee related compensation expense, including increased severance and restructuring costs of \$22 million, and an increase in facilities cost due to an overlap in terms on the lease of our new Los Angeles office with our existing office leases of \$4 million. Expressed as a percentage of revenue, general and administrative expense increased to 21% for the three months ended March 31, 2018 from 19% for the three months ended March 31, 2017.

Selling and marketing expense increased by \$11 million, or 10%, to \$124 million for the three months ended March 31, 2018 from \$113 million for the three months ended March 31, 2017. The increase in selling and marketing expense was primarily due to increased variable marketing expense. Expressed as a percentage of revenue, selling and marketing expense decreased to 13% for the three months ended March 31, 2018 from 14% for the three months ended March 31, 2017.

Distribution expense increased by \$1 million, or 7%, to \$16 million for the three months ended March 31, 2018 from \$15 million for the three months ended March 31, 2017. Expressed as a percentage of revenue, distribution expense remained flat at 2% for the three months ended March 31, 2018 and March 31, 2017.

#### Reconciliation of Net (Loss) Income Attributable to Warner Music Group Corp. and Operating Income to Consolidated OIBDA

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

|  | For the Three Months Ended |        |               |          |   |
|--|----------------------------|--------|---------------|----------|---|
|  | March 31,<br>2018          | 2017   | 2018 vs. 2017 |          |   |
|  |                            |        | \$ Change     | % Change |   |
| Net (loss) income attributable to Warner Music Group Corp. | \$ (3 )                    | \$ 19  | \$(22)        | -116     | % |
| Income attributable to noncontrolling interest             | 2                          | 1      | 1             | 100      | % |
| Net (loss) income  | (1 )                       | 20     | (21)          | -105     | % |
| Income tax expense   | 19                         | 3      | 16            | —        | % |
| Income before income taxes                                 | 18                         | 23     | (5 )          | -22      | % |
| Other expense, net   | 6                          | 19     | (13)          | -68      | % |
| Interest expense, net                                      | 36                         | 36     | —             | —        | % |
| Loss on extinguishment of debt                             | 23                         | —      | 23            | —        | % |
| Operating income   | 83                         | 78     | 5             | 6        | % |
| Amortization expense                                       | 55                         | 50     | 5             | 10       | % |
| Depreciation expense                                       | 14                         | 13     | 1             | 8        | % |
| OIBDA  | \$ 152                     | \$ 141 | \$ 11         | 8        | % |

#### OIBDA

OIBDA increased by \$11 million, or 8%, to \$152 million for the three months ended March 31, 2018 as compared to \$141 million for the three months ended March 31, 2017 as a result of higher Recorded Music and Music Publishing revenues. Expressed as a percentage of total revenue, OIBDA decreased to 16% for the three months ended March 31, 2018 from 17% for the three months ended March 31, 2017 largely due to increased overhead for severance and restructuring costs, and an increase in facilities costs due to an overlap in terms on the lease of our new Los Angeles office with our existing office leases.

#### Depreciation expense

Our depreciation expense increased by \$1 million, or 8%, to \$14 million for the three months ended March 31, 2018 from \$13 million for the three months ended March 31, 2017.

#### Amortization expense

Our amortization expense increased by \$5 million, or 10%, to \$55 million for the three months ended March 31, 2018 from \$50 million for the three months ended March 31, 2017, primarily due to an increase in amortizable intangible

assets and the impact of foreign currency exchange rates.

#### Operating income

Our operating income increased by \$5 million to \$83 million for the three months ended March 31, 2018 from \$78 million for the three months ended March 31, 2017. The increase in operating income was due to the factors that led to the increase in OIBDA.

#### Loss on extinguishment of debt

We recorded a loss on extinguishment of debt in the amount of \$23 million for the three months ended March 31, 2018 related to the partial redemption of the 6.75% Senior Notes. There was no such activity or comparable charges in the three months ended March 31, 2017. See Note 5 of our Consolidated Financial Statements for further discussion.

## Interest expense, net

Our interest expense, net, remained flat at \$36 million for the three months ended March 31, 2018 and March 31, 2017.

## Other expense, net

Other expense, net, for the quarter primarily includes foreign currency losses on our Euro denominated debt and derivative liabilities of \$13 million, partially offset by foreign currency gains on our intercompany loans of \$7 million. This compares to foreign currency losses on our Euro denominated debt and derivative assets of \$14 million and a \$7 million loss on investments in the prior year quarter.

## Income tax expense

Our income tax expense increased by \$16 million to \$19 million for the three months ended March 31, 2018 from \$3 million for the three months ended March 31, 2017. The change of \$16 million in income tax expense primarily relates to a U.S. tax benefit of \$9 million for a realized foreign currency loss on an intra-entity loan for the three months ended March 31, 2017.

## Net (Loss) Income

Net loss increased by \$21 million to net loss of \$1 million for the three months ended March 31, 2018 from a net income of \$20 million for the three months ended March 31, 2017 as a result of the factors described above.

## Noncontrolling interest

Income attributable to noncontrolling interest was \$2 million for the three months ended March 31, 2018 and \$1 million for the three months ended March 31, 2017.

## Business Segment Results

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

|  | For the Three Months Ended |        | 2018 vs. 2017 |          |   |
|--|----------------------------|--------|---------------|----------|---|
|  | March 31,<br>2018          | 2017   | \$ Change     | % Change |   |
| <b>Recorded Music</b>                      |                            |        |               |          |   |
| Revenue                                    | \$ 791                     | \$ 686 | \$105         | 15       | % |
| Operating income                           | 80                         | 69     | 11            | 16       | % |
| OIBDA                                      | 127                        | 112    | 15            | 13       | % |
| <b>Music Publishing</b>                    |                            |        |               |          |   |
| Revenue                                    | 174                        | 145    | 29            | 20       | % |
| Operating income                           | 41                         | 41     | —             | —        | % |
| OIBDA                                      | 60                         | 58     | 2             | 3        | % |
| <b>Corporate expenses and eliminations</b> |                            |        |               |          |   |
| Revenue elimination                        | (2 )                       | (6 )   | 4             | -67      | % |

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|                  |       |       |      |    |   |
|------------------|-------|-------|------|----|---|
| Operating loss   | (38 ) | (32 ) | (6 ) | 19 | % |
| OIBDA loss       | (35 ) | (29 ) | (6 ) | 21 | % |
| <b>Total</b>     |       |       |      |    |   |
| Revenue          | 963   | 825   | 138  | 17 | % |
| Operating income | 83    | 78    | 5    | 6  | % |
| OIBDA            | 152   | 141   | 11   | 8  | % |

## Recorded Music

## Revenues

Recorded Music revenue increased by \$105 million, or 15%, to \$791 million for the three months ended March 31, 2018 from \$686 million for the three months ended March 31, 2017. U.S. Recorded Music revenues were \$335 million and \$305 million, or 42% and 44%, of consolidated Recorded Music revenues for the three months ended March 31, 2018 and March 31, 2017, respectively. International Recorded Music revenues were \$456 million and \$381 million, or 58% and 56% of consolidated Recorded Music revenues for the three months ended March 31, 2018 and March 31, 2017, respectively.

The overall increase in Recorded Music revenue was mainly driven by strong releases and streaming revenue growth as described in the “Total Revenues” and “Revenue by Geographical Location” sections above.

## Cost of revenues

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

|                             | For the Three Months Ended |        | 2018 vs. 2017 |          |   |
|-----------------------------|----------------------------|--------|---------------|----------|---|
|                             | March 31,<br>2018          | 2017   | \$ Change     | % Change |   |
| Artist and repertoire costs | \$ 242                     | \$ 227 | \$ 15         | 7        | % |
| Product costs               | 153                        | 123    | 30            | 24       | % |
| Total cost of revenues      | \$ 395                     | \$ 350 | \$ 45         | 13       | % |

Recorded Music cost of revenues increased by \$45 million, or 13%, to \$395 million for the three months ended March 31, 2018 from \$350 million for the three months ended March 31, 2017. Expressed as a percentage of Recorded Music revenue, Recorded Music artist and repertoire costs decreased to 31% for the three months ended March 31, 2018 from 33% for the three months ended March 31, 2017. The increase in artist and repertoire costs was primarily due to higher royalty expense associated with a shift in revenue mix. Expressed as a percentage of Recorded Music revenue, Recorded Music product costs increased to 19% for the three months ended March 31, 2018 from 18% for the three months ended March 31, 2017. The increase in product costs was primarily driven by increased sales from lower margin releases.

