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

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number 001-32502

Warner Music Group Corp.

(Exact name of Registrant as specified in its charter)

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

1633 Broadway

New York, NY 10019

(Address of principal executive offices)

(212) 275-2000

(Registrant's telephone number, including area code)

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

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

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

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

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

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

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

WARNER MUSIC GROUP CORP.

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ITEM 1. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Warner Music Group Corp.

Consolidated Balance Sheets (Unaudited)

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

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

See accompanying notes

Warner Music Group Corp.

Consolidated Statements of Operations (Unaudited)

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

See accompanying notes

Warner Music Group Corp.

Consolidated Statements of Comprehensive Income (Loss) (Unaudited)

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

See accompanying notes

Warner Music Group Corp.

Consolidated Statements of Cash Flows (Unaudited)

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

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

See accompanying notes

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Warner Music Group Corp.

Consolidated Statements of Equity (Unaudited)

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

See accompanying notes

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Warner Music Group Corp.

Notes to Consolidated Interim Financial Statements (Unaudited)

1. Description of Business

Warner Music Group Corp. (the “Company”) 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 reissuances of previously released music and video titles. The Company also conducts its Recorded Music operations through a collection of additional record labels, including Asylum, Big Beat, Canvasback, East West, Elektra, Erato, FFRR, Fueled by Ramen, Nonesuch, Parlophone, Reprise, Roadrunner, Sire, Spinnin’, Warner Classics and Warner Music Nashville.

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

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

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

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

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

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

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

Music Publishing Operations

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

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

2. Summary of Significant Accounting Policies

Interim Financial Statements

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three month period ended December 31, 2017 are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2018.

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

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

Basis of Consolidation

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

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

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

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

Income Taxes

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

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

New Accounting Pronouncements

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

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

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

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

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

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

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

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

3. Comprehensive Income (Loss)

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

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

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

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

4. Goodwill and Intangible Assets

Goodwill

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

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

(a) Other adjustments during the three months ended December 31, 2017 represent foreign currency movements.

The Company performs its annual goodwill impairment test in accordance with ASC 350, Intangibles—Goodwill and other ("ASC 350") during the fourth quarter of each fiscal year as of July 1. The Company may conduct an earlier review if events or circumstances occur that would suggest the carrying value of the Company's goodwill may not be recoverable. No indicators of impairment were identified during the current period that required the Company to perform an interim assessment or recoverability test.

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

Intangible Assets

Intangible assets consist of the following:

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

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

5. Debt

Debt Capitalization

Long-term debt consists of the following:

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

(a) Reflects $150 million of commitments under the Revolving Credit Facility, less letters of credit outstanding of approximately $12 million at both December 31, 2017 and September 30, 2017. There were no loans outstanding under the Revolving Credit Facility at December 31, 2017 or September 30, 2017. On January 31, 2018, Acquisition Corp. entered into a new revolving credit facility that replaced our then existing revolving credit facility in its entirety. See Note 12 of our Consolidated Financial Statements for further discussion.

(b) Principal amount of $1.006 billion at both December 31, 2017 and September 30, 2017 less unamortized discount of $5 million and $6 million and unamortized deferred financing costs of $10 million and $10 million at December 31, 2017 and September 30, 2017, respectively.

(c) Principal amount of $248 million less unamortized deferred financing costs of $2 million at December 31, 2017 and September 30, 2017, respectively.

(d) Principal amount of $300 million less unamortized deferred financing costs of $3 million at both December 31, 2017 and September 30, 2017, respectively.

(e) Face amount of €345 million. Above amounts represent the dollar equivalent of such notes at December 31, 2017 and September 30, 2017. Principal amount of $412 million and $407 million at December 31, 2017 and September 30, 2017, respectively, less unamortized deferred financing costs of $5 million at both December 31, 2017 and September 30, 2017.

(f) Principal amount of $250 million at both December 31, 2017 and September 30, 2017 less unamortized deferred financing costs of $3 million and $4 million at December 31, 2017 and September 30, 2017, respectively.

(g) Principal amount of $635 million less unamortized deferred financing costs of $5 million at both December 31, 2017 and September 30, 2017, respectively.

(h) Principal amount of debt of $2.851 billion and $2.846 billion less unamortized discount of $5 million and $6 million and unamortized deferred financing costs of $28 million and $29 million at December 31, 2017 and September 30, 2017, respectively.

December 2017 Senior Term Loan Credit Agreement Amendment

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

New Revolving Credit Agreement

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

Interest Rates

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

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

Maturity of Senior Term Loan Facility

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

Maturity of Revolving Credit Facility

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

Maturities of Senior Notes and Senior Secured Notes

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

Interest Expense, net

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

6. Commitments and Contingencies

Pricing of Digital Music Downloads

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

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

Sirius XM

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

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

Other Matters

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

7. Income Taxes

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

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

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

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

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

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

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

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

8. Derivative Financial Instruments

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

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

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

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

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

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

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

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

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

9. Segment Information

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

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

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

10. Additional Financial Information

Cash Interest and Taxes

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

11. Fair Value Measurements

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

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

- Level 1—inputs are based upon unadjusted quoted prices for identical instruments traded in active markets.
- Level 2—inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3—inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques that include option pricing models, discounted cash flow models and similar techniques.

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

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

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

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

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

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

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

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

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

Fair Value of Debt

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

12. Subsequent Events

Special Cash Dividend

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

New Revolving Credit Agreement

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

WARNER MUSIC GROUP CORP.

Supplementary Information

Consolidating Financial Statements

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

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

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

Consolidating Balance Sheet (Unaudited)

December 31, 2017

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

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

Consolidating Balance Sheet

September 30, 2017

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

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

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Consolidating Statement of Operations (Unaudited)

For The Three Months Ended December 31, 2017

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

Consolidating Statement of Operations (Unaudited)

For The Three Months Ended December 31, 2016

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

Consolidating Statement of Comprehensive Income (Unaudited)

For The Three Months Ended December 31, 2017

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

Consolidating Statement of Comprehensive Income (Unaudited)

For The Three Months Ended December 31, 2016

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

Consolidating Statement of Cash Flows (Unaudited)

For The Three Months Ended December 31, 2017

	WMG Acquisition Corp. (issuer)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	WMG Acquisition Corp. Consolidated	WMG Holdings Corp.	Warner Music Group Corp.	Eliminations	Warner Music Group Corp. Consolidated
	(in millions)								
Cash flows from operating activities									
Net income	$4	$ 34	$ 41	$ (74)	$ 5	$ 4	$ 4	$ (8)	$ 5
Adjustments to reconcile net income to net cash provided by operating activities:									
Depreciation and amortization	—	32	33	—	65	—	—	—	65
Unrealized losses/gains and remeasurement of foreign denominated loans	6	1	(2)	—	5	—	—	—	5
Deferred income taxes	—	—	42	—	42	—	—	—	42
Loss on extinguishment of debt	1	—	—	—	1	—	—	—	1
Net gain on investments	—	(7)	—	—	(7)	—	—	—	(7)
Non-cash interest expense	1	—	—	—	1	—	—	—	1
Equity-based compensation expense	—	18	—	—	18	—	—	—	18
Equity (gains) losses, including distributions	(90)	(43)	—	133	—	(4)	(4)	8	—
Changes in operating assets and liabilities:									
Accounts receivable	—	(33)	(60)	—	(93)	—	—	—	(93)
Inventories	—	—	2	—	2	—	—	—	2
Royalty advances	—	5	(10)	—	(5)	—			