

Warner Music Group Corp.  
Form 10-Q  
August 06, 2015

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 June 30, 2015

OR

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

Commission File Number 001-32502

Warner Music Group Corp.

(Exact name of Registrant as specified in its charter)

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

1633 Broadway

New York, NY 10019

(Address of principal executive offices)

(212) 275-2000

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

There is no public market for the Registrant's common stock. As of August 6, 2015 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)

	June 30, 2015	September 30, 2014
	(in millions)	
<b>Assets</b>		
Current assets:		
Cash and equivalents	\$ 168	\$ 157
Accounts receivable, net of allowances of \$59 million and \$65 million	343	383
Inventories	39	39
Royalty advances expected to be recouped within one year	119	102
Deferred tax assets	46	46
Prepaid and other current assets	58	55
<b>Total current assets</b>	<b>773</b>	<b>782</b>
Royalty advances expected to be recouped after one year	219	190
Property, plant and equipment, net	227	227
Goodwill	1,633	1,661
Intangible assets subject to amortization, net	2,597	2,884
Intangible assets not subject to amortization	120	120
Other assets	95	90
<b>Total assets</b>	<b>\$5,664</b>	<b>\$ 5,954</b>
<b>Liabilities and Equity</b>		
Current liabilities:		
Accounts payable	\$ 151	\$ 215
Accrued royalties	1,111	1,132
Accrued liabilities	235	243
Accrued interest	48	60
Deferred revenue	247	219
Current portion of long-term debt	13	13
Other current liabilities	19	3
<b>Total current liabilities</b>	<b>1,824</b>	<b>1,885</b>
Long-term debt	2,983	3,017
Deferred tax liabilities, net	345	383
Other noncurrent liabilities	239	279
<b>Total liabilities</b>	<b>\$5,391</b>	<b>\$ 5,564</b>
<b>Equity:</b>		
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	(717 )	(649 )
Accumulated other comprehensive loss, net	(157 )	(108 )
<b>Total Warner Music Group Corp. equity</b>	<b>254</b>	<b>371</b>

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Noncontrolling interest	19	19
Total equity	273	390
Total liabilities and equity	\$5,664	\$ 5,954

See accompanying notes

Warner Music Group Corp.

## Consolidated Statements of Operations (Unaudited)

	Three Months Ended June 30, 2015		Nine Months Ended June 30, 2014	
	2015	2014	2015	2014
Revenue	\$710	\$788	\$2,216	\$2,256
Costs and expenses:				
Cost of revenue	(373)	(417)	(1,136)	(1,177)
Selling, general and administrative expenses (a)	(251)	(319)	(799)	(885)
Amortization expense	(63)	(67)	(191)	(199)
Total costs and expenses	(687)	(803)	(2,126)	(2,261)
Operating income (loss)	23	(15)	90	(5)
Loss on extinguishment of debt	—	(141)	—	(141)
Interest expense, net	(45)	(48)	(136)	(157)
Other (expense) income	(17)	4	(12)	(3)
Loss before income taxes	(39)	(200)	(58)	(306)
Income tax (expense) benefit	(4)	16	(7)	27
Net loss	(43)	(184)	(65)	(279)
Less: Income attributable to noncontrolling interest	(1)	(1)	(3)	(3)
Net loss attributable to Warner Music Group Corp.	\$(44)	\$(185)	\$(68)	\$(282)

(a) Includes depreciation expense of: \$(14) \$(14) \$(42) \$(39)

See accompanying notes

Warner Music Group Corp.

## Consolidated Statements of Comprehensive Loss (Unaudited)

	Three Months Ended June 30, 2015 2014		Nine Months Ended June 30, 2015 2014	
	(in millions)			
Net loss	\$(43)	\$(184)	\$(65 )	\$(279)
Other comprehensive loss, net of tax:				
Foreign currency adjustment	41	4	(49 )	(2 )
Other comprehensive income (loss), net of tax	41	4	(49 )	(2 )
Total comprehensive loss	(2 )	(180)	(114)	(281)
Less: Income attributable to noncontrolling interest	(1 )	(1 )	(3 )	(3 )
Comprehensive loss attributable to Warner Music Group Corp.	\$(3 )	\$(181)	\$(117)	\$(284)

See accompanying notes

Warner Music Group Corp.