## Selling, general and administrative expense

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

|  | For the Three Months Ended |        | 2018 vs. 2017 |          |   |
|--|----------------------------|--------|---------------|----------|---|
|  | March 31,<br>2018          | 2017   | \$ Change     | % Change |   |
| General and administrative expense (1) | \$ 141                     | \$ 107 | \$ 34         | 32       | % |

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|   |        |        |      |    |   |
|---|--------|--------|------|----|---|
| Selling and marketing expense                     | 121    | 111    | 10   | 9  | % |
| Distribution expense                              | 16     | 15     | 1    | 7  | % |
| Total selling, general and administrative expense | \$ 278 | \$ 233 | \$45 | 19 | % |

(1)Includes depreciation expense of \$9 million for both the three months ended March 31, 2018 and March 31, 2017. Recorded Music selling, general and administrative expense increased by \$45 million, or 19%, to \$278 million for the three months ended March 31, 2018 from \$233 million for the three months ended March 31, 2017. The increase in general and administrative expense was primarily due to increases in other employee related compensation expense including severance and restructuring costs of \$22 million, and an increase in facilities cost due to an overlap in terms on the lease of our new Los Angeles office with our existing office leases of \$4 million. The increase in selling and marketing expense was primarily due to increased variable marketing expense. Expressed as a percentage of Recorded Music revenue, Recorded Music selling, general and administrative expense increased to 35% for the three months ended March 31, 2018 from 34% for the three months ended March 31, 2017.

## Operating income and OIBDA

Recorded Music OIBDA included the following amounts (in millions):

|                               | For the Three Months Ended |        | 2018 vs. 2017 |          |   |
|-------------------------------|----------------------------|--------|---------------|----------|---|
|                               | March 31,<br>2018          | 2017   | \$ Change     | % Change |   |
| Operating Income              | \$ 80                      | \$ 69  | \$ 11         | 16       | % |
| Depreciation and amortization | 47                         | 43     | 4             | 9        | % |
| OIBDA                         | \$ 127                     | \$ 112 | \$ 15         | 13       | % |

Recorded Music OIBDA increased by \$15 million, or 13%, to \$127 million for the three months ended March 31, 2018 from \$112 million for the three months ended March 31, 2017 as a result of higher Recorded Music revenues partially offset by higher cost of revenue and higher selling, general and administrative expenses. Expressed as a percentage of Recorded Music revenue, Recorded Music OIBDA remained flat at 16% for the three months ended March 31, 2018 and March 31, 2017.

Recorded Music operating income increased by \$11 million to \$80 million for the three months ended March 31, 2018 from \$69 million for the three months ended March 31, 2017 due to the factors that led to the increase in Recorded Music OIBDA noted above.

## Music Publishing

## Revenues

Music Publishing revenues increased by \$29 million, or 20%, to \$174 million for the three months ended March 31, 2018 from \$145 million for the three months ended March 31, 2017. U.S. Music Publishing revenues were \$88 million and \$76 million, or 51% and 52%, of Music Publishing revenues for the three months ended March 31, 2018 and March 31, 2017, respectively. International Music Publishing revenues were \$86 million and \$69 million, or 49% and 48%, of Music Publishing revenues for the three months ended March 31, 2018 and March 31, 2017, respectively.

The overall increase in Music Publishing revenue was mainly driven by the increase in digital revenue as described in the "Total Revenues" and "Revenue by Geographical Location" sections above.

## Cost of revenues

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

|                             | For the Three Months Ended |       | 2018 vs. 2017 |          |   |
|-----------------------------|----------------------------|-------|---------------|----------|---|
|                             | March 31,<br>2018          | 2017  | \$ Change     | % Change |   |
| Artist and repertoire costs | \$ 95                      | \$ 71 | \$ 24         | 34       | % |

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Total cost of revenues \$ 95 \$ 71 \$24 34 %

Music Publishing cost of revenues increased by \$24 million, or 34%, to \$95 million for the three months ended March 31, 2018 from \$71 million for the three months ended March 31, 2017. Expressed as a percentage of Music Publishing revenue, Music Publishing cost of revenues increased to 55% for the three months ended March 31, 2018 from 49% for the three months ended March 31, 2017, primarily due to a shift in revenue mix.

Selling, general and administrative expense

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

|   | For the Three Months Ended |       | 2018 vs. 2017 |          |   |
|---|----------------------------|-------|---------------|----------|---|
|   | March 31,<br>2018          | 2017  | \$ Change     | % Change |   |
| General and administrative expense (1)            | \$ 20                      | \$ 16 | \$ 4          | 25       | % |
| Selling and marketing expense                     | 1                          | 1     | —             | —        | % |
| Total selling, general and administrative expense | \$ 21                      | \$ 17 | \$ 4          | 24       | % |

(1) Includes depreciation expense of \$2 million and \$1 million for the three months ended March 31, 2018 and March 31, 2017, respectively.

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Music Publishing selling, general and administrative expense increased by \$4 million, or 24%, to \$21 million for the three months ended March 31, 2018 from \$17 million for the three months ended March 31, 2017. General and administrative expense for the three months ended March 31, 2018 increased mainly due to an increase in compensation expense. Expressed as a percentage of Music Publishing revenue, Music Publishing selling, general and administrative expense remained flat at 12% for the three months ended March 31, 2018 and the three months ended March 31, 2017.

#### Operating income and OIBDA

Music Publishing OIBDA included the following amounts (in millions):

|                               | For the Three Months Ended |       | 2018 vs. 2017 |          |   |
|-------------------------------|----------------------------|-------|---------------|----------|---|
|                               | March 31,<br>2018          | 2017  | \$ Change     | % Change |   |
| Operating income              | \$ 41                      | \$ 41 | \$ —          | —        | % |
| Depreciation and amortization | 19                         | 17    | 2             | 12       | % |
| OIBDA                         | \$ 60                      | \$ 58 | \$ 2          | 3        | % |

Music Publishing OIBDA increased by \$2 million, or 3%, to \$60 million for the three months ended March 31, 2018 from \$58 million for the three months ended March 31, 2017. Expressed as a percentage of Music Publishing revenue, Music Publishing OIBDA decreased to 35% for the three months ended March 31, 2018 from 40% for the three months ended March 31, 2017 due to increased artist and repertoire costs.

Music Publishing operating income remained flat at \$41 million for both the three months ended March 31, 2018 and the three months ended March 31, 2017.

#### Corporate Expenses and Eliminations

Our operating loss from corporate expenses and eliminations increased by \$6 million to \$38 million for the three months ended March 31, 2018 from \$32 million for the three months ended March 31, 2017 due to increased costs associated with transformation initiatives.

Our OIBDA loss from corporate expenses and eliminations increased by \$6 million to \$35 million for the three months ended March 31, 2018 from \$29 million for the three months ended March 31, 2017 due to the factors that led to the increase in operating loss noted above.

## RESULTS OF OPERATIONS

Six Months Ended March 31, 2018 Compared with Six Months Ended March 31, 2017

## Consolidated Results

## Revenues

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

|   | For the Six<br>Months Ended |                   | 2018 vs. 2017 |          |   |
|---|-----------------------------|-------------------|---------------|----------|---|
|   | March 31,<br>2018           | March 31,<br>2017 | \$ Change     | % Change |   |
| <b>Revenue by Type</b>                  |                             |                   |               |          |   |
| Digital                                 | \$972                       | \$802             | \$170         | 21       | % |
| Physical                                | 370                         | 369               | 1             | 0        | % |
| Total Digital and Physical              | 1,342                       | 1,171             | 171           | 15       | % |
| Artist services and expanded-rights     | 179                         | 171               | 8             | 5        | % |
| Licensing                               | 174                         | 141               | 33            | 23       | % |
| Total Recorded Music                    | 1,695                       | 1,483             | 212           | 14       | % |
| Performance                             | 102                         | 87                | 15            | 17       | % |
| Digital                                 | 110                         | 86                | 24            | 28       | % |
| Mechanical                              | 38                          | 33                | 5             | 15       | % |
| Synchronization                         | 62                          | 58                | 4             | 7        | % |
| Other                                   | 5                           | 5                 | —             | —        | % |
| Total Music Publishing                  | 317                         | 269               | 48            | 18       | % |
| Intersegment eliminations               | (4 )                        | (10 )             | 6             | 60       | % |
| Total Revenue                           | \$2,008                     | \$1,742           | \$266         | 15       | % |
| <b>Revenue by Geographical Location</b> |                             |                   |               |          |   |
| U.S. Recorded Music                     | \$705                       | \$650             | \$55          | 9        | % |
| U.S. Music Publishing                   | 151                         | 127               | 24            | 19       | % |
| Total U.S.                              | 856                         | 777               | 79            | 10       | % |
| International Recorded Music            | 990                         | 833               | 157           | 19       | % |
| International Music Publishing          | 166                         | 142               | 24            | 17       | % |
| Total International                     | 1,156                       | 975               | 181           | 19       | % |
| Intersegment eliminations               | (4 )                        | (10 )             | 6             | 60       | % |
| Total Revenue                           | \$2,008                     | \$1,742           | \$266         | 15       | % |

## Total Revenue

Total revenue increased by \$266 million, or 15%, to \$2,008 million for the six months ended March 31, 2018 from \$1,742 million for the six months ended March 31, 2017. Prior to intersegment eliminations, Recorded Music and Music Publishing revenues represented 84% and 16% of total revenue for the six months ended March 31, 2018, respectively, and 85% and 15% of total revenue for the six months ended March 31, 2017, respectively. Prior to

intersegment eliminations, U.S. and international revenues represented 43% and 57% of total revenue for the six months ended March 31, 2018 and 44% and 56% of total revenue for the six months ended March 31, 2017, respectively.

Total digital revenue after intersegment eliminations increased by \$197 million, or 22%, to \$1,080 million for the six months ended March 31, 2018 from \$883 million for the six months ended March 31, 2017. Total digital revenue represented 54% and 51% of consolidated revenue for the six months ended March 31, 2018 and March 31, 2017, respectively. Prior to intersegment eliminations, total digital revenue for the six months ended March 31, 2018 was comprised of U.S. revenue of \$557 million and international revenue of \$525 million, or 51% and 49% of total digital revenue, respectively. Prior to intersegment eliminations, total digital revenue for the six months ended March 31, 2017 was comprised of U.S. revenue of \$490 million and international revenue of \$398 million, or 55% and 45% of total digital revenue, respectively.

Recorded Music revenue increased by \$212 million, or 14%, to \$1,695 million for the six months ended March 31, 2018 from \$1,483 million for the six months ended March 31, 2017. U.S. Recorded Music revenues were \$705 million and \$650 million, or 42% and 44%, of consolidated Recorded Music revenues for the six months ended March 31, 2018 and March 31, 2017, respectively. International Recorded Music revenues were \$990 million and \$833 million, or 58% and 56%, of consolidated Recorded Music revenues for the six months ended March 31, 2018 and March 31, 2017, respectively.

The overall increase in Recorded Music revenue was mainly driven by increases in digital revenue, licensing revenue, artist services and expanded-rights revenue, and physical revenue. Digital revenue increased by \$170 million as a result of continued success from Ed Sheeran and the continued growth in streaming services. Revenue from streaming services grew by \$208 million to \$819 million for the six months ended March 31, 2018 from \$611 million for the six months ended March 31, 2017 due to the continued growth in streaming services and strong release performance, and was partially offset by digital download and other digital declines of \$38 million to \$153 million for the six months ended March 31, 2018 from \$191 million for the six months ended March 31, 2017. Licensing revenue increased by \$33 million primarily due to higher broadcast fee income and increased synchronization activity. Artist services and expanded-rights revenue increased by \$8 million primarily due to the favorable impact of foreign currency exchange rates of \$12 million, partially offset by a decrease in touring revenue in Italy due to strong concert promotion revenue in the prior year. Physical revenue increased by \$1 million primarily due to the favorable impact of foreign currency exchange rates of \$21 million, partially offset by the continued shift from physical revenue to digital revenue.

Music Publishing revenues increased by \$48 million, or 18%, to \$317 million for the six months ended March 31, 2018 from \$269 million for the six months ended March 31, 2017. Excluding the favorable impact of foreign currency exchange rates, Music Publishing revenue increased by \$36 million, or 13%. U.S. Music Publishing revenues were \$151 million and \$127 million, or 48% and 47% of Music Publishing revenues for the six months ended March 31, 2018 and March 31, 2017, respectively. International Music Publishing revenues were \$166 million and \$142 million, or 52% and 53%, of Music Publishing revenues for the six months ended March 31, 2018 and March 31, 2017, respectively.

The overall increase in Music Publishing revenue was mainly driven by increases in digital revenue of \$24 million, performance revenue of \$15 million, mechanical revenue of \$5 million, and synchronization revenue of \$4 million. The increase in digital revenue was due to an increase in streaming revenue of \$28 million due to the continued growth in streaming, partially offset by download and other digital declines of \$4 million. The increase in performance revenue was attributable to increased market share and timing of distributions.

#### Revenue by Geographical Location

U.S. revenue increased by \$79 million, or 10%, to \$856 million for the six months ended March 31, 2018 from \$777 million for the six months ended March 31, 2017. U.S. Recorded Music revenue increased by \$55 million, or 9%. The primary driver was the increase in U.S. Recorded Music digital revenue, which increased by \$55 million due to the continued success of Ed Sheeran and the continued growth in streaming services. U.S. recorded music licensing revenue increased by \$6 million due to higher broadcast fee income. These increases were partially offset by a decline in U.S. physical revenue of \$5 million due to the shift from physical revenue to digital revenue. U.S. Music Publishing revenue increased by \$24 million, or 19%, to \$151 million for the six months ended March 31, 2018 from \$127 million for the six months ended March 31, 2017. This was primarily driven by the increase in U.S. Music Publishing digital revenue of \$12 million due to increases in streaming revenue of \$18 million due to the continued growth in streaming services, partially offset by download declines of \$6 million.

International revenue increased by \$181 million, or 19%, to \$1,156 million for the six months ended March 31, 2018 from \$975 million for the six months ended March 31, 2017. Excluding the favorable impact of foreign currency

exchange rates, International revenue increased by \$102 million or 10%. International Recorded Music revenue increased \$157 million primarily due increases in digital revenue of \$115 million, licensing revenue of \$27 million, artist services and expanded-rights revenue of \$9 million and physical revenue of \$6 million. International Recorded Music digital revenue increased due to a \$128 million increase in streaming revenue, partially offset by a \$13 million decline in digital download and other digital revenue. The increase in International Recorded Music streaming revenue was due to the continued success of Ed Sheeran and the continued growth in streaming services internationally. International licensing revenue increased due to higher broadcast fee income and the favorable impact of foreign currency exchange rates of \$8 million. International artist services and expanded-rights revenue increased due to the favorable impact of foreign currency exchange rates of \$12 million, partially offset by successful tours in Italy in the prior year quarter with no comparative tours in the current year. International physical revenue increased due to the favorable impact of foreign currency exchange rates of \$21 million, partially offset by the continued shift from physical revenue to digital revenue. International Music Publishing revenue increased \$24 million primarily due to increases in digital revenue of \$12 million, performance revenue of \$10 million, synchronization revenue of \$1 million and other revenue of \$1 million.

## Cost of revenues

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

|                             | For the Six<br>Months<br>Ended |       | 2018 vs. 2017 |          |   |
|-----------------------------|--------------------------------|-------|---------------|----------|---|
|                             | March 31,<br>2018              | 2017  | \$ Change     | % Change |   |
| Artist and repertoire costs | \$709                          | \$615 | \$94          | 15       | % |
| Product costs               | 348                            | 296   | 52            | 18       | % |
| Total cost of revenues      | \$1,057                        | \$911 | \$146         | 16       | % |

Total cost of revenues increased by \$146 million to \$1,057 million for the six months ended March 31, 2018 from \$911 million for the six months ended March 31, 2017. Expressed as a percentage of revenues, cost of revenues increased to 53% for the six months ended March 31, 2018 from 52% for the six months ended March 31, 2017.

Artist and repertoire costs increased by \$94 million, to \$709 million for the six months ended March 31, 2018 from \$615 million for the six months ended March 31, 2017. Artist and repertoire costs as a percentage of revenue remained flat at 35% for the six months ended March 31, 2018 and March 31, 2017.

Product costs increased by \$52 million, to \$348 million for the six months ended March 31, 2018 from \$296 million for the six months ended March 31, 2017. Product costs as a percentage of revenue remained flat at 17% for the six months ended March 31, 2018 and March 31, 2017.