## Consolidated Statements of Cash Flows (Unaudited)

	Nine Months Ended June 30, 2015	Nine Months Ended June 30, 2014
	(in millions)	
<b>Cash flows from operating activities</b>		
Net loss	\$(65 )	\$ (279 )
Adjustments to reconcile net loss to net cash provided by operating activities:		
Loss on extinguishment of debt	—	141
Depreciation and amortization	233	238
Unrealized gains/losses and remeasurement of foreign denominated loans	19	(41 )
Deferred income taxes	(17 )	(47 )
Non-cash interest expense	8	11
Non-cash share-based compensation expense	—	5
Changes in operating assets and liabilities:		
Accounts receivable	16	67
Inventories	(3 )	(4 )
Royalty advances	(55 )	(24 )
Accounts payable and accrued liabilities	(86 )	(96 )
Royalty payables	35	11
Accrued interest	(12 )	(25 )
Deferred revenue	39	93
Other balance sheet changes	6	(9 )
Net cash provided by operating activities	118	41
<b>Cash flows from investing activities</b>		
Acquisition of music publishing rights, net	(12 )	(20 )
Capital expenditures	(51 )	(46 )
Investments and acquisitions of businesses, net	(16 )	(26 )
Net cash used in investing activities	(79 )	(92 )
<b>Cash flows from financing activities</b>		
Proceeds from the Revolving Credit Facility	258	490
Repayment of the Revolving Credit Facility	(258)	(490 )
Repayment of Acquisition Corp. Senior Term Loan Facility	(10 )	(7 )
Proceeds from issuance of Acquisition Corp. 5.625% Senior Secured Notes	—	275
Proceeds from issuance of Acquisition Corp. 6.750% Senior Notes	—	660
Repayment of Acquisition Corp. 11.5% Senior Notes	—	(765 )
Financing costs paid	—	(104 )
Deferred financing costs paid	—	(12 )
Distribution to noncontrolling interest holder	(3 )	(2 )
Repayment of capital lease obligations	(2 )	(2 )
Net cash (used in) provided by financing activities	(15 )	43
Effect of exchange rate changes on cash and equivalents	(13 )	(5 )
Net increase (decrease) in cash and equivalents	11	(13 )



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Cash and equivalents at beginning of period	157	155
Cash and equivalents at end of period	\$168	\$ 142

See accompanying notes

Warner Music Group Corp.

## Consolidated Statements of Equity (Unaudited)

	Common Stock Shares	Additional Paid-in Value Capital	Accumulated Deficit	Other Comprehensive Loss	Warner Music Group Corp. Equity	Noncontrolling Interest	Total Equity
	(in millions, except share amounts)						
Balance at September 30, 2014	1,055	\$ — \$ 1,128	\$ (649 )	\$ (108 )	\$ 371	\$ 19	\$ 390
Net (loss) income	—	— —	(68 )	—	(68 )	3	(65 )
Other comprehensive income (loss), net of tax	—	— —	—	(49 )	(49 )	—	(49 )
Distribution to noncontrolling interest holders	—	— —	—	—	—	(3 )	(3 )
Balance at June 30, 2015	1,055	\$ — \$ 1,128	\$ (717 )	\$ (157 )	\$ 254	\$ 19	\$ 273

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 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”) in accordance with certain covenants contained in the agreements governing its outstanding indebtedness.

### Acquisition of Parlophone Label Group

On July 1, 2013, the Company completed its acquisition of Parlophone Label Group (the “PLG Acquisition”).

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

#### Recorded Music Operations

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

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 records 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; various distribution centers and ventures operated internationally; and an 80% interest in Word, which specializes in the distribution of music products in the Christian retail marketplace.

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, barnesandnoble.com and bestbuy.com and in digital form to online digital download services such as Apple's iTunes and Google Play, and are offered by digital streaming services such as Apple Music, Deezer, Rhapsody, Spotify and YouTube, including digital radio services such as iHeart Radio, iTunes Radio and Pandora.

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 a record 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 for at least the next several years 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 include Warner/Cha