## Selling, general and administrative expenses

|   | For the Six<br>Months<br>Ended |       | 2018 vs. 2017 |          |   |
|---|--------------------------------|-------|---------------|----------|---|
|   | March 31,<br>2018              | 2017  | \$ Change     | % Change |   |
| General and administrative expense (1)            | \$382                          | \$302 | \$80          | 27       | % |
| Selling and marketing expense                     | 252                            | 224   | 28            | 13       | % |
| Distribution expense                              | 36                             | 32    | 4             | 13       | % |
| Total selling, general and administrative expense | \$670                          | \$558 | \$112         | 20       | % |

(1) Includes depreciation expense of \$26 million and \$25 million for the six months ended March 31, 2018 and March 31, 2017, respectively.

Total selling, general and administrative expense increased by \$112 million to \$670 million for the six months ended March 31, 2018 from \$558 million for the six months ended March 31, 2017. Expressed as a percentage of revenue, selling, general and administrative expense increased to 33% for the six months ended March 31, 2018 from 32% for the six months ended March 31, 2017.

General and administrative expense increased by \$80 million, or 27%, to \$382 million for the six months ended March 31, 2018 from \$302 million for the six months ended March 31, 2017. The increase in general and administrative expense was mainly due to an increase in expense associated with our Senior Management Free Cash Flow Plan of \$9 million, which is associated with the increase in the fair value of our equity. The increase was also due to increases in other employee related compensation expense including severance and restructuring costs of \$27 million, and an increase in facilities cost due to overlap in terms on the lease of our new Los Angeles office with our existing office leases of \$8 million. Expressed as a percentage of revenue, general and administrative expense increased to 19% for the six months ended March 31, 2018 from 17% for the six months ended March 31, 2017.

Selling and marketing expense increased by \$28 million, or 13%, to \$252 million for the six months ended March 31, 2018 from \$224 million for the six months ended March 31, 2017. The increase in selling and marketing expense was primarily due to increased variable marketing expense on higher revenue. Expressed as a percentage of revenue, selling and marketing expense remained flat at 13% for both the six months ended March 31, 2018 and March 31, 2017.

Distribution expense increased by \$4 million, or 13%, to \$36 million for the six months ended March 31, 2018 from \$32 million for the six months ended March 31, 2017. Expressed as a percentage of revenue, distribution expense remained flat at 2% for both the six months ended March 31, 2018 and March 31, 2017.

## Reconciliation of Net (Loss) Income Attributable to Warner Music Group Corp. and Operating Income to Consolidated OIBDA

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

|   | For the Six Months Ended |                |                         |                        |   |
|---|--------------------------|----------------|-------------------------|------------------------|---|
|   | March 31, 2018           | March 31, 2017 | 2018 vs. 2017 \$ Change | 2018 vs. 2017 % Change |   |
| Net income attributable to Warner Music Group Corp. | \$1                      | \$41           | \$(40)                  | -98                    | % |
| Income attributable to noncontrolling interest      | 3                        | 3              | —                       | —                      | % |
| Net income  | 4                        | 44             | (40)                    | -91                    | % |
| Income tax expense                                  | 71                       | 20             | 51                      | —                      | % |
| Income before income taxes                          | 75                       | 64             | 11                      | 17                     | % |
| Other expense, net                                  | 2                        | —              | 2                       | —                      | % |
| Interest expense, net                               | 72                       | 76             | (4)                     | -5                     | % |
| Loss on extinguishment of debt                      | 24                       | 32             | (8)                     | -25                    | % |
| Operating income                                    | 173                      | 172            | 1                       | 1                      | % |
| Amortization expense                                | 108                      | 101            | 7                       | 7                      | % |
| Depreciation expense                                | 26                       | 25             | 1                       | 4                      | % |
| OIBDA   | \$307                    | \$298          | \$9                     | 3                      | % |

## OIBDA

OIBDA increased by \$9 million, or 3%, to \$307 million for the six months ended March 31, 2018 as compared to \$298 million for the six months ended March 31, 2017 as a result of higher Recorded Music and Music Publishing revenues. Expressed as a percentage of total revenue, OIBDA decreased to 15% for the six months ended March 31, 2018 from 17% for the six months ended March 31, 2017.

## Depreciation expense

Our depreciation expense increased by \$1 million, or 4%, to \$26 million for the six months ended March 31, 2018 from \$25 million for the six months ended March 31, 2017.

## Amortization expense

Our amortization expense increased by \$7 million, or 7%, to \$108 million for the six months ended March 31, 2018 from \$101 million for the six months ended March 31, 2017, primarily due to an increase in amortizable intangible assets and the impact of foreign currency exchange rates.

## Operating income

Our operating income increased by \$1 million to \$173 million for the six months ended March 31, 2018 from \$172 million for the six months ended March 31, 2017. The increase in operating income was due to the factors that led to the increase in OIBDA, as noted above.

#### Loss on extinguishment of debt

We recorded a loss on extinguishment of debt in the amount of \$24 million for the six months ended March 31, 2018 related to the partial redemption of the 6.75% Senior Notes and the December 2017 Senior Term Loan Credit Agreement Amendment. We recorded a loss on extinguishment of debt in the amount of \$32 million for the six months ended March 31, 2017, which represents the premium paid on early redemption and unamortized deferred financing costs related to the refinancing transactions that occurred during the six months ended March 31, 2017. See Note 5 of our Consolidated Financial Statements for further discussion.

#### Interest expense, net

Our interest expense, net, decreased by \$4 million, or 5%, to \$72 million for the six months ended March 31, 2018 from \$76 million for the six months ended March 31, 2017 due to lower interest rates as a result of refinancing transactions.

## Other expense, net

Other expense, net for the year includes a loss on our Euro denominated debt and derivative liabilities of \$19 million, partially offset by currency exchange gains on our intercompany loans of \$9 million and an \$8 million gain on the sale of investments. This compares to a gain on our Euro denominated debt and derivative assets of \$18 million, offset by currency exchange losses of \$13 million on our intercompany loans and a \$7 million loss on investments in the prior year quarter.

## Income tax expense

Our income tax expense increased by \$51 million to \$71 million for the six months ended March 31, 2018 compared to \$20 million of income tax expense for the six months ended March 31, 2017. The change of \$51 million in income tax expense primarily relates to U.S. tax expense of \$26 million for the reduction of our net U.S. deferred tax assets as a result of the change in the U.S. corporate statutory tax rate pursuant to the Tax Act and U.S. tax expense of \$8 million included in the six months ended March 31, 2018 as compared to the six months ended March 31, 2017 in which the U.S. tax expense was offset by a valuation allowance release, and U.S. tax benefit of \$9 million for a realized foreign currency loss on an intra-entity loan for the six months ended March 31, 2017.

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

## Net Income

Net income decreased by \$40 million to \$4 million for the six months ended March 31, 2018 from \$44 million for the six months ended March 31, 2017 as a result of the factors described above.

## Noncontrolling interest

Income attributable to noncontrolling interest was \$3 million for both the six months ended March 31, 2018 and the six months ended March 31, 2017.

## Business Segment Results

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

|                         | For the Six<br>Months Ended |                   | 2018 vs. 2017 |          |   |
|-------------------------|-----------------------------|-------------------|---------------|----------|---|
|                         | March 31,<br>2018           | March 31,<br>2017 | \$ Change     | % Change |   |
| <b>Recorded Music</b>   |                             |                   |               |          |   |
| Revenue                 | \$1,695                     | \$1,483           | \$212         | 14       | % |
| Operating income        | 209                         | 192               | 17            | 9        | % |
| OIBDA                   | 300                         | 277               | 23            | 8        | % |
| <b>Music Publishing</b> |                             |                   |               |          |   |
| Revenue                 | 317                         | 269               | 48            | 18       | % |

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|                                     |       |       |       |     |   |
|-------------------------------------|-------|-------|-------|-----|---|
| Operating income                    | 40    | 39    | 1     | 3   | % |
| OIBDA                               | 77    | 74    | 3     | 4   | % |
| Corporate expenses and eliminations |       |       |       |     |   |
| Revenue elimination                 | (4 )  | (10 ) | 6     | -60 | % |
| Operating loss                      | (76 ) | (59 ) | (17 ) | 29  | % |
| OIBDA loss                          | (70 ) | (53 ) | (17 ) | 32  | % |
| Total                               |       |       |       |     |   |
| Revenue                             | 2,008 | 1,742 | 266   | 15  | % |
| Operating income                    | 173   | 172   | 1     | 1   | % |
| OIBDA                               | 307   | 298   | 9     | 3   | % |

## Recorded Music

## Revenues

Recorded Music revenue increased by \$212 million, or 14%, to \$1,695 million for the six months ended March 31, 2018 from \$1,483 million for the six months ended March 31, 2017. U.S. Recorded Music revenues were \$705 million and \$650 million, or 42% and 44%, of consolidated Recorded Music revenues for the six months ended March 31, 2018 and March 31, 2017, respectively. International Recorded Music revenues were \$990 million and \$833 million, or 58% and 56% of consolidated Recorded Music revenues for the six months ended March 31, 2018 and March 31, 2017, respectively.

The overall increase in Recorded Music revenue was mainly driven by strong releases and streaming revenue growth as described in the “Total Revenues” and “Revenue by Geographical Location” sections above.

## Cost of revenues

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

|                             | For the Six<br>Months<br>Ended |                   | 2018 vs. 2017 |          |   |
|-----------------------------|--------------------------------|-------------------|---------------|----------|---|
|                             | March 31,<br>2018              | March 31,<br>2017 | \$ Change     | % Change |   |
| Artist and repertoire costs | \$509                          | \$461             | \$48          | 10       | % |
| Product costs               | 348                            | 296               | 52            | 18       | % |
| Total cost of revenues      | \$857                          | \$757             | \$100         | 13       | % |

Recorded Music cost of revenues increased by \$100 million, or 13%, to \$857 million for the six months ended March 31, 2018 from \$757 million for the six months ended March 31, 2017. Artist and repertoire costs as a percentage of revenue decreased to 30% for the six months ended March 31, 2018 from 31% for the six months ended March 31, 2017 due to higher artist related costs. Product costs as a percentage of revenue increased to 21% for the six months ended March 31, 2018 from 20% for the six months ended March 31, 2017 due to increased sales from lower margin releases. Expressed as a percentage of Recorded Music revenue, Recorded Music cost of revenues remained flat at 51% for the six months ended March 31, 2018 and March 31, 2017.

## Selling, general and administrative expense

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

|  | For the Six<br>Months<br>Ended | 2018 vs. 2017 |
|--|--------------------------------|---------------|
|--|--------------------------------|---------------|

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|   | March 31, |       |           |          |   |
|---|-----------|-------|-----------|----------|---|
|   | 2018      | 2017  | \$ Change | % Change |   |
| General and administrative expense (1)            | \$272     | \$213 | \$59      | 28       | % |
| Selling and marketing expense                     | 247       | 220   | 27        | 12       | % |
| Distribution expense                              | 36        | 32    | 4         | 13       | % |
| Total selling, general and administrative expense | \$555     | \$465 | \$90      | 19       | % |

(1) Includes depreciation expense of \$17 million and \$16 million for the six months ended March 31, 2018 and March 31, 2017, respectively.

Recorded Music selling, general and administrative expense increased by \$90 million, or 19%, to \$555 million for the six months ended March 31, 2018 from \$465 million for the six months ended March 31, 2017. The increase in Recorded Music selling, general and administrative expense was primarily due to an increase in expense of \$6 million associated with our Senior Management Free Cash Flow Plan, which is associated with the increase in the fair value of our equity. The increase was also due to increases in other employee related compensation including severance and restructuring costs of \$27 million, and increase in facilities cost due to overlap in terms on the lease of our new Los Angeles office with our existing office leases of \$8 million. Expressed as a percentage of revenue, selling and marketing expense remained flat at 15% for both the six months ended March 31, 2018 and March 31, 2017. Expressed as a percentage of Recorded Music revenue, Recorded Music selling, general and administrative expense increased to 33% for the six months ended March 31, 2018 from 31% for the six months ended March 31, 2017.

## Operating income and OIBDA

Recorded Music OIBDA included the following amounts (in millions):

|                               | For the Six<br>Months<br>Ended |                   | 2018 vs. 2017 |          |   |
|-------------------------------|--------------------------------|-------------------|---------------|----------|---|
|                               | March 31,<br>2018              | March 31,<br>2017 | \$ Change     | % Change |   |
| Operating Income              | \$209                          | \$192             | \$17          | 9        | % |
| Depreciation and amortization | 91                             | 85                | 6             | 7        | % |
| OIBDA                         | \$300                          | \$277             | \$23          | 8        | % |

Recorded Music OIBDA increased by \$23 million, or 8%, to \$300 million for the six months ended March 31, 2018 from \$277 million for the six months ended March 31, 2017 as a result of higher Recorded Music revenues. Expressed as a percentage of Recorded Music revenue, Recorded Music OIBDA decreased to 18% for the six months ended March 31, 2018 from 19% for the six months ended March 31, 2017.

Recorded Music operating income increased by \$17 million to \$209 million for the six months ended March 31, 2018 from \$192 million for the six months ended March 31, 2017 due to the factors that led to the increase in Recorded Music OIBDA noted above.

## Music Publishing

## Revenues

Music Publishing revenues increased by \$48 million, or 18%, to \$317 million for the six months ended March 31, 2018 from \$269 million for the six months ended March 31, 2017. U.S. Music Publishing revenues were \$151 million and \$127 million, or 48% and 47%, of Music Publishing revenues for the six months ended March 31, 2018 and March 31, 2017, respectively. International Music Publishing revenues were \$166 million and \$142 million, or 52% and 53%, of Music Publishing revenues for the six months ended March 31, 2018 and March 31, 2017, respectively.

The overall increase in Music Publishing revenue was mainly driven by the increase in digital revenue as described in the “Total Revenues” and “Revenue by Geographical Location” sections above.

## Cost of revenues

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

|  | For the Six<br>Months<br>Ended | 2018 vs. 2017 |
|--|--------------------------------|---------------|
|--|--------------------------------|---------------|

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|                             | March 31, |       |           |          |   |
|-----------------------------|-----------|-------|-----------|----------|---|
|                             | 2018      | 2017  | \$ Change | % Change |   |
| Artist and repertoire costs | \$204     | \$164 | \$40      | 24       | % |
| Total cost of revenues      | \$204     | \$164 | \$40      | 24       | % |

Music Publishing cost of revenues increased by \$40 million, or 24%, to \$204 million for the six months ended March 31, 2018 from \$164 million for the six months ended March 31, 2017. Expressed as a percentage of Music Publishing revenue, Music Publishing cost of revenues increased to 64% for the six months ended March 31, 2018 from 61% for the six months ended March 31, 2017, primarily due to revenue mix.

Selling, general and administrative expense

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

|   | For the Six Months Ended |      | March 31, 2018 vs. 2017 |          |   |
|---|--------------------------|------|-------------------------|----------|---|
|   | 2018                     | 2017 | \$ Change               | % Change |   |
| General and administrative expense (1)            | \$38                     | \$33 | \$5                     | 15       | % |
| Selling and marketing expense                     | 1                        | 1    | —                       | —        | % |
| Total selling, general and administrative expense | \$39                     | \$34 | \$5                     | 15       | % |

(1)Includes depreciation expense of \$3 million for both the six months ended March 31, 2018 and March 31, 2017.

Music Publishing selling, general and administrative expense increased by \$5 million, or 15%, to \$39 million for the six months ended March 31, 2018 from \$34 million for the six months ended March 31, 2017. General and administrative expense for the six months ended March 31, 2018 increased primarily due to an increase in compensation expense of \$3 million. Expressed as a percentage of Music Publishing revenue, Music Publishing selling, general and administrative expense decreased to 12% for the six months ended March 31, 2018 from 13% for the six months ended March 31, 2017.

#### Operating income and OIBDA

Music Publishing OIBDA included the following amounts (in millions):

|                               | For the Six<br>Months<br>Ended |      | March 31, 2018 vs. 2017 |          |   |
|-------------------------------|--------------------------------|------|-------------------------|----------|---|
|                               | 2018                           | 2017 | \$ Change               | % Change |   |
| Operating income              | \$40                           | \$39 | \$1                     | 3        | % |
| Depreciation and amortization | 37                             | 35   | 2                       | -6       | % |
| OIBDA                         | \$77                           | \$74 | \$3                     | 4        | % |

Music Publishing OIBDA increased by \$3 million to \$77 million for the six months ended March 31, 2018 from \$74 million for the six months ended March 31, 2017 as a result of higher Music Publishing revenue, as noted above. Expressed as a percentage of Music Publishing revenue, Music Publishing OIBDA decreased to 24% for the six months ended March 31, 2018 from 28% for the six months ended March 31, 2017.

Music Publishing operating income increased by \$1 million to \$40 million for the six months ended March 31, 2018 from \$39 million for the six months ended March 31, 2017 due to the factors that led to the increase in Music Publishing OIBDA noted above.

#### Corporate Expenses and Eliminations

Our operating loss from corporate expenses and eliminations increased by \$17 million to \$76 million for the six months ended March 31, 2018 from \$59 million for the six months ended March 31, 2017 due mainly to an increase in variable compensation expense of \$3 million associated with our Senior Management Free Cash Flow Plan, which is associated with the increase in the fair value of our equity and costs associated with transformation initiatives of \$4 million.

Our OIBDA loss from corporate expenses and eliminations increased by \$17 million to \$70 million for the six months ended March 31, 2018 from \$53 million for the six months ended March 31, 2017 due to the factors that led to the increase in operating loss noted above.

FINANCIAL CONDITION AND LIQUIDITY

Financial Condition at March 31, 2018

At March 31, 2018, we had \$2.947 billion of debt (which is net of \$33 million of deferred financing costs), \$612 million of cash and equivalents (net debt of \$2.335 billion, defined as total long-term debt, including the current portion, less cash and equivalents and deferred financing costs) and \$189 million of Warner Music Group Corp. equity. This compares to \$2.811 billion of debt (which is net of \$29 million of deferred financing costs), \$647 million of cash and equivalents (net debt of \$2.164 billion) and \$293 million of Warner Music Group Corp. equity at September 30, 2017.

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## Cash Flows

The following table summarizes our historical cash flows. The financial data for the six months ended March 31, 2018 and March 31, 2017 are unaudited and are derived from our interim financial statements included elsewhere herein. The cash flow is composed of the following (in millions):

|                             | For the Six<br>Months<br>Ended |        |
|-----------------------------|--------------------------------|--------|
|                             | March 31,                      |        |
|                             | 2018                           | 2017   |
| Cash provided by (used in): |                                |        |
| Operating Activities        | \$ 136                         | \$ 226 |
| Investing Activities        | (28 )                          | (12 )  |
| Financing Activities        | (149 )                         | (93 )  |

## Operating Activities

Cash provided by operating activities was \$136 million for the six months ended March 31, 2018 as compared with cash provided by operating activities of \$226 million for the six months ended March 31, 2017. The \$90 million decrease in cash provided by operating activities was due to higher bonus and compensation related payments, and an increase in cash payments for interest due to the partial redemption of and deposit for the 6.75% Senior Notes, partially offset by an increase in comparative OIBDA of \$9 million.

## Investing Activities

Cash used in investing activities was \$28 million for the six months ended March 31, 2018 as compared with cash used in investing activities of \$12 million for the six months ended March 31, 2017. The \$28 million of cash used in investing activities in the six months ended March 31, 2018 consisted of \$29 million of capital expenditures, which has increased due to investment in IT and costs incurred related to the build-out of our Los Angeles office, \$6 million of investments and acquisitions and \$5 million to acquire music publishing rights, partially offset by \$12 million of proceeds from sale of investments. The \$12 million of cash used in investing activities for the six months ended March 31, 2017 consisted of \$18 million of capital expenditures, \$6 million of investments and acquisitions and \$6 million to acquire music publishing rights, partially offset by \$18 million proceeds from divestitures.

## Financing Activities

Cash used in financing activities was \$149 million for the six months ended March 31, 2018 compared to \$93 million for the six months ended March 31, 2017. The \$149 million of cash used in financing activities for the six months ended March 31, 2018 consisted of the repayment of and deposit for Acquisition Corp.'s 6.75% Senior Notes of \$635 million, special cash dividends paid of \$125 million, call premiums paid on and redemption deposit for early redemption of \$23 million, deferred financing costs paid of \$9 million, and a distribution to our non-controlling interest holders of \$2 million, partially offset by proceeds from issuance of Acquisition Corp.'s 5.50% Senior Notes of \$325 million, and proceeds from the issuance of Acquisition Corp.'s Senior Term Loan Facility of \$320 million. The \$93 million of cash used in financing activities for the six months ended March 31, 2017 consisted of the repayment

of Acquisition Corp.'s 6.00% Senior Secured Notes of \$450 million, repayment of Acquisition Corp.'s 6.25% Senior Secured Notes of \$173 million, repayment of Acquisition Corp.'s 5.625% Senior Secured Notes of \$28 million, call premiums paid on early redemption of \$27 million, deferred financing costs paid of \$12 million, special cash dividends paid of \$54 million, and a distribution to our non-controlling interest holders of \$1 million, partially offset by proceeds from issuance of Acquisition Corp.'s 4.125% Senior Secured Notes of €345 million, proceeds from issuance of Acquisition Corp.'s 4.875% Senior Secured Notes of \$250 million and proceeds from the amendment of Acquisition Corp.'s Senior Term Loan Facility of \$22 million.

There were no drawdowns on the Revolving Credit Facility during the six months ended March 31, 2018 or the six months ended March 31, 2017.

### Liquidity

Our primary sources of liquidity are the cash flows generated from our subsidiaries' operations, available cash and equivalents and funds available for drawing under our Revolving Credit Facility. These sources of liquidity are needed to fund our debt service requirements, working capital requirements, capital expenditure requirements, strategic acquisitions and investments, and any dividends, prepayments of debt or repurchases or retirement of our outstanding debt or notes in open market purchases, privately negotiated purchases or otherwise, we may elect to pay or make in the future. We believe that our existing sources of cash will be sufficient to support our existing operations over the next twelve months.

## Existing Debt as of March 31, 2018

As of March 31, 2018, our long-term debt was as follows (in millions):

|  |         |
|--|---------|
| Revolving Credit Facility—Acquisition Corp. (a)            | \$—     |
| Senior Term Loan Facility due 2023—Acquisition Corp. (b)   | 1,307   |
| 5.625% Senior Secured Notes due 2022—Acquisition Corp. (c) | 246     |
| 5.00% Senior Secured Notes due 2023—Acquisition Corp. (d)  | 297     |
| 4.125% Senior Secured Notes due 2024—Acquisition Corp. (e) | 419     |
| 4.875% Senior Secured Notes due 2024—Acquisition Corp. (f) | 247     |
| 6.75% Senior Notes due 2022—Acquisition Corp. (g)          | 111     |
| 5.50% Senior Notes due 2026—Acquisition Corp. (h)          | 320     |
| Total long-term debt, including the current portion (i)    | \$2,947 |

- (a) Reflects \$180 million of commitments under the Revolving Credit Facility, less letters of credit outstanding of approximately \$12 million at March 31, 2018. There were no loans outstanding under the Revolving Credit Facility at March 31, 2018.
- (b) Principal amount of \$1.326 billion less unamortized discount of \$5 million and unamortized deferred financing costs of \$14 million at March 31, 2018.
- (c) Principal amount of \$248 million less unamortized deferred financing costs of \$2 million at March 31, 2018.
- (d) Principal amount of \$300 million less unamortized deferred financing costs of \$3 million at March 31, 2018.
- (e) Face amount of €345 million. Above amounts represent the dollar equivalent of such notes. Principal amount of \$424 million less unamortized deferred financing costs of \$5 million at March 31, 2018.
- (f) Principal amount of \$250 million less unamortized deferred financing costs of \$3 million at March 31, 2018.
- (g) Principal amount of \$112 million less unamortized deferred financing costs of \$1 million at March 31, 2018. Reflects amount not redeemed as of March 31, 2018. The remaining 6.75% Senior Notes were redeemed on April 15, 2018.
- (h) Principal amount of \$325 million less unamortized deferred financing costs of \$5 million at March 31, 2018.
- (i) Principal amount of debt of \$2.985 billion less unamortized discount of \$5 million and unamortized deferred financing costs of \$33 million at March 31, 2018. Of this amount, \$112 million representing the remaining principal amount of the 6.75% Senior Notes were redeemed on April 15, 2018 as described above under “Tender Offer and Notes Redemption.”

For further discussion of our debt agreements, see “Liquidity” in the “Financial Condition and Liquidity” section of our Annual Report on Form 10-K for the fiscal year ended September 30, 2017.

## Covenant Compliance

The Company was in compliance with its covenants under its outstanding notes, Revolving Credit Facility and Senior Term Loan Facility as of March 31, 2018.

Our Revolving Credit Facility contains a springing leverage ratio that is tied to a ratio based on Consolidated EBITDA, which is defined under the Credit Agreement governing the Revolving Credit Facility. Our ability to borrow funds under our Revolving Credit Facility may depend upon our ability to meet the leverage ratio test at the end of a fiscal quarter to the extent we have drawn a certain amount of revolving loans. Consolidated EBITDA differs from the

term “EBITDA” as it is commonly used. For example, the definition of Consolidated EBITDA, in addition to adjusting net income to exclude interest expense, income taxes, and depreciation and amortization, also adjusts net income by excluding items or expenses not typically excluded in the calculation of “EBITDA” such as, among other items, (1) the amount of any restructuring charges or reserves; (2) any non-cash charges (including any impairment charges); (3) any net loss resulting from hedging currency exchange risks; (4) the amount of management, monitoring, consulting and advisory fees paid to Access under the Management Agreement (as defined in the Credit Agreement); (5) business optimization expenses (including consolidation initiatives, severance costs and other costs relating to initiatives aimed at profitability improvement); (6) transaction expenses and (7) equity-based compensation expense. It also includes an adjustment for the pro forma impact of certain projected cost-savings and synergies. The indentures governing our notes and our Senior Term Loan Facility use financial measures called “Consolidated EBITDA” or “EBITDA” that have the same definition as Consolidated EBITDA as defined under the Credit Agreement governing the Revolving Credit Facility.

Consolidated EBITDA is presented herein because it is a material component of the leverage ratio contained in our Revolving Credit Agreement. Non-compliance with the leverage ratio could result in the inability to use our Revolving Credit Facility, which could have a material adverse effect on our results of operations, financial position and cash flow. Consolidated EBITDA does not represent net income or cash from operating activities as those terms are defined by U.S. GAAP and does not necessarily indicate whether cash flows will be sufficient to fund cash needs. While Consolidated EBITDA and similar measures are frequently used as measures of operations and the ability to meet debt service requirements, these terms are not necessarily comparable to other similarly titled captions of other companies due to the potential inconsistencies in the method of calculation. Consolidated EBITDA does not reflect the impact of earnings or charges resulting from matters that we may consider not to be indicative of our ongoing operations. In particular, the definition of Consolidated EBITDA in the Revolving Credit Agreement allows us to add back certain non-cash, extraordinary, unusual or non-recurring charges that are deducted in calculating net income. However, these are expenses that may recur, vary greatly and are difficult to predict.

Consolidated EBITDA as presented below is not a measure of the performance of our business and should not be used by investors as an indicator of performance for any future period. Further, our debt instruments require that it be calculated for the most recent four fiscal quarters. As a result, the measure can be disproportionately affected by a particularly strong or weak quarter. Further, it may not be comparable to the measure for any subsequent four quarter period or any complete fiscal year. In addition, our debt instruments require that the leverage ratio be calculated on a pro forma basis for certain transactions including acquisitions as if such transactions had occurred on the first date of the measurement period and may include expected cost savings and synergies resulting from or related to any such transaction. There can be no assurances that any such cost savings or synergies will be achieved in full.

The following is a reconciliation of net income, which is a U.S. GAAP measure of our operating results, to Consolidated EBITDA as defined, and the calculation of the Senior Secured Indebtedness to Consolidated EBITDA ratio, which we refer to as the Leverage Ratio, under our Revolving Credit Agreement for the most recently ended four fiscal quarters, or twelve months ended March 31, 2018. The terms and related calculations are defined in the Revolving Credit Agreement. All amounts in the reconciliation below reflect WMG Acquisition Corp. (in millions, except ratio):

|   | Twelve Months<br>Ended<br>March 31, 2018 |
|---|--|
| Net Income  | \$ 109                                   |
| Income tax expense                                | (101 )                                   |
| Interest expense, net                             | 146                                      |
| Depreciation and amortization                     | 259                                      |
| Loss on extinguishment of debt (a)                | 28                                       |
| Net gain on divestitures (b)                      | (6 )                                     |
| Restructuring costs (c)                           | 37                                       |
| Net hedging gains and foreign exchange losses (d) | 39                                       |
| Management fees (e)                               | 9  |
| Transaction costs (f)                             | 3  |
| Business optimization expenses (g)                | 18                                       |
| Equity based compensation expense (h)             | 79                                       |
| Other non-cash charges (i)                        | 22                                       |

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|  |          |
|--|----------|
| Pro forma impact of certain transactions (j) | 24       |
| Pro Forma Consolidated EBITDA                | \$ 666   |
| Senior Secured Indebtedness (k)              | \$ 2,348 |
| Leverage Ratio (l)                           | 3.53x    |

- (a) Reflects net loss incurred on the early extinguishment of our debt incurred as part of the May 2017 and December 2017 Senior Term Loan Credit Agreement Amendments and the partial redemption of the 6.75% Senior Notes.
- (b) Reflects net gain on divestitures.
- (c) Reflects severance costs and other restructuring related expenses.
- (d) Reflects net losses from hedging activities and unrealized losses due to foreign exchange on our Euro denominated debt and intercompany transactions.
- (e) Reflects management fees paid to Access, including an annual fee and related expenses. Pursuant to the Company's and Holdings' management agreement with Access, the base amount of the annual fee is approximately \$9 million, subject to certain potential upward adjustments.
- (f) Reflects mainly integration and other nonrecurring costs.
- (g) Reflects primarily costs associated with IT systems updates and U.S. shared services relocation.

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- (h) Reflects equity based compensation expense related to the Warner Music Group Corp. Senior Management Free Cash Flow Plan.
- (i) Reflects cash payments related to previous non-cash charges, including but not limited to costs associated with our Los Angeles office consolidations and losses on investments.
- (j) Reflects expected savings resulting from our U.S. shared services relocation and other transformation initiatives and proforma impact of specified transactions.
- (k) Reflects the principal balance of senior secured debt at Acquisition Corp. of approximately \$2.548 billion less cash of \$200 million.
- (l) Reflects the ratio of Senior Secured Indebtedness, including Revolving Credit Agreement Indebtedness, to Pro Forma Consolidated EBITDA as of the twelve months ended March 31, 2018. This is calculated net of cash and equivalents of the Company as of March 31, 2018 not exceeding \$200 million. If the outstanding aggregate principal amount of borrowings under our Revolving Credit Facility is greater than \$54 million at the end of a fiscal quarter, the maximum leverage ratio permitted under our Revolving Credit Facility is 4.75:1.00. The Company's Revolving Credit Facility does not impose any "leverage ratio" restrictions on the Company when the aggregate principal amount of borrowings under the Revolving Credit Facility is less than or equal to \$54 million at the end of a fiscal quarter.

#### Summary

Management believes that funds generated from our operations and borrowings under our Revolving Credit Facility and available cash and equivalents will be sufficient to fund our debt service requirements, working capital requirements and capital expenditure requirements for the foreseeable future. We also have additional borrowing capacity under our indentures and Senior Term Loan Facility. 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, the continued transition from physical to digital sales and continued growth in digital sales in the recorded music and music publishing businesses. We or any of our affiliates continue to evaluate opportunities to, from time to time depending on market conditions and prices, contractual restrictions, our financial liquidity and other factors, seek to prepay outstanding debt or repurchase or retire Acquisition Corp.'s outstanding debt or debt securities in open market purchases, privately negotiated purchases or otherwise. The amounts involved in any such transactions, individually or in the aggregate, may be material and may be funded from available cash or from additional borrowings. In addition, we may from time to time, depending on market conditions and prices, contractual restrictions, our financial liquidity and other factors, seek to refinance our Senior Credit Facilities or our outstanding debt or debt securities with available cash and/or with funds provided from additional borrowings.

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

As discussed in Note 13 to our audited Consolidated Financial Statements for the fiscal year ended September 30, 2017, the Company is exposed to market risk arising from changes in market rates and prices, including movements in foreign currency exchange rates and interest rates. As of March 31, 2018, other than as described below, there have been no material changes to the Company's exposure to market risk since September 30, 2017.

#### Foreign Currency Risk

Within our global business operations we have transactional exposures that may be adversely affected by changes in foreign currency exchange rates relative to the U.S. dollar. We may at times choose to use foreign exchange currency derivatives, primarily forward contracts, to manage the risk associated with the volatility of future cash flows denominated in foreign currencies, such as unremitted or future royalties and license fees owed to our U.S. domestic companies for the sale, or anticipated sale, of U.S.-copyrighted products sold abroad, that 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 major currencies, which can include the British Pound, Euro, Japanese Yen, Canadian Dollar, Swedish Krona and Australian Dollar, and in many cases we have natural hedges where we have expenses associated with local operations that offset the revenue in local currency and our Euro-denominated debt, which can offset declines in the Euro. As of March 31, 2018, the Company had outstanding hedge contracts for the sale of \$197 million and the purchase of \$114 million of foreign currencies at fixed rates. Subsequent to March 31, 2018, certain of our foreign exchange contracts expired.

The fair value of foreign exchange contracts is subject to changes in foreign currency exchange rates. For the purpose of assessing the specific risks, we use a sensitivity analysis to determine the effects that market risk exposures may have on the fair value of our financial instruments. For foreign exchange forward contracts outstanding at March 31, 2018, assuming a hypothetical 10% depreciation of the U.S. dollar against foreign currencies from prevailing foreign currency exchange rates and assuming no change in interest rates, the fair value of the foreign exchange forward contracts would have decreased by \$8 million. Because our foreign exchange contracts are entered into for hedging purposes, these losses would be largely offset by gains on the underlying transactions.

#### Interest Rate Risk

We had \$2.985 billion of principal debt outstanding at March 31, 2018, of which \$1.326 billion was variable rate debt and \$1.659 billion was fixed rate debt. As such, we are exposed to changes in interest rates. At March 31, 2018, 56% of the Company's debt was at a fixed rate. In addition, as of March 31, 2018, we have the option under all of our floating rate debt under our Senior Term Loan Facility to select a one, two, three or six month LIBOR rate. To manage interest rate risk on \$320 million of U.S. dollar denominated variable rate debt the Company has entered into interest rate swaps to effectively convert the floating interest rates to fixed interest on a portion of its debt.

Based on the level of interest rates prevailing at March 31, 2018, the fair value of the fixed rate and variable rate debt was approximately \$3.027 billion. Further, based on the amount of its fixed rate debt, a 25 basis point increase or decrease in the level of interest rates would decrease the fair value of the fixed rate debt by approximately \$9 million or increase the fair value of the fixed rate debt by approximately \$15 million. This potential increase or decrease is based on the simplified assumption that the level of fixed-rate debt remains constant with an immediate across the board increase or decrease in the level of interest rates with no subsequent changes in rates for the remainder of the period.



#### ITEM 4. CONTROLS AND PROCEDURES

##### Certification

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

##### Introduction

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

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

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

##### Evaluation of Disclosure Controls and Procedures

Based on our management’s evaluation (with the participation of our principal executive officer and principal financial officer), as of the end of the period covered by this report, our principal executive officer and principal financial

officer have concluded that our Disclosure Controls are effective to provide 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 in our Internal Controls over financial reporting or other factors during the quarter ended March 31, 2018 that have materially affected, or are reasonably likely to materially affect, our Internal Controls.

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

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

#### Sirius XM

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

As part of the settlement, plaintiffs agreed to negotiate in good faith to grant Sirius XM a license to publicly perform the plaintiffs' pre-1972 sound recordings for the five-year period running from January 1, 2018 to December 31, 2022. Pursuant to the settlement, if the parties are unable to reach an agreement on license terms, the royalty rate for each license will be determined by binding arbitration on a willing buyer/willing seller standard. On December 21, 2017, Sirius XM commenced a single arbitration against all of the plaintiffs in California through JAMS to determine the rate for the five-year period. On May 1, 2018, the Company filed a lawsuit against Sirius XM in New York state court to stay the California arbitration and to compel a separate arbitration in New York solely between Sirius XM and the Company.

#### Other Matters

In addition to the matter discussed above, the Company is involved in various litigation and regulatory proceedings arising in the normal course of business. Where it is determined, in consultation with counsel based on litigation and settlement risks, that a loss is probable and estimable in a given matter, the Company establishes an accrual. In the currently pending proceedings, the amount of accrual is not material. An estimate of the reasonably possible loss or range of loss in excess of the amounts already accrued cannot be made at this time due to various factors typical in contested proceedings, including (1) the results of ongoing discovery; (2) uncertain damage theories and demands; (3) a less than complete factual record; (4) uncertainty concerning legal theories and their resolution by courts or regulators; and (5) the unpredictable nature of the opposing party and its demands. However, the Company cannot predict with certainty the outcome of any litigation or the potential for future litigation. As such, the Company continuously monitors these proceedings as they develop and adjusts any accrual or disclosure as needed. Regardless of the outcome, litigation could have an adverse impact on the Company, including the Company's brand value, because of defense costs, diversion of management resources and other factors and it could have a material effect on the Company's results of operations for a given reporting period.

#### ITEM 1A. RISK FACTORS

In addition to the other information contained in this Quarterly Report on Form 10-Q, certain risk factors should be considered carefully in evaluating our business. A wide range of risks may affect our business and financial results, now and in the future. We consider the risks described in Part I, Item 1A "Risk Factors" of our Annual Report on Form 10-K for the fiscal year ended September 30, 2017, to be the most significant. There may be other currently unknown or unpredictable economic, business, competitive, regulatory or other factors that could have material adverse effects on our future results.

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

Not applicable.

#### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

#### ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

On May 2, 2018, we entered into an amendment to the employment agreement of our Executive Vice President and Chief Financial Officer, Eric Levin. The amendment to Mr. Levin's agreement is set forth as Exhibit 10.5 to this Quarterly Report.

On May 2, 2018, we entered into an amendment to the employment agreement of our Executive Vice President and General Counsel and Secretary, Paul M. Robinson. The amendment to Mr. Robinson's agreement is set forth as Exhibit 10.6 to this Quarterly Report.

ITEM 6. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

The agreements and other documents filed as exhibits to this report are not intended to provide factual information or other disclosure other than with respect to the terms of the agreements or other documents themselves, and you should not rely on them for that purpose. In particular, any representations and warranties made by us in these agreements or other documents were made solely within the specific context of the relevant agreement or document and may not describe the actual state of affairs as of the date they were made or at any other time.

Exhibit

Number Description

- 10.1(1) Revolving Credit Agreement, dated as of January 31, 2018, among WMG Acquisition Corp., the lenders party thereto and Credit Suisse AG, as administrative agent and collateral agent.
- 10.2(2) Increase Supplement, dated March 14, 2018, among WMG Acquisition Corp., the lenders party thereto, WMG Holdings Corp., Credit Suisse AG, Cayman Islands Branch, as increasing lender, and Credit Suisse AG, as administrative agent.
- 10.3(2) Guarantee dated, March 14, 2018, issued by Warner Music Group Corp., relating to the 5.500% Senior Notes due 2026.
- 10.4(2) Fifth Supplemental Indenture, dated as of March 14, 2018, among WMG Acquisition Corp., the guarantors listed on the signature pages thereto and Wells Fargo Bank, National Association, as Trustee, relating to the 5.500% Senior Notes due 2026.
- 10.5\*\$ Letter Agreement, dated as of May 2, 2018, between Warner Music Inc. and Eric Levin.
- 10.6\*\$ Letter Agreement, dated as of May 2, 2018 between Warner Music Inc. and Paul M. Robinson.
- 31.1\* Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended
- 31.2\* Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, 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
- 101.1\* Financial statements from the Quarterly Report on Form 10-Q of Warner Music Group Corp. for the quarter ended March 31, 2018, filed on May 7, 2018, formatted in XBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statement of Comprehensive Loss, (iv) Consolidated Statements of Cash Flows, (v) Consolidated Statements of Equity and (vi) Notes to Consolidated Interim Financial Statements

\*Filed herewith

\*\*Pursuant to SEC Release No. 33-8212, this certification will be treated as “accompanying” this Quarterly Report on Form 10-Q and not “filed” as part of such report for purposes of Section 18 of the Securities Exchange Act, as amended, or otherwise subject to the liability of Section 18 of the Securities Exchange Act, 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, except to the extent that the registrant specifically incorporates it by reference

\$Represents management contract, compensatory plan or arrangement in which directors and/or executive officers are eligible to participate

(1) Incorporated by reference to Warner Music Group Corp.’s Quarterly Report on Form 10-Q for the period ended December 31, 2017 (File No. 001-32502).

(2) Incorporated by reference to Warner Music Group Corp.’s Current Report on Form 8-K filed on March 14, 2018 (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.

May 7, 2018

Warner Music Group Corp.

By: /S/ STEPHEN COOPER

Name: Stephen Cooper

Title: Chief Executive Officer

(Principal Executive Officer)

By: /S/ ERIC LEVIN

Name: Eric Levin

Title: Chief Financial Officer (Principal Financial

Officer and Principal Accounting Officer)